SEC Proposes Rules to Permit General Solicitation and Advertising in 144A Offerings and Private Placements

September 6, 2012

On April 5, 2012, the U.S. Congress enacted The Jumpstart Our Business Startups Act (the "JOBS Act"), a package of capital access reforms intended, among other things, to facilitate the ability of companies to raise capital in private offerings without registration with the Securities and Exchange Commission (the "SEC"). The JOBS Act directed the SEC to amend its rules to permit (1) general solicitation or general advertising in connection with offerings of securities under Rule 506 of Regulation D ("Rule 506") under the Securities Act of 1933, as amended (the "Securities Act"), provided that all purchasers of the securities are accredited investors and that the issuer has taken reasonable steps to verify that all purchasers of the securities are accredited investors and (2) offers of securities under Rule 144A under the Securities Act to persons other than qualified institutional buyers ("QIBs")[1], including by means of general solicitation or general advertising, provided that the securities are sold only to persons whom the seller and any person acting on behalf of the seller reasonably believes is a QIB.

On August 29, 2012, the SEC proposed rules (the "Proposed Rules") to implement these changes to Rule 506 and Rule 144A.[2] The SEC will seek public comments on the Proposed Rules and any comments must be received on or before October 5, 2012. Following the review of comments by the SEC, the final rules will be issued. Issuers are not able to avail themselves of the Proposed Rules until final rules are enacted and effective. Since Rule 506 offerings and Rule 144A offerings are widely used by U.S and foreign issuers to access the capital markets, we anticipate that the final rules, assuming that they are substantially similar to the Proposed Rules, will allow for greater flexibility in the capital raising process by relaxing existing regulatory requirements on publicity.

The SEC has also proposed a revision to Form D to add a checkbox for issuers to indicate whether they are using general solicitation or general advertising in a Rule 506 offering.

THE PROPOSED RULES

Rule 144A

Section 201(a) of the JOBS Act directed the SEC to revise Rule 144A(d)(1) under the Securities Act to provide that securities may be offered to persons other than QIBs, including by general solicitation and general advertising, so long as securities are sold only to persons that the seller

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[1] The term "qualified institutional buyer" is defined in Rule 144A(a)(1).

[2] For the full text of the release (the "Release") proposing the rules, please see: http://www.sec.gov/rules/proposed/2012/33-9354.pdf.

and any person acting on behalf of the seller reasonably believes is a QIB. The SEC is proposing to amend Rule 144A by deleting the references to "offer" and "offeree" and to only require that securities are sold to a QIB or to a purchaser that the seller and any person acting on behalf of the seller reasonably believes is a QIB. As a result, resales of securities pursuant to Rule 144A could be conducted using general solicitation and general advertising, since current law requires that purchasers are limited in this manner.

Rule 506(c)

Rule 506 is a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act, which exempts transactions by an issuer "not involving any public offering" from the registration requirements of Section 5 of the Securities Act. Under Rule 506 as it currently exists, issuers may offer and sell securities without a dollar ceiling so long as the conditions of the safe harbor are met. One of the current conditions is that there can be no general solicitation or general advertising in connection with the offering.[3] New Rule 506(c) as proposed by the SEC would allow for the use of general solicitation and general advertising when the following conditions are met:

- the issuer has taken reasonable steps to verify that the purchasers of the securities in the offering are accredited investors;
- all purchasers of securities are accredited investors, either because they fall within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they do, at the time of the sale of the securities; and
- all terms and conditions of Rule 501, Rule 502(a) and Rule 502(d) have been satisfied.[4]

The SEC stated its belief that the requirement for issuers to meet a higher threshold of verification for offerings with general solicitation was to "reduce the risk, that the use of general solicitation under Rule 506 may result in sales to investors who are not, in fact, accredited investors." While the SEC considered whether to require issuers to use specified methods of verification, it expressly decided against doing so. Instead, the SEC opted for an approach that gives issuers and purchasers flexibility and stated that whether the steps taken by the issuer to

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[3] Examples of general solicitation or general advertising provided in Rule 502(c) include newspaper/magazine ads, television/radio broadcasts, seminars whose invitees are invited by general solicitation and publicly available websites. Other conditions that apply to offers under existing Rule 506 include certain information requirements, a limit of 35 non-accredited investors and certain sophistication requirements.

[4] As a result, any securities that are acquired under proposed Rule 506(c) would be subject to the resale limitations under Rule 502(d) and therefore would be "restricted securities" as defined in Rule 144(a)(3)(ii). Further, Section 201(b) of the JOBS Act added Section 4(b) of the Securities Act, which provides that "[o]ffers and sales exempt under [Rule 506 as amended pursuant to Section 201 of the JOBS Act] shall not be deemed public offerings under the Federal securities laws as a result of general advertising or general solicitation." Thus, securities acquired under proposed Rule 506(c) would also meet the definition of "restricted securities" under Rule 144(a)(3)(i) ("[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering").

verify the accredited investor status of the purchaser are "reasonable" would be an objective test, based on the particular facts and circumstances of each offering and each purchaser. The SEC indicated that issuers would be able to consider a number of factors when determining the reasonableness of the steps to verify that a purchaser is an accredited investor. Some examples of the factors to be taken into consideration are the following: 1) the nature of the purchaser and the type of accredited investor that the purchaser claims to be; 2) the amount and type of information that the issuer has about the purchaser; and 3) the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering and the terms of the offering, such as whether there was a minimum investment amount.

