



SEC Adopts Rules to Permit General Solicitation and Advertising in Certain Private Securities Offerings, Adopts the “Bad Actor” Disqualification and Proposes New Private Offering Filing and Disclosure Requirements

July 11, 2013

On July 10, 2013, the Securities and Exchange Commission adopted (i) amendments to Rule 144A under the Securities Act of 1933, as amended, and Rule 506 of Regulation D under the Securities Act to permit use of general solicitations and general advertising in private securities offerings made pursuant to these rules, subject to the satisfaction of certain conditions, and (ii) amendments to Rule 506 to disqualify certain “bad actors” from conducting private placements in reliance upon this rule. The rulemaking eliminating the ban on general solicitations and general advertising implements Section 201(a) of The Jumpstart Our Business Startups Act, the so-called JOBS Act, enacted last summer and the rulemaking relating to the disqualification of bad actors implements Section 926 of the Dodd-Frank Wall Street Reform and Consumer Protection Act enacted in July 2010. In addition to the final approval of these new rules, in response to concerns relating to possible abuse of the offering flexibility afforded by the elimination of the prohibition on general solicitation and general advertising for certain private placements and in order to better monitor the usage of Rule 506, the SEC proposed amendments to Rule 506 that, if adopted, would impose new filing and disclosure requirements on private offerings made in reliance upon this rule.¹

A summary of the newly adopted and proposed rules follows. Readers who are interested in the possible impact of the rule changes on private investment funds should also refer to our separate memorandum that considers the adopted and proposed rules from the perspective of private investment funds.²

¹ For the full text of the release adopting the amendments to eliminate the prohibition on general solicitations and general advertising in connection with private offerings made in reliance upon Rule 144A and Rule 506, please see: <http://www.sec.gov/rules/final/2013/33-9415.pdf>. For the full text of the release adopting the amendments imposing the bad actor disqualification, please see: <http://www.sec.gov/rules/final/2013/33-9414.pdf>. For the full text of the release proposing new filing and disclosure requirements in relation to rules, please see: <http://www.sec.gov/rules/proposed/2013/33-9416.pdf>.

² Our memorandum “SEC Adopts Rules to Eliminate Prohibition Against General Solicitation and Advertising in Certain Private Securities Offerings; Also Proposes New, Related Investor Protection Requirements – Private Investment Funds Perspective” can be accessed at our Firm website at the following address: <http://www.stblaw.com/siteContent.cfm?contentID=4&itemID=80&focusID=1629>.

RULE 144A

Rule 144A is a non-exclusive safe harbor from the registration requirements of the Securities Act for resales of certain restricted securities to “qualified institutional buyers”, or so-called QIBs. The SEC has amended Rule 144A to eliminate restrictions on offerings pursuant to this rule and to only require, in addition to the other Rule 144A conditions that remain unchanged, that securities are sold to a QIB or to a purchaser that the seller and any person acting on behalf of the seller reasonably believes is a QIB. As a result, upon the effectiveness of the amendments, there will be no offeree restrictions applicable to Rule 144A transactions and Rule 144A transactions may be conducted using general solicitations, provided that the purchasers in such transactions are all reasonably believed to be QIBs.

RULE 506

Rule 506 is a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act, which exempts transactions by an issuer “not involving any public offering” from the registration requirements of Section 5 of the Securities Act. Under new clause (c) of Rule 506, general solicitation and general advertising will be permitted in connection with private securities offerings made in reliance upon this rule provided that the following conditions are met:

- the issuer has taken reasonable steps to verify that the purchasers of its securities are accredited investors;
- all purchasers of securities are accredited investors, either because they fall within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they do, at the time of the sale of the securities; and
- all terms and conditions of Rule 501, Rule 502(a) and Rule 502(d) have been satisfied.

The SEC has stated that whether the steps taken by the issuer to verify the accredited investor status of the purchaser are “reasonable” is an objective test, based on the particular facts and circumstances of each offering and each purchaser. Factors that issuers should consider under this analysis include:

- the nature of the 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, such as the manner in which the purchaser was solicited to participate in the offering and the terms of the offering, such as the minimum investment amount.

