



SEC Issues New Guidance on General Solicitation and Advertising in Regulation D Offerings

On August 6, 2015, the SEC's Division of Corporation Finance ("DCF") updated its Compliance and Disclosure Interpretations ("CDI") with eleven new CDI on general solicitation and advertising in Regulation D offerings. That same day, the DCF also issued a no-action letter finding that an online venture capital firm's procedures for creating online pre-existing substantial relationships did not constitute general solicitation and advertising under the rules. The new CDI and no-action letter are summarized below.

Background

Traditionally, general solicitation or advertising was prohibited in connection with any offering under Rule 506 of Regulation D. An offer to sell securities is considered a general solicitation unless there is a pre-existing, substantive relationship with the offeree.

While general solicitation continues to be prohibited under Rule 506(b), the new Rule 506(c), promulgated under the JOBS Act, allows for companies to generally solicit and advertise to potential investors. Unlike Rule 506(b), Rule 506(c) requires that all purchases be made by accredited investors and puts the burden on the issuer to verify the potential investor's status as an accredited investor. It is not enough for the investor to check a box confirming that they are accredited, as is typically done in a Rule 506(b) offering.

The New Compliance and Disclosure Interpretations

The new CDI address when a communication is considered to be general solicitation, with the majority providing guidance on when a substantial pre-existing relationship exists between the issuer and the offeree.

1. Public websites that offer or sell securities constitute general solicitation

Offering or selling securities on a website that is able to be accessed by the public without restriction constitutes general solicitation. Any issuer that does so would need to comply with the provisions of Rule 506(c) for that offering.

2. Dissemination of factual information about a company, without an offer to sell securities, is not general solicitation

An issuer may disseminate factual information about its business without it being considered a solicitation or advertisement under Regulation D, so long as that information does not "condition the public mind or arouse public interest in a securities offering". While what constitutes factual business information depends on the specific facts and circumstances, it is generally limited to information about the company, its business, financial condition, products, services, or advertisement of its products or services that do not reference securities or a securities offering. Predictions, projections, forecasts or opinions and valuations of securities are typically excluded from factual information. Additionally, information on the past performance of a fund would be considered a securities offering if the fund was engaged in an offering when the information was released.



3. Demo day or venture fair participation is not necessarily general solicitation

A presentation given by a company, such as by participating in a demo day or venture fair, is not general solicitation if no securities are offered. It would also not be considered a general solicitation if the audience was comprised only of persons with whom the issuer or the organizer of the event had a pre-existing, substantive relationship, or if they were contacted via a pre-screened group of accredited, sophisticated investors, such as an angel group (see #4, below). If invitations to the event were sent out to individuals without a pre-existing relationship and/or groups without accreditation pre-screening and the company offered securities, then the presentation would be a general solicitation under Regulation D.

4. Not all offers made to persons where there is no pre-existing, substantive relationship constitute general solicitation

A “pre-existing” relationship is one that the issuer, or someone acting on the issuer’s behalf, has formed with the potential investor before the offering has begun. Broker-dealers and investment advisers may be engaged to act on the issuer’s behalf in order to solicit the securities to their networks, thereby allowing the issuer to reach a larger network while avoiding general solicitation.

The SEC acknowledged the long-standing practice of issuers contacting potential investors who are members of a network of people with experience investing in private offerings, such as angel investor groups, and the sharing of investment opportunities within those networks. While it is a fact-specific determination whether a general solicitation has occurred, members of sophisticated investor networks may introduce the issuer to other members of the network without the communication being considered a general solicitation. The more persons without financial experience that are contacted through impersonal, non-selective means of communication, the more likely the communications are part of a general solicitation.

5. There is no time requirement for a “substantive” relationship

Determining whether a “substantive” relationship exists with a potential investor is a fact specific determination, and there is no minimum amount of time that the issuer, or person acting on its behalf, must know the prospective investor. A substantive relationship does require that the issuer, or the person acting on its behalf, has sufficient information to evaluate, and in fact does evaluate, the prospective investor’s financial circumstances, sophistication, and established accreditation. Self-certification by the investor is not sufficient. In addition, the relationship must have existed prior to the commencement of the offering to be considered “pre-existing”.

The Citizen VC No-Action Letter

Citizen VC, Inc., a venture capital firm that forms subsidiaries as special purpose vehicles (“SPVs”) to aggregate accredited investors’ investments in seed, early-stage, emerging growth, and late-stage companies under Rule 506(b), sought a no-action determination from the SEC that its online procedure establishes substantial pre-existing relationships with potential investors and therefore does not constitute general solicitation. The SPVs are created for purposes of investing in particular portfolio companies and not as blind pools for a later investment opportunity.

Citizen VC’s website is publicly accessible, and potential new members can apply via the website. Offering documents and information about portfolio companies are password-protected and only available to members that have been accepted by Citizen VC. Before accepting a potential investor as a member, Citizen VC requires that the potential investor complete an accredited investor questionnaire. If the



questionnaire is satisfactory, Citizen VC then evaluates the potential investor's sophistication, financial circumstances, and ability to understand the nature and risks related to the types of investment Citizen VC undertakes, which includes phone discussions with the potential investor and obtaining his or her credit history. Only after Citizen VC has determined that the investor is accredited and sophisticated during this relationship establishment period is he or she admitted as a member and given access to the password-protected portions of the platform.

The SEC agreed with Citizen VC that its procedures as set forth in its no-action request letter were sufficient to establish a substantial pre-existing relationship with potential investors, such that its subsequent offers to invest in the SPVs after the potential investor is accepted as a member did not constitute general solicitation under Regulation D.