

General Solicitation and Advertising Is Now Permitted For US Securities Offerings

Among the significant changes to the United States' existing securities law effected by the Jumpstart Our Business Startups Act, which became law on 5 April 2012, was the elimination of the prohibition on using general solicitation and advertising in private offerings of securities. On 10 July 2013, the SEC finally adopted rules implementing these provisions.

On 5 April 2012, President Barack Obama signed the Jumpstart Our Business Startups Act (the 'JOBS Act'), which significantly changed existing laws and procedures involved in raising new capital in the United States.

Of particular relevance to non-US companies (foreign private issuers or 'FPIs') were the changes brought about by the JOBS Act which allowed for enhanced opportunities for FPIs to raise capital through private debt and equity offerings under Rule 506 of Regulation D and Rule 144A of the Securities Act of 1933, as amended (the 'Securities Act')¹.

Upon effectiveness of the amendments to Regulation D and Rule 144A on 23 September 2013, issuers of securities in a private offering under Rule 506 of Regulation D and the seller of securities in a Rule 144A offering will be permitted to engage in general solicitation and advertising, so long as all purchasers in a Regulation D offering are 'accredited investors' and the seller of securities in a Rule 144A offering has taken 'reasonable steps' to ensure that all purchasers are 'qualified institutional buyers' ('QIBs'). This change in the law, providing an alternative to a traditional Rule 506 private offering conducted without general solicitation or advertising, represents a significant departure from long-established requirements in private placements under US securities laws.

General solicitation and advertising includes, among other things, newspaper ads, television and radio broadcast pitches, outdoor billboards and use of the internet. The current ban on these activities in private placement transactions, of course hampers an issuer's ability to reach the widest universe of potential investors and imposes considerable costs in carrying out capital raising transactions via the internal and external vigilance procedures required to ensure compliance with the previously-effective rules. It should be noted that these changes also may increase the risk of investor



fraud claims, to the extent that general solicitation and advertising communications are not prepared with the same rigour and discipline as the 'private' communications used in current practice.

Rule 506 of Regulation D

Under the amendments to Regulation D, which pertain only to offerings of securities sold pursuant to Rule 506, issuers may use general solicitation and general advertising to offer their debt and equity securities provided that:

1. the issuer takes 'reasonable steps to verify' that each of the purchasers of the securities is an accredited investor; and
2. all purchasers are accredited investors, or the issuer reasonably believes that all purchasers are accredited investors, at the time of sale of the securities.

Thus, for the first time the SEC has stated that securities may be offered to persons other than accredited investors pursuant to a Rule 506 offering, provided that the issuer reasonably believes that all purchasers are accredited investors. Yet the SEC also has increased the burden on issuers to confirm the accredited status of investors.

In the amended Rule 506, the SEC provides examples of the 'reasonable steps' required to be taken by an issuer of securities to verify that a purchaser is an accredited investor. None of these steps are mandatory or exclusive; rather they act as 'safe harbours' for issuers. With respect to an individual investor, the steps that may be taken to determine if that purchaser is an accredited investor on the basis of *income* include reviewing any Internal Revenue Service form that reports the purchaser's income for the two most recent years, such as a Form W-2, a Form 1099 or a copy of a filed Form 1040, and obtaining a written representation from the purchaser that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year. For a purchaser who is accredited on the basis of *net worth*, steps that may be taken include reviewing, with respect to assets, bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments and appraisal reports issued by independent third parties. With respect to liabilities, the issuer could review a consumer report from at least one of the nationwide consumer reporting agencies.

An additional or alternative form of verification set forth in the rule could involve obtaining a written confirmation from a registered broker-dealer, an investment adviser registered with the SEC, an attorney licensed and in good standing in the jurisdiction in which he or she is admitted to practice, or a certified public accountant duly registered and in good standing under the laws of the place of his or her residence or principal office, in each case that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the prior three months and has determined that such purchaser is an accredited investor.

