LEGAL UPDATES PUBLISHED: JULY 16, 2013

SEC Lifts the Ban on General Solicitation and Advertising

Service

Securities & Corporate Governance

It has been more than a year since the rulemaking deadline imposed by Title II of the Jumpstart Our Business Startups Act – also known as the JOBS Act – has come and gone. On July 10, 2013, during a contentious open meeting, the Securities and Exchange Commission (SEC) adopted rules to permit the use of general solicitation and general advertising in Rule 506 and Rule 144A offerings. The SEC also adopted rules mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act to disqualify felons and other "bad actors" from participation in Rule 506 offerings. Finally, the SEC proposed rule amendments to, among other things, allow it to collect information and evaluate and monitor the effect of the new general solicitation rules on the private placement market.

General Solicitation

The SEC adopted amendments to Rules 506 and 144A of the Securities Act of 1933 to allow issuers to solicit investors and to advertise in Rule 506 offerings, provided that the issuer takes reasonable steps to verify that purchasers are accredited investors or that Rule 144A resales of securities are limited to qualified institutional buyers.

In both the proposed and final rules, an issuer must make an objective determination whether it has taken reasonable steps to verify that purchasers are accredited investors, based on the facts and circumstances of each purchaser and each transaction. However, the SEC did add to its final rules a nonexclusive (and nonmandatory) list of methods that issuers may use to verify the accredited investor status of individuals. These three possible methods are:

Reviewing copies of any Internal Revenue Service (IRS) form that reports the purchaser's income along with a written representation that the purchaser will likely continue to earn the reported amount.

Reviewing bank statements, brokerage statements, certificates of deposit (CDs), tax assessments, appraisal reports and consumer reports with respect to net worth.

Receiving a written confirmation from a registered broker-dealer, registered investment advisor, licensed attorney or CPA that such party has taken reasonable steps to verify a purchaser's accredited investor status.

The SEC amended Form D, the Securities Act form required to be filed to give notice of an exempt offering of securities, to include an indication that the issuer intends to use general solicitation or general advertising pursuant to the new Rule 506(c) of Regulation D. The amendment was adopted by a 4-1 vote over strong criticism from Commissioner Luis Aguilar, who believes the rule should only be adopted concurrently with investor-protection safeguards. He admonished the SEC for waiting until now to propose the safeguards instead of including them with the August 2012 proposal to permit general solicitation. The changes go into effect 60 days after the publication of the final rules in the Federal Register.

Rule 506 "Bad Actor" Disqualification

In 2010, the Dodd-Frank Act mandated the SEC to adopt rules that would prohibit the use of the Rule 506 exemption for any securities offering in which certain felons and other bad actors are involved, substantially similar to the bad actor disqualification provisions of Regulation A. On July 10, the SEC unanimously adopted final rules similar to those originally proposed in May 2011, with minor modifications to the persons covered and the specific actions covered. Under the final rules, issuers cannot rely on Rule 506 if the issuer or any other person covered by the rule has had a "disqualifying event."

Covered persons

A "covered person" means the issuer, including its predecessors and affiliated issuers, as well as:

Directors and certain officers, general partners and managing members of the issuer.

Twenty percent beneficial owners of the issuer.

Promoters.

Investment managers and principals of pooled investment funds.

Persons compensated for soliciting investors as well as the general partners, directors, officers and managing members of any compensated solicitor.

Disqualifying events

A "disqualifying event" means:

Criminal convictions, court injunctions and restraining orders in connection with the purchase or sale of a security, in connection with the making of a false filing with the SEC, or arising out of the conduct of certain types of financial intermediaries

Final orders that bar the issuer from associating with a regulated entity, engaging in the business of securities, insurance or banking, or engaging in savings association or credit union activities or are based on fraudulent, manipulative or deceptive conduct and are issued within 10 years of the proposed sale of securities.

Certain SEC disciplinary orders relating to brokers, dealers, municipal securities dealers, investment companies, and investment advisors and their associated persons.

SEC cease-and-desist orders related to violations of certain anti-fraud provisions and registration requirements of the federal securities laws.

SEC stop orders and orders suspending the Regulation A exemption issued within five years of the proposed sale of securities.

Suspension or expulsion from membership in a self-regulatory organization (SRO) or from association with an SRO member.

U.S. Postal Service false representation orders issued within five years before the proposed sale of securities.

Reasonable care exception

The final rule provides an exception from disqualification when the issuer can show it did not know and, in the exercise of reasonable care, could not have known that a covered person with a disqualifying event participated in the offering.

Disclosure of pre-existing disqualifying events

Disqualification applies only for disqualifying events that occur after the effective date of this rule (likely due to a constitutional prohibition on *ex post facto* laws – laws that retroactively change the legal consequences or status of actions that were committed, or relationships that existed, before the enactment of the law). However, matters that existed before the effective date of the rule and would otherwise be disqualifying are subject to mandatory disclosure to investors.

New Proposed Rules

The SEC proposed new rules that, if adopted, will require additional disclosures for general solicitation materials to enable the SEC to evaluate and monitor the effect of the new rule on the Rule 506 market. The proposed rules were narrowly adopted by a vote of 3-2 and were strongly condemned by the objecting commissioners as overly burdensome and restrictive regulation. The proposed rules are subject to a 60-day public comment period.

Rule 506 offerings – advance notice filing and amended Form D upon completion

The proposed rules would require issuers to file an advance notice of sale on Form D at least 15 days before commencing a Rule 506(c) offering. Issuers offering securities under Rule 506(c) would also be required to amend Form D to update information and indicate that the offering has ended within 30 days of completing the offering.

Amendments to Form D to enhance SEC data collection for Rule 506(c) offerings

The proposed rules would also make extensive amendments to Form D to require an issuer to provide additional information about itself and the Rule 506(c) offering, including:

Identification of the issuer's website.

Expanded information about the issuer.

Additional information about the offered securities.

Additional information about the types of investors in the offering.

Additional information about the use of proceeds from the offering.

Information on the types of general solicitation used.

The methods used to verify the accredited investor status of investors.

Delinquent Form D filers to be temporarily disqualified from using Rule 506

The SEC has proposed to amend Rule 507 to temporarily disqualify those issuers who fail to file any required Form D from using Rule 506. The rule provides for a cure period for late filings, but if an

issuer fails to file any required Form D filings before the end of the cure period, the issuer would be disqualified from using Rule 506 for one year from the date that all delinquent Form D filings are made.

General solicitation materials

The proposed rules would require issuers to include legends and cautionary statements in written general solicitation materials used in Rule 506(c) offerings and to submit any such written general solicitation materials to the SEC through an intake page on the SEC website. The SEC would not make any of the submitted general solicitation materials available to the general public. The requirement to submit general solicitation materials to the SEC would be temporary, expiring after the first two years.

What This Means for Issuers

Once the newly adopted rules become effective, issuers will have a choice to take advantage of new Rule 506(c) to make offerings using general solicitation and general advertising or to use the existing provisions of Rule 506 to conduct offerings without the use of general solicitation and general advertising, avoiding the requirement to take reasonable steps to verify the accredited investor status of purchasers.

The new rules create opportunities for issuers – including private equity and hedge funds – to advertise offerings by issuing press releases or reaching out to various networks to identify accredited investors interested in an offering. Smaller companies and entrepreneurs who have not been able to build relationships with angel investors and venture capital firms will also benefit from the lifting of the general solicitation ban.

Contact Information

If you have questions concerning these or any other securities or corporate governance issues, please contact your Husch Blackwell attorney or one of our Securities & Corporate Governance attorneys.