

WIGGIN AND DANA

For further information about this Advisory, please contact:

WILLIAM J. KILGALLEN
203.498.4388
wkilgallen@wiggins.com

MICHAEL GRUNDEI
203.363.7630
mgrunde@wiggins.com

MARK S. KADUBOSKI
203.363.7627
mkaduboski@wiggins.com

SCOTT L. KAUFMAN
212.551.2639
skaufman@wiggins.com

FRANK J. MARCO
203.498.4344
fmarco@wiggins.com

SEC Proposes Rules to Implement JOBS Act Provision Allowing General Solicitation and Advertising in Private Placements

The Jumpstart Our Business Startups Act or “JOBS Act” was enacted on April 5, 2012. The JOBS Act includes several provisions with the potential to stimulate investments by both reducing restrictions on the manner in which companies may seek funding and by easing regulatory burdens both during and following the fundraising process.

The JOBS Act requires the Securities and Exchange Commission to amend its rules to allow the use of general solicitation or advertising to solicit investors in private placements under Rule 506 of Regulation D of the Securities Act of 1933 (the “Securities Act”) as long as companies take reasonable steps to verify that purchasers of the securities are “accredited investors” using methods as determined by the SEC. The SEC is also required to amend its rules to allow the use of general solicitation or advertising in connection with offerings under Rule 144A to “qualified institutional buyers” (typically, large institutional investors). By eliminating the prohibition against general solicitation and advertising in these offerings, the rule amendments are designed to open the Internet and other media to fundraising efforts. On August 29, 2012, the SEC issued proposed new rules to implement these amendments.

Sales to accredited investors in reliance on Rule 506 are the primary means by which most private companies obtain funding. In its proposing release for the new rules, the SEC noted that its estimated amount of capital raised by all companies in Rule 506 offerings during 2011 and 2010 was \$895 billion and \$902 billion, respectively, compared to \$984 billion and \$1.07 trillion, respectively, raised in registered offerings. An investor qualifies as an “accredited investor” if the investor:

- is one of several enumerated entities listed in Rule 501 under the Securities Act; or
- is an individual who has individual net worth, or joint net worth with a spouse, that exceeds \$1 million at the time of the investment, excluding the value of the investor’s primary residence, or who has income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year.

If a company uses general solicitation or advertising in seeking investment by accredited investors under Rule 506, the proposed new rules require the company to take reasonable steps to verify that an investor is an accredited investor. The SEC declined to propose specific verification methods or “safe harbors” that would constitute reasonable steps under the new rules. Instead, the proposing release explains that companies are to consider the facts and circumstances of each offering, which includes among other things the following factors:

- the type of investor and the type of accredited investor that the investor claims to be;
- the amount and type of information that the company has about the investor; and
- the nature of the offering, meaning the manner in which the investor was solicited to participate in the offering and the terms of the offering, such as a minimum investment amount.

In its proposing release, the SEC notes that verification methods that would constitute reasonable steps under the new rules would likely vary depending on the type of accredited investor that the investor claims to be (for example, steps that would be reasonable to verify whether an entity is accredited would differ from steps that would be reasonable to verify whether an individual is accredited). Examples of the types of information that companies could rely upon, depending on the circumstances, to constitute reasonable steps to verify accredited investor status include information in publicly available filings with the SEC or other regulators, and third-party documentation such as a W-2.

continued next page

SEC Proposes Rules to Implement JOBS Act Provision Allowing General Solicitation and Advertising in Private Placements CONTINUED

WIGGIN AND DANA

ABOUT OUR SECURITIES
AND CAPITAL MARKETS
GROUP

Broadly experienced in public offerings and private placements of securities, Exchange Act compliance, PIPE transactions, angel and venture capital financings, bond finance, and other areas of equity and debt financing, our veteran Securities and Capital Markets Group provides sophisticated, innovative and market-savvy counsel to NYSE, NASDAQ and NYSE Amex-listed companies, emerging companies, underwriters, venture capital firms, and hedge funds.

ABOUT OUR EMERGING
COMPANIES AND PRIVATE
EQUITY GROUP

Our deep understanding of the issues faced by emerging growth companies and our business-like approach have won the trust of numerous emerging growth companies at all stages of development—in industries such as software/information technology, telecommunications equipment, biotechnology, the Internet and web commerce, medical devices, clean technology, media, and health care services.

The SEC also notes that a company that solicits new investors through a website accessible to the general public or through a widely disseminated email or social media solicitation would likely be obligated to take greater measures to verify accredited investor status than a company that solicits new investors from a database of pre-screened accredited investors created and maintained by a reasonably reliable third party such as a registered broker-dealer. The SEC explains that, in the case of the former, it does not believe that a company would have taken reasonable steps to verify accredited investor status if it required only that a person check a box in a questionnaire or sign a form but, in the case of the latter, the company would be entitled to rely on the third-party verification provided there is a reasonable basis for that reliance.

The SEC expresses the view in its proposing release that the ability of an investor to satisfy a minimum investment amount requirement that is sufficiently high such that only accredited investors could reasonably be expected to meet it could be taken into consideration in verifying accredited investor status.

Regardless of the particular steps taken, the SEC warns that it would be important for companies to retain adequate records that document the steps taken to verify accredited investor status because a company claiming an exemption from the registration requirements of the Securities Act has the burden of showing that it is entitled to that exemption.

The proposed rules would preserve the existing portions of Rule 506 as a separate exemption so that companies conducting Rule 506 offerings without the use of general solicitation or advertising would not be subject to the new verification requirements.

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

One concern that is likely to be raised in comment letters sent to the SEC will be the lack of specific verification methods or “safe harbors” that would constitute reasonable steps to verify accredited investor status under the new rules. Many companies may hesitate to take advantage of the ability to utilize general solicitation or advertising in raising funds due to uncertainty as to whether the steps they have taken to verify accredited investor status are reasonable, particularly because, if an investor was ultimately shown not to be accredited and the company was found not to have taken reasonable steps to verify accredited investor status, the offering could be deemed a public offering in violation of the Securities Act. Certain investors in Rule 506 offerings currently require the issuer’s legal counsel to deliver an opinion that the offering was exempt from the Securities Act registration requirements. If the new rules do not include specific SEC guidance with respect to the verification requirements, legal counsel may be unable or unwilling to deliver that opinion.

The proposed rules are now subject to a 30-day comment period after which the SEC will adopt final rules.

We will continue to monitor developments with respect to the new rules and will provide an update at the appropriate time.

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.