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SEC Issues Interpretive Guidance on General Solicitations

On August 6, the SEC's Division of Corporation Finance offered interpretive guidance with respect to conducting a private placement under Rule 506(b) of Regulation D without running afoul of the "general solicitation" restrictions of Rule 502(c). Rule 502(c) provides in relevant part that neither the issuer nor any person acting on the issuer's behalf may sell securities under Rule 506(b) by means of "general solicitation" or "general advertising." Neither "general solicitation" nor "general advertising" has been defined by the SEC and while Rule 502(c) provides qualifying examples including newspaper and magazine advertisements, television and radio broadcasts, and seminars, it does not specifically address the use of communications such as the Internet or "demo days" (Note that if an offering falls under Rule 506(c) because there is a general solicitation, there are additional burdens placed on the issuer. See our earlier release on this topic by visiting <http://www.wiggindana.com/14473>)

This SEC interpretive guidance was provided in conjunction with a no-action letter to Citizen VC, Inc. (available [here](#)) in which the SEC affirmed that the "quality of the relationship between an issuer (or its agent) and an investor is the most important factor" in making a determination as to whether what the SEC terms a "substantive relationship" exists, thereby placing the securities offering outside the ambit of a general solicitation. The SEC explained further that a substantive relationship

is one in which the issuer has sufficient information to evaluate (and does, in fact, evaluate) a prospective investor's financial circumstances and sophistication, rather than simply asking the investor to complete a questionnaire, in determining the investor's status as accredited or sophisticated. The SEC also clarified that "a pre-existing, substantive relationship is one means, *but not the exclusive means*, of demonstrating the absence of a general solicitation in a Regulation D offering" (emphasis added).

SOLICITATION OVER THE INTERNET

Additional detail and guidance was provided by the SEC through Compliance and Disclosure Interpretations ("C&DIs"), numbered 256.23-33 and available [here](#). In particular, the SEC explained that "the use of an unrestricted, publicly available website constitutes a general solicitation and is not consistent with the prohibition on general solicitation and advertising in Rule 502(c) *if the website contains an offer of securities*" (emphasis added). However, the SEC went on to explain that an issuer may disseminate "factual business information" widely without contravening Rule 502(c), which the SEC described as "information about the issuer, its business, financial condition, products, services, or advertisement of such products or services, provided the information is not presented in such a manner as to constitute an offer of the issuer's securities," and provided further that such information typically excludes "predictions, projections, forecasts or

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opinions with respect to valuation of a security.” The interpretations confirmed that an issuer may offer securities to prospective investors via password-protected webpages (as Citizen VC, Inc. describes as its practice), *provided that the issuer has policies and procedures in place sufficient to verify, and does indeed verify, the prospective investor’s financial circumstances and sophistication.*

PITCH EVENTS

While the subject matter of the Citizen VC No-Action Letter related to the sale of securities over the Internet, the C&DIs provide clarification from the SEC that an issuer’s participation in a demo day or venture fair could, but does not necessarily, constitute a general solicitation. Applying similar principles to those pertaining to websites, the SEC explained that if an issuer’s presentation does not involve the offer of a security, Rule 502(c) is not implicated, but even if such a presentation does involve the offer of a security, there may be no general solicitation if, for instance, the event is attended only by persons with whom the issuer or the organizer of the event has a pre-existing, substantive relationship or who have been contacted through an “informal, personal network” (e.g., angel investor networks)[1]. The SEC was careful to note, however, that “the greater the number of persons without financial experience, sophistication or any prior personal or business relationship with the issuer” that are contacted through an informal, personal network, the more likely the issuer’s communications will be deemed part of a general solicitation.

CONCLUSIONS AND GUIDANCE

Based on the SEC’s August 6 pronouncements, an issuer seeking to do a private placement under Rule 506(b) must be mindful of its relationship with prospective investors and whether the issuer has sufficient information to evaluate such investors’ sophistication, financial circumstances and ability to understand the nature and risks of the securities to be offered (the “Relationship Criterion”) before making any such offer. While the SEC did not provide any information about other ways an issuer might avoid violating Rule 502(c), it did assert that “a pre-existing, substantive relationship is one means, *but not the exclusive means*, of demonstrating the absence of a general solicitation in a Regulation D offering” (emphasis added). The SEC also made clear through its no-action letter to Citizen VC, Inc. and the related C&DIs that an issuer may be able to use the Internet or pitch events to offer securities to potential investors under the limited circumstances described below.

Use of the Internet:

If the issuer chooses to use the Internet purely for the wide dissemination of factual business information and not for the offer of securities, then there will be no general solicitation.

If, however, the issuer chooses to use the Internet to offer securities to potential investors, it may avoid running afoul of the general solicitation restrictions of Rule 502(c) by putting in place (and following) policies and procedures designed to evaluate the Relationship Criterion. In this regard, solely relying on an accreditation questionnaire will not be sufficient.

Use of pitch events, demo days or similar events:

If the issuer chooses to participate in such an event purely for the wide dissemination of factual business information and not for the offer of securities, then there will be no general solicitation.

If, however, the issuer would like to offer securities to potential investors at such an event, the issuer should ensure that the event is attended only by persons with whom the issuer or the organizer of the event has a pre-existing, substantive relationship, as determined by the Relationship Criterion. As noted above, if persons have all been contacted through an “informal, personal network,” the issuer may be able to rely on facts regarding the network to establish a reasonable belief that the Relationship Criterion has been satisfied.

Please do not hesitate to contact us to discuss any of the matters described above or other nuances involved in making an offer of securities under Rule 506 of Regulation D.

[1] The SEC expressly acknowledged that groups of experienced, sophisticated investors, such as “angel investors,” share information about offerings through their personal networks. Issuers that contact potential investors through this type of referral may be able to rely on membership in such a network to establish a reasonable belief that the investors have the necessary financial experience and sophistication.