

THE JOBS ACT: SEC PROPOSES RULES TO PERMIT GENERAL SOLICITATION AND GENERAL ADVERTISING IN CERTAIN PRIVATE PLACEMENTS

INTRODUCTION

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the "JOBS Act"), a collection of reforms to the U.S. federal securities laws designed to reduce the regulatory burdens on small businesses and facilitate capital formation.¹ The JOBS Act directed the Securities and Exchange Commission (the "SEC") to amend Rule 506 of Regulation D under the Securities Act of 1933 to permit general solicitation or general advertising in unregistered offerings made under Rule 506, provided that all purchasers are accredited investors. The SEC proposed rules on August 29, 2012 to implement that requirement.

PROPOSED AMENDMENTS TO RULE 506

Section 4(a)(2) of the Securities Act exempts from registration the offer and sale of securities by an issuer in a transaction "not involving any public offering." This exemption has been interpreted to restrict an issuer from using public announcements, advertising or general solicitations when offering and selling securities. Rule 506, which creates a "safe harbor" for issuers seeking to use the Section 4(a)(2) exemption, currently prohibits the issuer, or any person acting on its behalf, from offering or selling securities through any form of general solicitation or general advertising.

To implement the JOBS Act, the SEC proposes to add new Rule 506(c), which would permit the use of

general solicitation to offer and sell securities under Rule 506, provided that:

- the issuer takes reasonable steps to verify that the purchasers are accredited investors;
- all purchasers of securities are accredited investors, either because they fit within one of the categories of persons that qualify as accredited investors or the issuer reasonably believes that they do, at the time of the sale of securities; and
- the other requirements of Regulation D (other than the general solicitation prohibition) are satisfied.

The proposed amendments preserve under Rule 506(b) the current exemption that allows issuers to conduct Rule 506 offerings without the use of general solicitation and general advertising. Issuers that choose to rely on Rule 506(b) would not be subject to the new requirement that they take "reasonable steps" to verify a purchaser's accredited investor status (i.e., they can rely on an investor's self-certification or a pre-existing substantive relationship with the investor) and they may still sell privately to up to 35 non-accredited investors who meet Rule 506(b)'s sophistication requirements.

VERIFICATION OF ACCREDITED INVESTOR STATUS

The SEC noted that the purpose of the verification mandate is to address concerns, and reduce the risk, that the use of general solicitation under Rule 506 may result in sales to non-accredited investors. The SEC noted that under the proposed rule, whether the steps taken by an issuer to verify that all purchasers are accredited investors are "reasonable" would be an objective determination that is based on the facts and circumstances of each transaction. The SEC also noted that amendments to Rule 506 must be flexible to accommodate different types of issuers and different types of accredited investors that may purchase securities in these offerings. The SEC provided a non-exclusive list of factors that an issuer would consider

¹ The text of the JOBS Act, as passed by the House on March 27, 2012, is available at <http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf>. For a more comprehensive discussion of the changes to U.S. federal securities laws instituted by the JOBS Act, please see our earlier client alert, *The U.S. Jumpstart Our Business Startups Act (The JOBS Act)*, available at <http://www.curtis.com/siteFiles/Publications/Public%20Company%20Client%20Alert.pdf>.

when determining the reasonableness of the steps taken to verify that a purchaser is an accredited investor, including:

- 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 and terms of the offering*, including the manner in which the issuer was solicited and whether it requires a high minimum investment amount.

Nature of the Purchaser

The definition of accredited investor in Rule 501(a) of Regulation D identifies several different types of accredited investors including both natural persons and entities. The steps that would be reasonable for an issuer to take to verify whether a purchaser is an accredited investor thus vary depending on the type of accredited investor that the purchaser claims to be. For example, registered broker-dealers are accredited investors. An issuer can easily verify the registered status of a broker-dealer and thereby satisfy the verification requirement. Verification of a natural person investor, on the other hand, presents significant challenges because many investors will be reluctant to provide copies of their tax returns or W-2 Forms. The SEC acknowledges that verification of the accredited investor status of natural persons poses practical difficulties that are exacerbated by privacy concerns about disclosing personal financial information.

