July 11, 2013

SEC Adopts Final Rules Lifting the Ban on General Solicitation and General Advertising for Some Private Placements

On July 10, 2013, the Securities and Exchange Commission (the "SEC") adopted final rules lifting the ban on general solicitation and general advertising for some private offerings under Rule 144A and 506 under the Securities Act of 1933, as amended (the "Securities Act"), as contemplated by the JOBS Act. Additionally, the SEC unanimously adopted a final rule implementing Section 926 of the Dodd Frank Act to disqualify an issuer from relying on Rule 506 for an offering if certain felons or "bad actors" are involved on behalf of the issuer (including as directors and officers).

The SEC also issued proposed rules intended, if adopted, to provide the SEC with additional disclosure in connection with Rule 506 offerings to enable the SEC to consider additional investor protections and enhance its ability to monitor the Rule 506 offering market.

The final rules become effective 60 days after publication in the Federal Register, or mid-September 2013.

Revised Rule 144A: General Solicitation and General Advertising Permitted in all Rule 144A Transactions

Rule 144A(d)(1) under the Securities Act provides a safe harbor exempting the resale of securities by a seller, other than the issuer, from registration under the Securities Act so long as, among other requirements, the securities were *offered* or sold only to qualified institutional buyers ("QIBS"), thereby prohibiting general solicitation and general advertising.

Upon effectiveness of the new final rule, the safe harbor will no longer be conditioned on the nature of the offerees. Accordingly, securities may be *offered* to non-QIBs, including by means of a general solicitation or general advertising, without compromising the availability of the Rule 144A exemption, so long as they are *sold* only to QIBs or purchasers the seller reasonably believes to be QIBs.

New Rule 506(c): General Solicitation or General Advertising Permitted, Subject to Satisfaction of Additional Conditions

Rule 506(b) under the Securities Act (previously Rule 506) is the principal safe harbor from registration for private placements under Registration D. It provides a safe harbor from registration for offerings by an issuer of its securities "not involving any public offering." The safe harbor is available so long as several conditions are met, including, among others, that the offering is made without general

solicitation or general advertising, and the purchasers include only accredited investors and up to 35 investors who are not accredited.

New Rule 506(c) will provide an alternative safe harbor available notwithstanding the use of general solicitation and general advertising in the offering, so long as the issuer satisfies all of the following conditions:

- all of the historical requirements under Rules 501 (definitions), 502(a) (integration) and 502(d) (resale restrictions) are satisfied;
- all purchasers are accredited investors (or the issuer reasonably believes they are at the time of sale of the securities); and
- the issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors.

Note that even if all purchasers are, in fact, accredited, a failure to take reasonable steps to verify that status would preclude reliance on the 506(c) safe harbor. The determination of whether an issuer has taken "reasonable steps to verify" is an objective one based on the particular facts and circumstances of each purchaser and transaction, such as:

- 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 (e.g., publicly available information in filings with federal, state or local regulatory bodies and reliable third-party information); and
- 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 the minimum investment amount.

Rule 506(c) sets forth the following four specific non-exclusive methods of verifying accredited investor status for natural persons that, if used, will be deemed to satisfy the verification requirement:

- Annual Income: reviewing copies of any recent IRS form that reports income for the two most recent years, along with obtaining written representation from the investor that the investor has a reasonable expectation of meeting the income test during the current year.
- Net Worth: reviewing one or more of certain documents, dated within the prior three months, including certain bank or brokerage statements, statements of securities holding, certificates of deposit, tax assessments, appraisal reports, and a credit report, in addition to written representation from the investor that all liabilities necessary to make a net worth determination have been disclosed.
- Confirmation by Independent Professional: obtaining written confirmation from a registered broker-dealer, SEC-registered investment adviser, licensed attorney, or certified public accountant that such independent professional has taken reasonable steps to verify that the investor is an accredited investor with in the past three months, and that the investor is accredited.

- Investors who previously invested with issuer as Accredited Investors and desire to invest in a new Rule 506 offering: obtaining certification from the investor at time of sale that the investor is accredited.

The SEC has also amended Form D to include a separate box for issuers to indicate whether an offering is conducted in reliance on Rule 506(b) or Rule 506(c).

New Rule 506(d): Bad Actor Disqualification

As required by Section 926 of the Dodd-Frank Act, the SEC adopted amendments to Rule 506 that will prevent issuers from relying on either subsection of Rule 506 if certain felons or "bad actors" are involved on behalf of the issuer in the offering. An issuer, its predecessor and affiliated issuers are disqualified from relying on Rule 506 if a "covered person"[1] has a "disqualifying event"[2] after the effective date of the final rule. The time periods for disqualification generally address conduct occurring five or ten years prior to the date of the Rule 506 offering, depending on the disqualifying event.

The rule includes a "reasonable care" exception from disqualification, applicable if an issuer can demonstrate that it did not know, and in the exercise of reasonable care could not have known, that a disqualification existed because of the presence or participation of a covered person. We expect that

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[1] The following are "covered persons" for purposes of the Bad Actor disqualification under Rule 506:

- the issuer, any predecessor of the issuer and any affiliated issuer;
- any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer;
- any beneficial owner of 20% or more of the issuer's outstanding voting equity securities;
- any promoter connected with the issuer in any capacity at the time of sale;
- any investment manager of an issuer that is a pooled investment fund;
- any person that has been or will be paid, directly or indirectly, to solicit purchasers in connection with the sale of securities;
- any general partner or managing member of any such investment manager or solicitor; and
- any director, executive officer or other officer participating in the offering of any such investment manager, solicitor, general partner or managing member of any such investment manager or solicitor.

