



**SEC Proposes Rule Amendments to Eliminate the
Prohibition against General Solicitation and Advertising in
Certain Securities Offerings**

Prepared By:
The Public Companies Group

On Wednesday, August 29, 2012, the Securities and Exchange Commission (the "SEC") proposed rule amendments that would eliminate the prohibition against general solicitation and general advertising in certain securities offerings. The rule amendments, which would impact Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 (the "Securities Act"), were proposed in accordance with the requirements of Section 201(a) of the Jumpstart Our Business Startups Act (the "JOBS Act").

Background

Section 201(a)(1) of the JOBS Act directs the SEC to amend Rule 506 of Regulation D under the Securities Act to permit general solicitation or general advertising in offerings made under Rule 506, provided that all purchasers of the securities are accredited investors. Section 201(a)(1) also states that the amended rules must require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors. Section 201(a)(2) of the JOBS Act requires the SEC to revise Rule 144A(d)(1) under the Securities Act to permit offers of securities pursuant to Rule 144A to persons other than qualified institutional buyers ("QIBs"), including by means of general solicitation or general advertising, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

Rule 506 is a non-exclusive safe harbor under Section 4(a)(2) (formerly Section 4(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 existing Rule 506, an issuer may offer and sell securities, without any limitation on the offering amount, to an unlimited number of "accredited investors," as defined in Rule 501(a) of Regulation D, and to no more than 35 non-accredited investors who meet certain "sophistication" requirements. The availability of the Rule 506 safe harbor is subject to a number of requirements and is currently conditioned on the issuer, or any person acting on its behalf, not offering or selling securities through any form of general solicitation or general advertising, such as advertisements published in newspapers and magazines, communications broadcast over television and radio, unrestricted Web sites and seminars whose attendees have been invited by general solicitation or general advertising.

Rule 144A is a non-exclusive safe harbor exemption from the registration requirements of the Securities Act for resales of certain “restricted securities” to QIBs. Resales to QIBs in accordance with the conditions of Rule 144A are exempt from registration pursuant to Section 4(a)(1) (formerly Section 4(1)) of the Securities Act, which exempts transactions by any person “other than an issuer, underwriter, or dealer.”

The JOBS Act requires that the rule amendments be adopted no later than 90 days after the April 5, 2012 enactment date of the JOBS Act. The SEC already missed this deadline. Initially, the SEC had planned to adopt interim final rules on August 22, 2012 that would have been effective immediately but still subject to comment and revision. However, the SEC abandoned that plan and instead proposed these rule amendments, which it will adopt only after a typical comment and review process.

For a summary of the JOBS Act, please read [Congress Passes the JOBS Act](#).

In this Client Alert, as in the proposing release, general solicitation and general advertising are sometimes referred to collectively as “general solicitation.”

The Proposed Rules

1. Rule 506

In order to implement Section 201(a)(1) of the JOBS Act, the SEC has proposed a new Rule 506(c) which would permit the use of general solicitation to offer and sell securities under Rule 506, provided the following conditions are satisfied:

- The issuer must take reasonable steps to verify that the purchasers of the securities are accredited investors;
- All purchasers of securities must be accredited investors, either (i) because they come within one of the categories of persons who are accredited investors under existing Rule 501, or (ii) the issuer reasonably believes that they meet one of the categories at the time of the sale of the securities; and
- All terms and conditions of Rule 501 and Rules 502(a) and 502(d) must otherwise be satisfied.

The proposing release notes that the SEC is preserving the existing ability of issuers to conduct an offering under Rule 506(b) without the use of general solicitation. A company may still wish to utilize this exemption if it does not wish to use general solicitation and thus become subject to the requirement to take reasonable steps to verify the accredited investor status of purchasers or because the company wishes to take advantage of the ability under Rule 506(b) to sell to up to 35 non-accredited investors who meet Rule 506(b)'s sophistication requirements.