As noted, the SEC has emphasised that these are non-exclusive verification methods and that an issuer is not required to use any of these methods. Rather, an issuer of securities can apply the reasonableness standard directly to the specific facts and circumstances presented by the offering and the investors.

Rule 144A

Rule 144A has been amended to permit 'offers' to be made to persons who are not QIBs. Accordingly, upon effectiveness of the amendment, general solicitation and advertising may be used in connection with an offering of securities that qualifies for exemption from registration because it is conducted pursuant to Rule 144A. However, the exemption for such Rule 144A offerings is conditioned on the securities being sold only to QIBs, or to purchasers that the seller and any person acting on its behalf reasonably believes are QIBs. Unlike the amendments to Rule 506, the amendment to Rule 144A does not include any standards or guidelines to be used by the seller or any person acting on its behalf in determining whether the seller reasonably believes that a purchaser is a QIB.

Regulation S

Regulation S provides a safe harbour for offers and sales of securities which are made outside of the United States. To qualify for the Regulation S exemption from registration, the securities must be sold in an offshore transaction and there can be no directed selling efforts in the US. In this regard, a directed selling effort includes any activity undertaken for the purpose of, or that could be reasonably be expected to have the effect of, conditioning the market in the US for any of the securities offered offshore in reliance on Regulation S.

In its Release adopting the aforesaid Rule amendments, the SEC stated that offerings under Regulation S would

Sellers of securities through Rule 506 Regulation D or Rule 144A are now permitted to advertise or generally solicit buyers.

not be integrated with concurrent domestic unregistered offerings under Rule 506 or Rule 144A in which general advertising or solicitation occurred. Thus, a US private offering under Rule 506 or Rule 144A in which, for example, an advertisement in a publication with a general circulation in the US was made, would not disqualify a concurrent offshore offering being made by the issuer in reliance on Regulation S.

Conclusion

As previously described, an issuer of securities, including an FPI offering, selling its debt or equity securities in a Rule 506 Regulation D or Rule 144A offering is now permitted to engage in general solicitation and advertising with respect to its offering, provided all of the purchasers in the Rule 506 Regulation D offering are accredited investors and the issuer has taken reasonable steps to verify that the purchasers are accredited investors, and provided that all purchasers in the Rule 144A offering are reasonably believed by the seller and any person acting for it to be QIBs.

The existing provisions of Rule 506 as a separate exemption from registration under the Securities Act are not affected by the final rule. Accordingly, issuers conducting Rule 506 offerings without the use of general solicitation or advertising can continue to conduct their securities offerings in the same manner as previously conducted and are not subject to the new verification requirements.

Notes:

- Under the Securities Act, an offer to sell securities must either be registered with the SEC or meet an exemption from registration. Regulation D contains three rules providing exemptions from the registration requirements, including Rule 506 which permits an issuer to raise an unlimited amount of money if it sells only to 'accredited investors' (generally defined to include institutional investors and individual investors with a net worth exceeding US\$1 million (exclusive of the equity in such person's primary residence), or an individual income of more than US\$200,000 per year, or a joint income with their spouse of more than US\$300,000, in each of the last two years and an expectation to reasonably maintain the same level of income in the current year) and no more than 35 other purchasers. Rule 144A provides a registration exemption for private re-sales to certain large institutional investors by a broker or dealer who acquired restricted securities from an issuer. Rule 144A has been the principal exemption from registration relied on by FPI's when accessing the US capital markets.



Kenneth J. Stuart
Becker, Glynn, Muffly, Chassin &
Hosinski LLP

Kenneth J. Stuart, Of Counsel to Becker, Glynn, Muffly, Chassin & Hosinski LLP, practises in the areas of securities, M&A, private equity, venture capital, hedge funds and general corporate and financing transactions. Before joining Becker Glynn, he was General Counsel at ORIX USA Corporation and a partner at several prominent law firms.