Amount and Type of Information about Purchaser

The SEC indicates that the amount and type of information that an issuer has about a purchaser is a significant factor in determining what additional steps would be reasonable to verify accredited investor status. The SEC provides examples of the types of information that issuers could review or rely upon to constitute reasonable steps to verify a purchaser's accredited investor status, including:

- Publicly available information in filings with a federal, state or local regulatory body;
- Third-party information that provides reasonably

reliable evidence, such as W-2 Forms, tax returns or trade publications; and

- Verification of a person's status by a third party, such as a broker-dealer, attorney or accountant, provided that the issuer has a reasonable basis to rely on such third-party verification.

Nature and Terms of the Offering

Another factor that the SEC instructs issuers to consider when verifying the accredited status of investors is the nature and the terms of the offering. The issuer should consider the means through which the issuer publicly solicits purchasers. According to the SEC, an issuer that solicits new investors through a website accessible to the general public or through a widely disseminated email or social media solicitation would likely be obligated to take greater measures to verify accredited investor status than an issuer that solicits new investors from a database of pre-screened accredited investors created and maintained by a reasonably reliable third party such as a registered broker-dealer. As a result, issuers may begin to utilize the services of broker-dealers who have amassed a large pool of pre-screened accredited investors. In such case, the issuer could presumably rely upon the broker-dealer to verify the accredited status as long as the issuer understands the methods used by the broker-dealer to undertake the pre-screening and the issuer reasonably believes that the broker-dealer is conducting such pre-screening effectively.

FORM D CHECK BOX FOR RULE 506(c)

The proposed rules also would revise Form D to add a separate check box for issuers to indicate whether they used general solicitation or general advertising in a Rule 506 offering.

SPECIFIC ISSUES FOR PRIVATELY OFFERED FUNDS

The SEC also confirmed that privately offered funds such as hedge funds, venture funds and private equity funds would be able to utilize general solicitation and general advertising to raise capital under Rule 506(c) without running afoul of restrictions under the Investment Company Act of 1940.

PROPOSED AMENDMENT TO RULE 144A

In addition to mandating changes to Rule 506, the JOBS Act directs the SEC to revise Rule 144A(d)(1) under the Securities Act to provide that securities sold pursuant to Rule 144A may be offered to persons other than QIBs,² including by means of general solicitation or general advertising, provided that securities are sold only to persons that the seller and any person acting on the seller's behalf reasonably believe is a QIB. As amended the rule would require only that the 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. Under the amended rule, resales of securities pursuant to Rule 144A could be conducted using general solicitation, so long as the purchasers are similarly limited.

NO INTEGRATION WITH OFFSHORE OFFERINGS

The SEC made it clear that its long-standing policy that offshore offerings under Regulation S are not integrated with domestic offerings under Regulation D is unchanged by the JOBS Act and related rule amendments.

CONCLUSION

There will be a 30-day comment period on the proposed rules from the date the rule proposal is published in the Federal Register. If the Final Rules closely resemble those proposed then Issuers should take a totality of the circumstances approach when developing reasonable accredited investor verification procedures. The type of accredited investor the purchaser claims to be, the type of information available about that purchaser and the nature and terms of the offering should all be examined in their entirety to determine how extensive the verification process should be.

² QIBs are defined generally as institutions that own and invest at least \$100 million in securities on a discretionary basis.

ABOUT CURTIS

Curtis, Mallet-Prevost, Colt & Mosle LLP is a leading international law firm. Headquartered in New York, Curtis has 16 offices in the United States, Mexico, Europe, the Middle East and Central Asia. Curtis represents a wide range of clients, including multinational corporations and financial institutions, governments and state-owned companies, money managers, sovereign wealth funds, family-owned businesses, individuals and entrepreneurs.

For more information about Curtis, please visit www.curtis.com.

Attorney advertising. The material contained in this Newsletter is only a general review of the subjects covered and does not constitute legal advice. No legal or business decision should be based on its content.

FOR FURTHER INFORMATION, CONTACT:

CARL A. RUGGIERO, PARTNER

E-MAIL: CRUGGIERO@CURTIS.COM

TEL.: 212 696-6116

VICTOR L. ZIMMERMANN, PARTNER

E-MAIL: VZIMMERMANN@CURTIS.COM

TEL.: 212 696-6952

THOMAS LAURER, COUNSEL

E-MAIL: TLAURER@CURTIS.COM

TEL.: 212 696-6077

NEW YORK

101 PARK AVENUE

NEW YORK, NEW YORK 10178

TEL +1 212.696.6000

FAX +1 212.697.1559