

# Corporate Finance Alert

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## SEC Proposes Rules to Remove the Prohibition Against General Solicitation for Certain Private Placements

The SEC, by a margin of 4-1, recently voted to propose **rule amendments** to implement Section 201 of the Jumpstart Our Business Startups Act of 2012 (the JOBS Act). The proposed rules have the potential to alter substantially the private placement market.

The amendments to Rule 506 of Regulation D would remove the prohibition against general solicitation and general advertising, provided that the issuer had taken reasonable steps to verify that all *purchasers* of the securities are accredited investors and the issuer reasonably believed all of those purchasers to be accredited investors. The amendments to Rule 144A would permit securities to be *offered* to persons other than qualified institutional buyers (QIBs), including by means of general solicitation or general advertising, provided that the securities are *sold* only to persons that the seller and any person acting on behalf of the seller reasonably believes is a QIB. Unlike other provisions of the JOBS Act, which benefit only the newly created category of issuers called “emerging growth companies,” the amendments to Rule 506 and Rule 144A generally will benefit all issuers.

In choosing to propose rule amendments, the SEC declined to pursue so-called “interim final” rules as had been expected. Interim final rules would have been effective immediately (but subject to potential further revision). Notwithstanding the delay that will accompany the public comment process, it is expected that the SEC will attempt to move quickly to adopt final rules.<sup>1</sup>

During the interim period, the current versions of Rule 506 and Rule 144A remain in effect. Accordingly, issuers and their advisers should continue to follow the guidance in the “**14 Law Firm Consensus Report**.”

### Background

Issuers traditionally have relied on the exemptive safe harbors under Rule 506 of Regulation D and/or Rule 144A as a means to raise capital. Under Rule 506, issuers currently may not offer or sell securities through any form of general solicitation or general advertising. Further, although Rule 144A does not include an express limitation against general solicitation, offers of securities under Rule 144A currently must be limited to QIBs.

The JOBS Act directs the SEC to revise Rule 506 and Rule 144A to provide issuers with the ability to communicate freely to attract capital, provided that issuers do not use the new freedoms to then sell securities to investors that are not qualified to participate in such offerings.<sup>2</sup>

Four Times Square  
New York, NY 10036  
212.735.3000

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## Rule 506

Under the proposed rules, an issuer would be permitted to use general solicitation and general advertising to offer securities under Rule 506, provided that certain conditions are satisfied:

- The issuer takes reasonable steps to verify that the purchasers of the securities are accredited investors;
- All purchasers of securities are accredited investors, either because they fall within one of the categories of persons that qualify as an accredited investor (under Rule 501) or the issuer reasonably believes that they fall within one of the categories at the time the securities are sold; and
- The sales otherwise satisfy the definitional, integration and resale provisions of the Regulation D safe harbor.

The SEC did not propose specific verification methods that would be deemed reasonable for purposes of satisfying the new exemption under Rule 506. Rather, in determining the reasonableness of the steps that an issuer must take to verify that a purchaser is an accredited investor, the proposed rule aims to provide issuers and market participants sufficient flexibility to adopt different approaches to verification depending on the particular circumstances of a transaction and market practices and innovations, including development of third-party databases of accredited investors. The proposing release explains that issuers should consider the facts and circumstances of the transaction, including, among other things, the following factors:

- The type of 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, meaning:
  - The manner in which the purchaser was solicited to participate in the offering; and
  - The terms of the offering, such as a minimum investment amount.

The proposing release notes that the information gained from the consideration of these factors would help an issuer determine whether there is a reasonable likelihood that a potential purchaser is an accredited investor. This would, in turn, assist the issuer in determining which steps would be reasonable to take to verify a purchaser's accredited investor status. The SEC acknowledged that many practices currently employed by issuers in connection with existing Rule 506 transactions would satisfy the verification requirement. The SEC also clarified that an issuer would not lose the ability to rely on the amended safe harbor for an offering where an investor purchased securities after providing false information or documentation relating to their accredited investor status, so long as the issuer took reasonable steps to verify that the purchaser was an accredited investor and the issuer had a reasonable belief that such person was an accredited investor.

The amendments to Rule 506 would not otherwise impact the existing exemption under Rule 506, which would remain available to issuers who want to conduct Rule 506 offerings without the use of general solicitation and general advertising and without becoming subject to the new verification rule.