In response to comments seeking greater guidance on what would constitute “reasonable” verification, the SEC has included in the amendments to Rule 506 a non-exclusive list of methods that issuers may use to verify that a natural person is an accredited investor:

- if the purchaser’s accredited investor status is premised on meeting the accredited investor income test,³ reasonable verification can be establishing by review of copies of an IRS form that reports the income of the person and receipt of a written representation that the person reasonably expects to earn an amount meeting the accredited investor income test in the current year;
- if the purchaser’s accredited investor status is premised on meeting the net worth test,⁴ reasonable verification can be established by obtaining, within the preceding three months, representations from the purchaser and review of, with regard to assets, bank statements, brokerage statements and certain other specified documentation and, with respect to liabilities, a credit report of a national consumer reporting agency;
- if either the income or net worth test is being employed, receipt of a written confirmation from a registered broker-dealer, SEC-registered investment adviser, licensed attorney or certified public accountant that such entity or person has taken reasonable steps to verify the purchaser’s accredited investor status; or
- in regard to any person who purchased securities in an issuer’s Rule 506(b) offering as an accredited investor prior to the effective date of Rule 506(c) and continues to hold such securities, for the same issuer’s Rule 506(c) offering, obtaining a certification by such person at the time of sale that he or she qualifies as an accredited investor.

Form D was also amended to add a separate checkbox for issuers to indicate whether they are using general solicitation or general advertising in a Rule 506 offering.

The existing safe harbor for private offerings not using any general solicitation or general advertising is unchanged by the new rules and these safe harbors may be relied upon without

³ The definition of accredited investor in Rule 501 includes any natural person who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person’s spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.

⁴ The definition of accredited investor in Rule 501 includes any natural person whose individual net worth, or joint net worth with that person’s spouse, exceeds \$1,000,000. For purposes of calculating net worth: (A) the person’s primary residence is excluded as an asset; (B) Indebtedness that is secured by the person’s primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, is excluded as a liability (except that if the amount of such indebtedness outstanding at the time of sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and (C) Indebtedness that is secured by the person’s primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities is included as a liability.

regard to the accredited investor verification requirement applicable to Rule 506 private placements conducted with general solicitations or general advertising.

BAD ACTOR DISQUALIFICATION

Under the bad actor disqualification rule approved by the SEC, an issuer will not be able to rely on Rule 506, regardless of whether the offering is made using general solicitations or general advertising pursuant to Rule 506(c), if the issuer or any other person covered by the rule⁵ had a “disqualifying event.”⁶ The rule will not apply if the issuer can show that it did not know and, using reasonable care could not have known, that a covered person with a disqualifying event participated in the offering. Additionally, the SEC may grant waivers from disqualification under certain circumstances including a change of control and absence of notice and opportunity for hearing. The rule applies only to disqualifying events that occur after its effective date, but disqualifying events that occurred prior to the effective date must be disclosed to investors.

PROPOSED AMENDMENTS TO PRIVATE OFFERING RULES

The SEC has also approved proposed rules which, if adopted, would impose new filing and disclosure requirements on private offerings conducted using general solicitations or general advertising in reliance upon Rule 506(c). Under the proposed rules, issuers would need to file an “Advance Form D” at least 15 days prior to first use of general solicitation or general advertising for the offering and an amended Form D would need to be filed within 30 days after the termination of the offering. The proposed rule would also expand the information required to be disclosed in Form D filings and require disclosure of, among other things, the number of purchasers who qualified as accredited investors under its different bases, the types of general solicitation or general advertising used or to be used, the methods used or to be used to verify accredited investor status.

⁵ Covered persons include predecessors of the issuer, affiliated issuers, directors and certain officers, general partners and managing members of the issuer, 20% beneficial owners of the issuer, promoters, investment managers and principals of pooled investment funds, persons compensated for soliciting investors as well as the general partners, directors, officers and managing members of any compensated solicitor.

