

PUBLICATION

General Solicitation and Advertising Permitted under Rule 506(c) – The SEC Takes First Steps in JOBS Act Rulemaking

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Effective September 23, 2013, finalized rulemaking by the Securities and Exchange Commission (SEC), implementing Section 201(a)(1) of the Jumpstart Our Business Startups Act (the JOBS Act), allows issuers of securities to engage in general solicitation and advertising to accredited investors in some private placement offerings of securities. This advertising activity was previously prohibited under the widely-used private placement exemption of SEC Rule 506, enacted under Regulation D, to perfect exemption from the registration requirements of the Securities Act of 1933, as amended. Although the SEC announcement leaves several notable questions unanswered, Rule 506(c) has the potential to enhance the utility of private placements for issuers seeking to utilize social media and other unconventional capital-raising avenues.

Rule 506(c) now permits securities issuers to use general advertising and solicitation, typically manifested as published advertisements, articles and notices in newspapers, magazines and other broadcast media. This will enable crowdfunding ventures, for example, to reach a greater audience in marketing investments in their businesses. However, these issuers may sell only to **accredited** investors, purchasers of securities who possess, or who the issuer reasonably believes immediately before the sale of securities possess, "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment."

New Rule 506(c) is noteworthy because sellers of securities are required to "take reasonable steps to **verify** that purchasers of securities . . . are accredited investors." Unlike existing Rule 506 offerings, there is **no** 35-individual exception for **non**-accredited investors under Rule 506(c). Unfortunately, administrative guidance surrounding the new rule somewhat muddles the verification process for accredited investors, although the SEC's release provides a non-exhaustive list for what constitutes "reasonable verification:"

- Reviewing copies of any IRS form that reports the income of the purchaser and obtaining a written representation that the purchaser will likely continue to earn the necessary income in the current year.
- Receiving a written confirmation from a registered broker-dealer, SEC-registered investment adviser, licensed attorney or certified public accountant that such entity or person has taken reasonable steps to verify the purchaser's accredited status.

This rule is thus double-edged: general solicitation will allow a broader audience to be reached by issuers who otherwise are limited in identifying potential investors, but that base is limited to those who are accredited, which determination requires the issuer's somewhat subjective determination, grounded in individualized facts and circumstances, rather than clear SEC guidance.

Rule 506(c) modifies only Title II of the JOBS Act, but leaves Title III of the JOBS Act, Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 (the CROWDFUND Act), untouched. Investors eager to work outside the current securities regime are hopeful that when the rules are finally released under CROWDFUND, they will be permitted to sell to *any* investor, accredited or otherwise, through the use of online funding portals. Accordingly, general solicitation and advertisement would likely be limited, i.e., issuers would **not** be permitted to advertise in print, through broadcast media or through social media as

permitted under Rule 506(c). These unwritten regulations may be more of a boon to less-sophisticated or smaller-scale issuers in comparison to Title II's somewhat tempered Rule 506(c).

Another challenge that may arise as a result of new Rule 506(c) is the interplay between federal securities law and state blue sky laws. Although transactions effectuated under Rule 506 preempt state law generally, state registration requirements for broker-dealers and investment advisors are **not** affected by the SEC's new rule. If Rule 506(c), and later CROWDFUND, open the floodgates of entrepreneurial investing, issuers should be aware that the use of an unregistered intermediary may run afoul of state law. This may be a concern for multi-state issuers employing a broker-dealer or other intermediary to solicit possible investors.

As things currently stand, the recent change in Rule 506(c) is a half-step, rather than a leap, forward. CROWDFUND is not fully implemented for non-accredited investors. The SEC's ballyhooed rulemaking giving issuers more flexibility to find qualified investors on the Internet and through general advertising isn't the implementation of the JOBS Act that markets have been anticipating. If the implementation of the general solicitation rule under 506(c) succeeds, the SEC will be pressed to expand the scope to crowdfunding in order to bring the JOBS Act's capital raising potential closer to realization.

Should you wish to discuss the impact of Rule 506(c) on your particular facts and circumstances, please do not hesitate to contact any of the attorneys in the Firm's Securities and Corporate Governance Group.