SEC ADOPTS AMENDMENTS TO PRIVATE OFFERING RULES

The SEC adopted final rule amendments implementing certain mandates under the Jumpstart Our Business Startups Act (JOBS Act) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The revised rules should significantly improve the ability of many businesses to raise capital.

OVERVIEW

The SEC has increased the opportunity for issuers to find potential investors by permitting the use of general solicitation in certain offerings under Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933, as amended (the Securities Act). While the rule amendments will enhance the flexibility with which issuers are able to market their offerings, issuers must comply with certain restrictions to make use of the amended safe harbor provisions to target a larger audience for private offerings. Since the SEC has indicated that Rule 506 accounts for an estimated 90% - 95% of all Regulation D offerings, the new rules hold the promise of reinvigorating the private offering market.

RULE AMENDMENTS

The amendments to Rule 506 and Rule 144A eliminate a ban on general solicitation or general advertising for certain private securities offerings. Additionally, the amendments ban certain “bad actors” from using the Rule 506 exemption. The SEC also proposed rules to enhance monitoring by imposing new filing and disclosure requirements on private offerings made in reliance upon revised Rule 506.

REMOVAL OF BAN ON GENERAL SOLICITATIONS

Rule 506 is a non-exclusive safe harbor that exempts certain securities offerings from registration requirements. Historically, the availability of the Rule 506 safe harbor was conditioned on the issuer not offering or selling securities through any form of general solicitation or general advertising (e.g., advertisements in newspapers, radio or television). To implement a JOBS Act mandate, the SEC has amended Rule 506 to remove the prohibition on general solicitation or general advertising, provided that all purchasers of securities are accredited investors and the issuer takes “reasonable steps” to verify that the purchasers of the securities are accredited investors.

NEW RULE 506(c) OFFERINGS

Under new Rule 506(c), whether the steps taken toward this verification requirement are “reasonable” is an objective test, based on the particular facts and circumstances of each purchaser and transaction. The rule includes a principles-based approach,
under which issuers should consider a number of factors, including the nature of the purchaser, the amount and type of information the issuer has about the purchaser, and the nature and terms of the offering. To provide additional guidance, the rule also includes a non-exclusive list of methods to verify accredited investor status of natural persons.

The non-exclusive list provides that the issuer may satisfy the verification requirement by taking certain actions, including:

- Analyzing income by reviewing tax returns or other IRS forms for the two most recent years and obtaining written representation of income level qualification in the current year;
- Analyzing net worth by reviewing bank statements, brokerage statements, appraisal reports, credit reports and other specified documents dated within the prior three months; or
- Obtaining written confirmation from a registered broker-dealer, an SEC-registered investment adviser, an attorney or a certified public accountant that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the past three months.

It is important to note that it is still possible to sell securities to non-accredited investors under Rule 506 but only if no general solicitation or general advertising is utilized.

Rule 144A is a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain restricted securities to qualified institutional buyers (QIBs). Offerings under Rule 144A can use general solicitation and general advertising because only QIBs can participate. The amendment to Rule 144A provides that the exemption is not lost because an investor is not a QIB if, when the securities were sold, the seller and any person acting on behalf of the seller reasonably believed that all purchasers were QIBs.

**DISQUALIFICATION OF BAD ACTORS**

To implement a Dodd-Frank Act mandate, the SEC amended Rule 506 to prevent certain felons and other “bad actors” from relying on the Rule 506 safe harbor. The Rule 506 exemption is now unavailable for a securities offering if the issuer or other relevant persons (such as underwriters, placement agents, directors and certain officers and shareholders) have had a “disqualifying event.” Disqualifying events include certain criminal convictions, court injunctions and restraining orders, final orders of banking, commodities, insurance and other regulators, certain SEC disciplinary orders and cease-and-desist orders and SRO suspensions.

The disqualification will not apply in certain circumstances, including if:

- The disqualifying event occurred prior to September 23, 2013, the effective date of the amendments;
- The issuer establishes that it did not and could not have known that a person participating in the offering had a disqualifying event;
- The court or agency that issued the disqualifying judgment or order advises the SEC against disqualification in that instance; or
- The SEC issues a waiver.

**PROPOSAL TO AMEND PRIVATE OFFERING RULES**

The SEC has also published proposed amendments to Rule 506 that would impose new filing and disclosure requirements on private offerings conducted using general solicitation or general advertising. The proposed amendments should help the SEC monitor market practices in Rule 506 offerings using general solicitation and general advertising.
The proposed changes would amend Regulation D, Form D and Rule 156 and add new Rule 509 and Rule 510T under the Securities Act to require:

- Filing of a Form D at least 15 days before first use of general solicitation in Rule 506 offerings;
- Filing of a closing Form D amendment within 30 days after the termination of a Rule 506 offering;
- Automatic disqualification of an issuer from relying on Rule 506 for at least one year if the issuer, or any predecessor or affiliate of the issuer, did not comply with Form D filing requirements in a Rule 506 offering within the past five years;
- Inclusion of certain legends in written general solicitation materials used in Rule 506 offerings and additional disclosures for private funds if such materials include performance data; and
- For a period of two years after the effective date of the proposed rule, submission to the SEC, on a non-public basis, of any written general solicitation material used in Rule 506 offerings.

For More Information

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