[2] The following are "disqualifying events" for purposes of the Bad Actor disqualification under Rule 506:

- criminal convictions in connection with purchases or sales of a security, false filings with the SEC or arising from conducting business as an underwriter, broker-dealer, investment adviser or paid solicitor;
- injunctions and court orders related to engaging in or continuing conduct or practices relating to such activities;
- final orders of certain federal and state regulators banning engagement in securities, insurance, banking or similar activities (or from association with any entity regulated by the regulator issuing the order) or based on violation of anti-fraud laws or regulations;
- SEC cease-and-desist or disciplinary orders;
- suspension, expulsion or being barred from association with a national securities exchange or association for improper conduct;
- filing or being named as an underwriter in a registration statement as to which a stop or suspension order was issued; or
- U.S. Postal Service false representation orders and certain temporary restraining orders/injunctions.

many issuers will expand their use of questionnaires to relevant "covered persons" prior to the anticipated launch of a Rule 506 offering.

Effects of the Rule 506 and Section 144A Amendments on other Exempt Offerings

Issuers will continue to have the ability to conduct private placements without the use of general solicitation or general advertising. The amendments do not affect small offerings under Rule 504 or 505. Offerings made without general solicitation or general advertising under the old Rule 506, now Rule 506(b), may proceed as before with issuers able to offer or sell to an unlimited number of accredited investors and up to 35 other investors.

Additionally, the new rule has no effect on private offerings made under Section 4(a)(2) of the Securities Act or private resales under "Section 4(1½)."

The SEC has also confirmed that offshore transactions made in compliance with Regulation S will not be integrated with transactions in the United States made in compliance with the new rules. Accordingly, the use of general solicitation or general advertising in connection with a Rule 144A or Rule 506(c) offering will not constitute directed selling efforts under Regulation S for a concurrent offering made outside of the United States.

Issuers electing to engage in general solicitation or general advertising under Rule 506(c) may do so without affecting the validity of prior sales made in reliance on Rule 506(b). Non-accredited investors who previously purchased securities in a Rule 506(b) offering may continue to hold the issuer's previously purchased securities but may not purchase new securities in a Rule 506(c) offering unless the investor is accredited.

Specific Considerations Related to Private Funds

Private funds that rely on Section 4(a)(2) and Rule 506 to offer and sell their interests without registration under the Securities Act may now advertise and engage in general solicitation or general advertising without jeopardizing availability of the exemptions under Section 4(a)(2), Regulation D and the exclusions from the definition of "investment company" contained in Section 3(c)(1) and 3(c)(7) under the Investment Company Act. Accordingly, offerings by private funds engaging in general solicitation or general advertising and relying on Rule 506(c) will not be considered "public" offerings for purposes of the Investment Company Act exclusions.

In the final rules, the SEC cautioned fund managers that although Rule 506(c) permits general solicitation and general advertising, fund managers should be aware that exemptions from regulation by the Commodities Futures Trading Commission may be unavailable to fund managers who conduct general solicitations or engage in general advertising.

Proposed Rules Would Impose Additional Requirements for Rule 506(c) Offerings, Expand Requirements of Regulation D

The SEC proposed several new rules and rule changes that, if adopted, would affect private offerings, particularly under the new Rule 506(c).

- Additional Information Solicited by Form D: Under the proposed revision to Rule 503, Form D information would need to be filed 15 days prior to engaging in general solicitation or general advertising under Rule 506(c), Form D would be revised to include additional items detailing the

issuers website address, use of proceeds, number and types of accredited investors participating in the offering, whether general solicitation and general advertising materials were filed with FINRA, the types of general solicitation or general advertising used or to be used and methods used or to be used to verify accredited investor status of purchasers.

- Additional Filing of Form D upon Closing: Under the proposed revision to Rule 503, issuers would be required to file a final amendment to a Form D no more than 30 days after termination of any Regulation D offering, whether under Rule 506(b) or 506(c).

- Submission of Written General Solicitation and General Advertising Materials to the SEC: Proposed new Rule 510T would require that written general solicitation or general advertising materials be submitted to the SEC no later than the date of first use of such materials. This proposed rule would be effective for two years.

- Failure to File Form D Results in Loss of Regulation D Exemption: Under the proposed revision to Rule 507, an issuer would be disqualified from relying on Rule 506 for future offerings for one year if the issuer or its affiliates did not comply, within the previous five years, with all Form D filing requirements in a Rule 506 offering. The five-year period would relate to non-compliance occurring only after the effective date of the proposed rule.

- Amendment to Rule 156 to include Sales Literature Used by Private Funds: Rule 156 prohibits the use of materially misleading sales literature by registered investment funds. The proposed revisions to Rule 156 would include sales literature used by private funds.

- Legend and Disclosure Requirements for General Solicitation and General Advertising Materials: Proposed new Rule 509 would require specified legends for written general solicitation and general advertising materials.

- Additional Private Fund Legend and Disclosure: New Rule 509 would require private funds under the Investment Company Act to include an additional legend to disclose that (i) the securities offered are not subject to the protections of the Investment Company Act and (ii) limitations on usefulness of performance data, if such data included in general solicitation and general advertising materials. Additionally, private funds using performance data in solicitation materials would need to disclose certain information regarding such data and provide access to current performance data.

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