

Venture Capital & Emerging Companies Alert

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Opportunities Under New Private Placement Rules

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Historically, the biggest difference between a registered public offering and a private placement of securities in the United States has been the prohibition of general solicitations and general advertising in connection with a private placement. This distinction is about to change and will mark a sea change in the way individual companies and funds can raise capital under the private placement exemption provided by Regulation D.

Most offerings of securities in the United States for private companies and for funds are conducted under an exemption from registration known as Regulation D. Private placements are far less expensive and can be conducted more rapidly than public offerings because there is no SEC review. One of the limitations under private placements, however, has been the strict rules against general solicitations and advertising which has limited the way private offerings are conducted and has essentially prevented on-line private placements. Under the JOBS Act passed earlier this year, Congress mandated the SEC to change the rules governing private placements to permit general solicitations and advertising if the securities are purchased only by Accredited Investors. The SEC has proposed the new rules (to be known as Rule 506 (c) under Regulation D) and the comment period for the new rules has ended. We anticipate that the final rules will be announced by the SEC in the next 30 – 60 days. Under the proposed new rules, we believe that there will be a tremendous opportunity to raise capital on-line from Accredited Investors and that it may make sense to start planning for this opportunity now.

Under the proposed new Rule 506 (c) under Regulation D, a private company or a fund can raise capital directly on-line provided that “the issuer must take reasonable steps to verify that the purchasers of the securities are Accredited Investors.” According to the SEC’s proposal, whether the steps taken are reasonable would be an objective determination, based on the particular facts and circumstances of each transaction. In essence, this would be a “principle based test” and not a “strict bright-line rule based test.” In making a determination of Accredited Investor status of potential investors, issuers would consider a number of factors, 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 of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as the minimum investment amount.

Interestingly, one of the examples provided by the SEC as a reasonable step to verify the accredited status of a purchaser would be third-party verification by the purchaser’s attorney, accountant, or broker dealer. Combined with a thorough investor questionnaire, this type of verification should, in most cases, be considered a reasonable step.

Under Regulation D, individual investors are considered “Accredited Investors” if they have a net worth of \$1 million (excluding the equity value of their primary residence) or income of \$200k per year (or \$300k with their

spouse). Most private placements in the United States are already limited in practice to Accredited Investors as the disclosure rules can be more broadly construed if limited to this class of investors. With the new Rule 506, companies and funds will now be able to reach this class of persons directly on-line from their website or by e-mail.

Please contact us if you would like to learn more about this new method of conducting private placement offerings.

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