Client Alert

October 2, 2013

Private Offerings: Questions that Might Frequently be Asked Sometime Soon (Part II)

Shortly after the Securities and Exchange Commission (SEC) adopted the final rule relaxing the prohibition against general solicitation in connection with offerings made pursuant to new Rule 506(c) and Rule 144A, we provided our perspective on various interpretative questions that might arise as issuers and financial intermediaries began to avail themselves of the new offering exemption and the ability to communicate more broadly. See http://www.mofo.com/files/Uploads/Images/130723-Private-Offerings.pdf. In this alert, we provide our views on additional questions that we have received from market participants.

The Interplay of Rule 506(b) and Rule 506(c)

If an issuer completed a Rule 506(b) offering to its existing investors and then proposes to commence an offering to new investors in reliance on Rule 506(c), must the issuer go back to the existing investors that participated in the Rule 506(b) offering to obtain additional information in order to satisfy verification requirements?

No. The Rule 506(b) offering is deemed completed, and a new offering is being commenced. Even if one were concerned about the integration of the Rule 506(b) offering and the subsequent Rule 506(c) offering, the issuer would not have had to undertake additional verification steps with respect to its existing investors, beyond confirming that those investors were still "accredited investors."

Does the requirement to verify the status of investors in a Rule 506(c) offering change the process for establishing a reasonable belief as to accredited investor status for purposes of a Rule 506(b) offering?

No. The process in relation to Rule 506(b) offerings has not changed. An issuer may continue to rely on its (or its financial intermediary's) pre-existing relationship with investors, and on investor questionnaires and investor representations regarding their status.

Should materials used to market a Rule 506(c) offering include legends similar to those proposed by the SEC in its Release No. 33-9416 (proposing changes to Regulation D, Form D and Rule 156)?

No, the materials do not need to include the legends that were included in the SEC's proposal relating to Regulation D offerings; however, offering materials used in connection with a private offering should contain clear and prominent legends indicating the private nature of the offering, that, to the extent applicable, the materials are confidential and are being provided by the issuer or its adviser to a recipient and may not be shared, that the securities that are being offered are being offered in an exempt transaction, and that the securities will be "restricted securities" that will be subject to transfer restrictions. It would be permissible to include the legends contemplated by the SEC's proposed amendments, even though they are not technically required to be included.

The Use of Websites

Can you use general solicitation to garner interest in a site that provides general information about investment opportunities without conducting additional verification?

Yes, general solicitation may be used to promote a site that provides only general information about investments and does not provide access to specific investment opportunities.

Can website providers continue to rely on the SEC Staff's prior guidance on the use of password-protected internet-based offerings?

Yes, the guidance in *IPONet* and *Lamp Technologies* is still relevant. A website provider may want to use general solicitation to attract users to its website, and may provide information that is of general interest and not related to a specific offering on pages that are not subject to password protection and are freely accessible. Prior to providing any visitor or user with access to information about a particular issuer or particular investment opportunity, the website provider can implement investor verification procedures. If only investors that are determined to be "accredited investors" are permitted to access information about an offering, then the issuer can presumably continue to rely on Rule 506(b).

Can matchmaking sites generally advertise and then provide access only to accredited investors without undertaking additional verification steps?

No. Of course, a matchmaking site can continue to make certain opportunities available on a limited basis only to investors that it has previously determined are accredited investors, while making other investments available broadly and conducting additional verification steps.

Use of General Solicitation by Funds

Is it still necessary to impose a waiting period for investments once investors have been qualified to access information about fund offerings?

Yes, to the extent that a fund is engaged in a continuous offering and the fund intends to rely on Rule 506(b), rather than Rule 506(c).

Do the same investor verification rules apply if you use general solicitation but sell only to qualified purchasers?

Presumably, if general solicitation is used, and sales are being made by a fund solely to investors that are "qualified purchasers," the fund or a financial intermediary acting on its behalf will need to consider carefully the verification procedures that it implements and be certain that the verification procedures will ascertain the investor's status as a "qualified purchaser" (not just an "accredited investor"). For funds that charge incentive fees, the verification process also must contemplate ascertaining that the investor is a "qualified client."

How do the general solicitation rules apply to a fund that relies on the CFTC's *de minimis* exemption from the commodity pool operator registration requirement or Rule 4.7?

