



General Solicitation and Advertising In Connection With Private Securities Offerings Under Rule 506(c)

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Emerging companies that seek to raise capital by offering and selling securities must comply with applicable federal and state securities laws. One approach under federal law is to register the offering by filing a registration statement with the Securities and Exchange Commission (SEC). But registration is an expensive and time-consuming process and is not typically a feasible alternative for emerging companies. Rather than registering the offering, emerging companies generally look for an exemption from the federal registration requirements, and several of the most common exemptions are those contained in Regulation D.

Regulation D Generally

Regulation D currently is a series of nine rules (Rules 500 through 508) establishing three different exemptions from the federal registration requirements (two new rules under Regulation D have been proposed but not yet adopted). Rules 504, 505, and 506 contain the substantive exemptions, each differing with respect to certain factors such as issuer eligibility requirements, limitations on the number and qualifications of investors, information disclosure obligations, and limitations on the aggregate offering price of securities sold. (For information on Regulation D generally, and on the specific requirements applicable to Rule 504, 505 and 506 offerings, see our November 12, 2014 Quick Study "Stock Offerings and Securities Laws – Regulation D.")

General Solicitation and Advertising

Until recently, the use of any general solicitation or advertising in connection with the offer or sale of securities under Rule 506 was prohibited. Included within this prohibition, with limited exceptions, were advertisements, articles, notices, and other communications published in a newspaper or magazine, or broadcast over television or radio, as well as seminars and meetings to which the attendees were invited by general solicitation or advertising. This changed on July 10, 2013, with the SEC's adoption of new Rule 506(c).

Rule 506(c) Generally

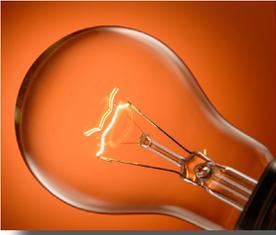
Rule 506(c) permits the use of general solicitation and advertising to offer and sell securities under Rule 506, provided that the following conditions are met:

- The issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors (for information on accredited investor status, see our November 21, 2013 Quick Study "Stock Offerings and Securities Laws: What is an Accredited Investor?");
- All purchasers of the securities must be accredited investors (either because they come within one of the enumerated categories of persons that qualify as accredited investors or the issuer, after having taken reasonable steps to verify, reasonably believes that they do) at the time of the sale of the securities; and
- All terms and conditions of Rules 501, 502(a), and 502(d) must be satisfied.

Verification Under Rule 506(c)

As noted above, an issuer must take reasonable steps to verify the accredited investor status of purchasers. Whether the steps are reasonable is an objective determination, based on the facts and circumstances of each purchaser and transaction. In Release No. 33-9415, the SEC advises that factors to be considered include:

- The nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- The amount and type of information that the issuer has about the purchaser; and



- The nature of the offering, such as the manner in which the purchaser was solicited, and the terms of the offering, such as a minimum investment amount.

In addition to the objective assessment discussed above, Rule 506(c) includes a nonexclusive safe harbor applicable to purchasers who are natural persons. Specifically, an issuer will be deemed to have taken reasonable steps to verify that a natural person is an accredited investor if the issuer uses one of the following methods:

- In regard to whether a purchaser is an accredited investor on the basis of income, reviewing any IRS form that reports the purchaser's income for the two most recent years (including but not limited to Form W-2, Form 1099, Schedule K-1 to Form 1065, and Form 1040) and obtaining a written representation from the purchaser that he or she has a reasonable expectation of reaching the necessary income level during the current year;
- In regard to whether a purchaser is an accredited investor on the basis of net worth, reviewing (i) with respect to assets, bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments, and appraisal reports issued by independent third parties and dated within the prior three months, and (ii) with respect to liabilities, a consumer report from at least one of the nationwide consumer reporting agencies dated within the prior three months, and obtaining a written representation from the purchaser that all liabilities necessary to make a determination of net worth have been disclosed;
- Obtaining a written confirmation from a registered broker-dealer, a registered investment adviser, a licensed attorney in good standing, or a registered certified public accountant in good standing, to the effect that such person or entity has taken within the prior three months reasonable steps to verify that the purchaser is an accredited investor and has determined that the purchaser is an accredited investor; or
- In regard to any person who purchased securities in an issuer's 506 offering as an accredited investor before the effective date of Rule 506(c) and who continues to hold such securities, obtaining a certification by such person at the time of sale that he or she qualifies as an accredited investor for the same issuer's Rule 506(c) offering.

However, none of these verification methods will suffice if the issuer has knowledge that a purchaser is not an accredited investor. Additionally, it is important to note that the verification requirement is independent of the requirement that all purchasers must be accredited investors, and the verification requirement must be satisfied even if all purchasers are accredited investors. In other words, if all of the purchasers in an offering are accredited investors but the issuer did not take reasonable steps to verify such status, the issuer may not rely on Rule 506(c). On the other hand, an issuer will not lose the ability to rely on Rule 506(c) if a person who is not an accredited investor purchases securities in the offering so long as the issuer took reasonable steps to verify and had a reasonable belief that the purchaser was an accredited investor at the time of the sale of the securities.

Rule 506 Offerings Without General Solicitation and Advertising

Although Rule 506(c) permits general solicitation and advertising in connection with Rule 506 offerings, it does not affect the ability of issuers to conduct Rule 506 offerings without the use of general solicitation and advertising, thus avoiding the need to comply with Rule 506(c).

Proposed Amendments Related to Rule 506(c)

The SEC has recently proposed amending Regulation D to add new Rule 509 and new Rule 510T. Proposed Rule 509 would require issuers to include certain legends in any written communication that constitutes a general solicitation in any offering conducted in reliance on Rule 506(c). Proposed Rule 510T would require issuers, on a temporary basis, to submit any written general solicitation materials used in their Rule 506(c) offerings to the SEC no later than the date of the first use of the materials. The materials would be submitted through the SEC's website, and not through the SEC's EDGAR system, and the materials would not be available to the public.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the author:

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