Since the definition of "accredited investor" in Rule 501(a) includes both entities and natural persons, the steps taken to verify whether a purchaser is an accredited investor may be different depending on the particular enumerated category in the definition applicable to such purchaser. For instance, confirming whether a registered broker-dealer is an accredited investor could be done by simply going to FINRA's BrokerCheck website, whereas more practical difficulties may be encountered in verifying whether a natural person is an accredited investor, including a person's privacy concerns with respect to the disclosure of personal financial information.

The amount and type of information that an issuer has about a purchaser would be a significant factor in determining what additional steps are needed to confirm accredited investor status. The more information that an issuer has about a prospective purchaser, the greater the ability of the issuer to reduce the amount of steps required to verify the status of such purchaser. Possible verification techniques that would be considered reasonable steps in and of themselves include reviewing publicly available information such as federal, state or local regulatory filings (i.e., proxy statements that state a person's annual salary or IRS filings that state a certain level of assets); third-party information that provides reasonably reliable evidence that a person falls within one of the categories in the accredited investor definition such as a W-2; and verification of status by a third party, such as a broker-dealer, attorney or accountant if the issuer has a reasonable basis to rely on such verification.

The nature of the offering and the manner of solicitation are relevant in determining reasonableness of the steps taken to verify the status of the purchaser. As an example, the SEC stated that if an issuer solicits new investors through a website accessible to the general public or through a widely disseminated email or "social media" solicitation, the SEC does not believe that an issuer would have taken reasonable steps to verify the accredited investor status if the issuer required only that a person check a box in a questionnaire or sign a form, absent other information about the purchaser indicating accredited investor status. By the same token, the SEC acknowledged that if the terms of the offering require a high minimum investment amount such that only an accredited investor could reasonably be expected to meet them, then it may be reasonable for the issuer to take no steps to verify accredited investor status other than to confirm that the purchaser's cash investment is not being financed by the issuer or by a third party, absent any facts to the contrary. The SEC also stated that it would be important for an issuer to retain adequate records that document the steps taken to verify that all of its purchasers were accredited investors.

Importantly, the SEC made it clear that the verification obligation does not override the "reasonable belief" standard contained in the Rule 501 definition of "accredited investor." If an issuer takes reasonable steps to verify that a purchaser is accredited, and therefore reasonably

believes the purchaser is accredited, the issuer's ability to rely on the proposed Rule 506(c) exemption will not be lost because the purchaser is not in fact accredited.

An issuer must notify the SEC that it is taking advantage of the ability to use general solicitations and general advertising under proposed Rule 506(c) by noting that it is doing so in its Form D filing by way of checking a new separate box that will be added to Form D.[5] Accordingly, to take advantage of the new rules an issuer would need to conduct the offering in accordance with Regulation D and cannot rely solely on Section 4(a)(2).

We anticipate that the final rules, assuming that they are substantially similar to the Proposed Rules, will allow greater flexibility in press releases and other communications relating to 144A offerings and private placements under Rule 506(c).

NO CHANGES TO THE EXISTING RULE 506 SAFE HARBOR

The Proposed Rules are almost as important for what they do not change as for what they do change. Notably, the existing safe harbor for offerings not using any general solicitation or general advertising is unchanged and remains available as is without the need to comply with the new verification requirement. As a result, issuers will still have the ability to engage in offerings without the use of general solicitation or general advertising in order to sell privately to no more than 35 non-accredited investors who meet Rule 506(b)'s sophistication requirements or to investors with whom an issuer has a pre-existing relationship. In addition, at this time the SEC is not imposing any format or content limitations on general solicitations or general advertising. Finally, the SEC did not propose any change in the definition of an "accredited investor" that is eligible to invest in offerings that use general solicitation or general advertising.[6]

INTEGERATION WITH OFFSHORE OFFERINGS AND INTERACTION WITH OTHER REGULATORY FRAMEWORKS

The SEC also confirmed prior advice that an offering in the United States conducted in compliance with Rule 506 or Rule 144A, each as proposed to be amended, that employed

[5] To the extent that an issuer that has already filed its Form D wishes to take advantage of this ability, an amendment to Form D may be required.

[6] Section 413 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") requires the SEC to conduct a comprehensive study of whether the definition of an accredited investor should be "adjusted or modified for the protection of investors, in the public interest, and in light of the economy" four years after enactment (i.e., by December 2014). The Comptroller General is charged with conducting a study on the appropriate criteria for determining the financial thresholds or other criteria needed to qualify for accredited investor status and eligibility to invest in private funds and report to Congress by December 2013. These mandates, coupled with concerns expressed by some SEC Commissioners, industry watchdogs and numerous states securities commissions and ongoing investor losses in fraudulent offerings, may result in changes to the definition of accredited investor and may result in limitations on, or specific disclosure requirements for, advertisements and other forms of general solicitation.

general solicitation or general advertising would not be integrated with a concurrent offshore offering in compliance with Regulation S under the Securities Act.

For an examination of how the proposed rules affect private investment funds, please see Simpson Thacher & Bartlett LLP's client memo "SEC Proposes Rules to Eliminate the Prohibition Against General Solicitation and Advertising in Certain Private Securities Offerings – Private Investment Funds Perspective," published August 31, 2012.

The impact of the Proposed Rules on other areas of regulation will require study as the final rules are adopted.

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