To date, there has been no guidance from the CFTC regarding whether a general solicitation in the context of a Rule 506(c) offering or a Rule 144A offering would be considered "marketing to the public" under the applicable CFTC rules. As a result, funds that rely on these rules should not use general solicitation until guidance has been issued.

Bad Actor Rule

Has the SEC provided guidance regarding the implementation of the bad actor disqualification provisions of Rule 506?

The SEC provided some guidance on various aspects of the bad actor rule in a recently issued Small Entity Compliance Guide, available at http://www.sec.gov/info/smallbus/secg/bad-actor-small-entity-compliance-guide.htm. The guide addresses various transition issues and reiterates that the rules affect only sales of securities made on or after September 23, 2013. Sales of securities made before the effective date of the bad actor provisions will not be affected by the disqualification and disclosure requirements, even if such sales are part of an offering that continues after the effective date. Only sales made after the effective date of the amendments will be subject to disqualification and mandatory disclosure.

The guide also addresses disqualifying events that occur while an offering is underway and notes that sales made before the occurrence of the disqualifying event will not be affected by the disqualifying event, but sales made afterward will not be entitled to rely on Rule 506 unless the disqualification is waived or removed, or, if the issuer is not aware of a triggering event, the issuer may be able to rely on the reasonable care exception.

Will the SEC waive the disclosure requirement for bad actor disqualification triggering events that occurred prior to the September 23, 2013 effective date?

The SEC Staff has indicated that it does not have the authority to waive the requirement to disclose bad actor disqualification triggering events that occurred prior to the effective date.

Content Requirements; Filing Requirements

Are there any content or filing requirements for written general solicitation materials?

The SEC's proposal regarding amendments to Regulation D, Form D and Rule 156 is only a proposed rule, and the status of the proposal is unclear; however, there is an existing regulatory framework that is applicable to materials used in connection with an offering of securities.

An issuer will have liability in respect of written general solicitation materials. Any written general solicitation materials should be closely reviewed. Certain types of issuers may be subject to more detailed regulatory requirements. For example, commodity pools are subject to requirements relating to the format and content of written solicitation materials. For more on these, see http://www.mofo.com/files/Uploads/Images/130920-Rules-for-CPOs.pdf. Similarly, issuers that are investment companies are subject to requirements relating to the content of solicitation materials.

To the extent that a broker-dealer is engaged in the offering, the broker-dealer is subject to requirements relating to its communications. Communications must be fair and balanced. This will require careful consideration of the contents of any solicitation materials to ensure that risks are appropriately presented. In addition, broker-dealers are subject to FINRA rules relating to advertising, such as FINRA Rule 2110. Communications that are considered "retail communications" are subject to review, filing and recordkeeping requirements. For more on FINRA Rule 2210, see http://www.mofo.com/files/Uploads/Images/120627-FINRA-Rule-Governing-Communications.pdf. FINRA members also are subject to the requirements of Rule 5123 relating to private offerings, see http://www.mofo.com/files/Uploads/Images/120615-FINRA-Rule-5123.pdf.

Are there special considerations involved in using social media?

Yes. Issuers should consider carefully the means through which they conduct any general solicitation, and should implement a social media policy. Broker-dealers and registered investment advisers also are subject to specific rules and regulatory guidance relating to their use of social media. We discuss many of the considerations relating to the use of social media in our guide, available here http://www.mofo.com/files/Uploads/Images/130905-Social-Media-Securities-Laws.pdf.

Documentation Issues

Should the documentation used in connection with private offerings be updated?

Both issuers and financial intermediaries should consider implementing changes to documents used in connection with a Rule 506 or a Rule 144A offering. For example, an issuer will need to undertake a bad actor inquiry in relation to itself, affiliates, control persons, etc., and will want to obtain representations or a certification from a placement agent or other financial intermediary that the intermediary is not a bad actor and has not engaged in any disqualifying event that requires disclosure. On its part, any financial intermediary that is actively involved in the private offering market will want to undertake its own bad actor compliance process. Engagement letters, purchase agreements and placement agency agreements should be reviewed and provisions may need to be added addressing the bad actor rule; identifying an offering as a Rule 506(b) offering (not using general solicitation) or as a Rule 506(c) offering; addressing the preparation and use of, as well as liability for, any written general solicitation materials. We provide sample provisions at http://us.practicallaw.com/cs/Satellite/usclassic/resource-us/4-537-0305.

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