In determining the reasonableness of the steps that an issuer must take to verify that a purchaser is an accredited investor, the proposing release explains that issuers are to consider the particular facts and circumstances of each transaction. Factors to be considered include:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be (for instance, the reasonable steps to verify accredited investor status for a registered broker-dealer would necessarily differ from those reasonable to verify the status of a natural person);
- the amount and type of information that the issuer has about the purchaser (for example, the more information an issuer has evidencing accredited investor status, the fewer steps reasonably required to verify such status);
- the nature of the offering, such as the manner in which the purchaser was solicited to participate (for instance, solicitation through a publicly accessible Website or mass e-mail solicitation vs. targeted solicitation from a list of pre-screened accredited investors); and
- the terms of the offering, such as a minimum investment amount (for example, the amount may be sufficiently high that only accredited investors could reasonably be expected to meet it).

The SEC noted in the proposing release that it considered but ultimately decided not to propose requiring issuers to use specified methods of verification, stating that it "would be impractical and potentially ineffective in light of the numerous ways in which a purchaser can qualify as an accredited investor, as well as the potentially wide range of verification issues that may arise, depending on the nature of the purchaser and the facts and circumstances of a particular Rule 506(c) offering." Similarly, the SEC determined not to propose providing a non-exclusive list of specified methods for satisfying the verification requirement, stating that there may be circumstances where such information would not

actually verify accredited investor status and also stating a concern that such a list could be implicitly viewed by the market as required verification methods and thus eliminate the flexibility the new proposed rule is intended to provide.

In response to concerns voiced by some commentators on Section 201(a) of the JOBS Act, the SEC confirmed its interpretation that the JOBS Act and the new proposed Rule 506(c) do not replace the existing "reasonable belief" standard in the accredited investor definition of Rule 501(a) with an absolute standard. The SEC stated, "[i]f a person who does not meet the criteria for any category of accredited investor purchases securities in a Rule 506(c) offering, we believe that the issuer would not lose the ability to rely on the proposed Rule 506(c) exemption for that offering, so long as the issuer took reasonable steps to verify that the purchaser was an accredited investor and had a reasonable belief that such purchaser was an accredited investor." But the proposing release also cautions that, whatever steps are taken to verify accredited investor status, it will be important for an issuer to maintain adequate records of its actions since any issuer claiming an exemption from registration requirements will have the burden of showing its entitlement to the exemption if challenged.

Finally, the SEC confirmed its belief that the effect of the JOBS Act is to permit privately offered funds such as hedge funds, venture capital funds and private equity funds to make general solicitations under Rule 506(c) without losing their ability to utilize either of the Section 3(c)(1) or Section 3(c)(7) exclusions from the definition of "investment company" under the Investment Company Act of 1940.

2. Rule 144A

Pursuant to Section 201(a)(2) of the JOBS Act, the SEC also proposed an amendment to Rule 144A(d)(1). As amended, the rule would require only that securities are sold to a QIB or to a purchaser that the seller and any person acting on behalf of the seller reasonably believe is a QIB. Likewise, resales of securities pursuant to Rule 144A could be conducted using general solicitation as long as purchasers are limited in this same manner.

3. Form D

The SEC also proposed to amend Form D, the notice of sale that issuers must file with the SEC for each new offering of securities made in reliance on a Regulation D exemption. The revised form would add a separate box for issuers to check if they are claiming the

exemption under new Rule 506(c) and rename the existing check box as “Rule 506(b)” (currently stated simply as “Rule 506”). This will assist the SEC’s efforts to monitor use of the new exemption, practices that develop under the exemption and the size of this offering market.

Comment Period

The SEC is seeking public comment on the proposed rule amendments and certain enumerated topics and questions relating thereto that are set forth in the proposing release. The comment period will remain open until 30 days after the proposed rules are published in the Federal Register. The SEC expects to review the comments

ABOUT SCHIFF HARDIN LLP

With a long-standing expertise in the federal securities laws, Schiff Hardin is well positioned to provide public companies across the United States with the full range of services necessary to compete effectively in today's global marketplace. Our primary goals are to know our clients, learn their businesses and their industries, and work closely with them to address the many legal, regulatory and other challenges currently facing public companies.

© 2012 Schiff Hardin LLP

This publication has been prepared for the general information of clients and friends of the firm. It is not intended to provide legal advice with respect to any specific matter. Under rules applicable to the professional conduct of attorneys in various jurisdictions, it may be considered advertising material.

For more information visit our Web site at www.schiffhardin.com.