## Form D

The proposed rules would amend Form D, which issuers must file with the SEC when they sell securities under Regulation D. The revised form would add a separate box for issuers to check if they are claiming the new Rule 506 exemption that would permit general solicitation and general advertising.

## Specific Issues for Privately Offered Funds

Privately offered funds (such as private equity funds, hedge funds and venture capital funds) are precluded from relying on either of two critical statutory exclusions from the definition of “investment company” under Sections 3(c)(1) or 3(c)(7) of the Investment Company Act if they make a public offer of securities.

Consistent with the historical treatment of Rule 506 offerings and the language in Section 201(b) of the JOBS Act, which provides that offers and sales under revised Rule 506 will not be deemed public offerings, the proposing release makes clear that privately offered funds may make a general solicitation under amended Rule 506 without losing either of the exclusions under the Investment Company Act.

### Rule 144A

Under the proposed rules, securities sold pursuant to Rule 144A could be offered to persons other than QIBs, including by means of general solicitation, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believes is a QIB.

### Impact on Regulation S – Integration With Offshore Offerings

In response to concerns expressed by a number of commenters that the use by an issuer of general solicitation or general advertising in connection with a Rule 506 or Rule 144A offering might constitute “directed selling efforts” by that issuer for a side-by-side global offering under Regulation S, the proposing release makes clear that, consistent with historical practices, concurrent offshore offerings that are conducted in compliance with Regulation S would not be integrated with domestic offerings that are conducted in compliance with Rule 506 or Rule 144A, each as proposed to be amended.

## END NOTES

- 1 Comments on the proposed rule amendments are due October 5, 2012.
- 2 The JOBS Act mandate and the proposed rules address only the rule-based safe harbors under Rule 506 and Rule 144A, and do not affect offerings conducted solely under the statutory exemption under Section 4(a)(2) (formerly Section 4(2)). Section 4(a)(2) offerings remain subject to the prohibition against general solicitation and general advertising.

## Attorney Contacts

### New York Office

**Richard B. Aftanas**  
212.735.4112  
richard.aftanas@skadden.com

**Gregory A. Fernicola**  
212.735.2918  
gregory.fernicola@skadden.com

**David J. Goldschmidt**  
212.735.3574  
david.goldschmidt@skadden.com

**Stacy J. Kanter**  
212.735.3497  
stacy.kanter@skadden.com

**Phyllis G. Korff**  
212.735.2694  
phyllis.korff@skadden.com

**Andrea L. Nicolas**  
212.735.3416  
andrea.nicolas@skadden.com

**Yossi Vebman**  
212.735.3719  
yossi.vebman@skadden.com

**Dwight S. Yoo**  
212.735.2573  
dwight.yoo@skadden.com

**Michael J. Zeidel**  
212.735.3259  
michael.zeidel@skadden.com

### Frankfurt Office

**Katja Kaulamo**  
49.69.74220.130  
katja.kaulamo@skadden.com

**Stephan Hutter**  
49.69.74220.170  
stephan.hutter@skadden.com

### Hong Kong Office

**Z. Julie Gao**  
852.3740.4850  
julie.gao@skadden.com

**Jonathan B. Stone**  
852.3740.4703  
jonathan.stone@skadden.com

**Alec P. Tracy**  
852.3740.4710  
alec.tracy@skadden.com

### London Office

**Richard A. Ely**  
44.20.7519.7171  
richard.ely@skadden.com

**James P. Healy**  
44.20.7519.7042  
james.healy@skadden.com

**Pranav L. Trivedi**  
44.20.7519.7026  
pranav.trivedi@skadden.com

### Los Angeles Office

**Jonathan B. Ko**  
213.687.5527  
jonathan.ko@skadden.com

**Gregg A. Noel**  
213.687.5234  
gregg.noel@skadden.com

### Palo Alto Office

**Thomas J. Ivey**  
650.470.4522  
thomas.ivey@skadden.com

### Sydney Office

**Adrian J. S. Deitz**  
61.2.9253.6015  
adrian.deitz@skadden.com

### Washington, D.C.

**Brian V. Breheny**  
202.371.7180  
brian.breheny@skadden.com

*Washington, D.C. counsel Andrew J. Brady and Washington, D.C. associate Hagen J. Ganem assisted in the preparation of this memorandum.*