⁶ A disqualifying event includes the following: (1) criminal convictions occurring within ten years of the proposed sale of securities in connection with the purchase or sale of a security, a false filing with the SEC or the conduct of certain types of financial intermediaries; (2) court injunctions and restraining orders occurring within five years of the proposed sale of securities in connection with the purchase or sale of a security, a false filing with the SEC or the conduct of certain types of financial intermediaries; (3) final orders from the Commodity Futures Trading Commission, federal banking agencies and certain other regulators that bar the issuer from associating with a regulated entity, engaging in the business of securities, insurance or banking, savings association or credit union activities or are based on fraudulent conduct issued within ten years before the proposed sale of securities; (4) certain SEC disciplinary orders relating to brokers, dealers and their associated persons; (5) SEC cease-and-desist orders relating to violations of certain anti-fraud provisions and registration requirements of the federal securities laws; (6) SEC stop orders and orders suspending the Regulation A exemption issued within five years before the proposed sale of securities; (7) suspension or expulsion from membership in a self-regulatory organization (“SRO”) or from association with an SRO member and (8) U.S. Postal Service false representation orders issued within five years before the proposed sale of securities.

In addition to new filing and disclosure requirements, the proposed rules would also mandate the use of specified legends in any written materials constituting a general solicitation or general advertising, including, among others, legends indicating that the offering is limited to accredited investors, that the securities are subject to legal restrictions on transfer and resale and that investing in the securities involves risk and investors should be able to bear the loss of their investment. Additional legend and disclosures would also be required for private fund written general solicitation materials. Issuers would also be obligated to temporarily submit written general solicitation materials to the SEC via a website for two years. This website would be different from the SEC's public EDGAR website and, as proposed, the submitted materials would not be publicly available.

The proposed rules would also amend Rule 507 which currently disqualifies an issuer from using Regulation D (offerings under Rules 504, 505 or 506), if the issuer, or a predecessor or affiliate, has been enjoined by a court for violating the Form D filing requirements in Rule 503. As proposed, Rule 507 would be amended so that, in addition to the current disqualifications, an issuer would be automatically disqualified from relying on Rule 506 for a new offering for one year if the issuer, or any predecessor or affiliate of the issuer, did not comply, within the past five years, with Form D filing requirements in a Rule 506 offering. This one-year period would commence following the filing of all required Form D filings or, if the offering has been terminated, following the filing of a closing amendment.

In addition, Rule 507, if revised as proposed, would provide that no exemption under Rule 506 would be available for an issuer if the issuer, any of its predecessors or affiliates have been subject to any order, judgment, or decree temporarily, preliminary or permanently enjoining such person for failure to comply with the proposed legending requirements or the proposed temporary requirement that written materials used in general solicitations or general advertising pursuant to Rule 506 be submitted to the SEC.

* * *

Please contact any of the members of our Capital Markets group for more information.

This memorandum is for general information purposes and should not be regarded as legal advice. Please contact your relationship partner if we can be of assistance regarding these important developments. The names and office locations of all of our partners, as well as our recent memoranda, can be obtained from our website, www.simpsonthacher.com.

The contents of this publication are for informational purposes only. Neither this publication nor the lawyers who authored it are rendering legal or other professional advice or opinions on specific facts or matters, nor does the distribution of this publication to any person constitute the establishment of an attorney-client relationship. Simpson Thacher & Bartlett LLP assumes no liability in connection with the use of this publication.

UNITED STATES**New York**

425 Lexington Avenue
New York, NY 10017
+1-212-455-2000

Houston

2 Houston Center
909 Fannin Street
Houston, TX 77010
+1-713-821-5650

Los Angeles

1999 Avenue of the Stars
Los Angeles, CA 90067
+1-310-407-7500

Palo Alto

2475 Hanover Street
Palo Alto, CA 94304
+1-650-251-5000

Washington, D.C.

1155 F Street, N.W.
Washington, D.C. 20004
+1-202-636-5500

EUROPE**London**

CityPoint
One Ropemaker Street
London EC2Y 9HU
England
+44-(0)20-7275-6500

ASIA**Beijing**

3919 China World Tower
1 Jian Guo Men Wai Avenue
Beijing 100004
China
+86-10-5965-2999

Hong Kong

ICBC Tower
3 Garden Road, Central
Hong Kong
+852-2514-7600

Seoul

West Tower, Mirae Asset Center 1
26 Eulji-ro 5-gil, Jung-gu
Seoul 100-210
Korea
+82-2-6030-3800

Tokyo

Ark Hills Sengokuyama Mori Tower
9-10, Roppongi 1-Chome
Minato-Ku, Tokyo 106-0032
Japan
+81-3-5562-6200

SOUTH AMERICA**São Paulo**

Av. Presidente Juscelino Kubitschek, 1455
São Paulo, SP 04543-011
Brazil
+55-11-3546-1000