SEC Issues Guidance on Rule 144A and Rule 506 Offerings Regarding General Solicitation and General Advertising and Other Aspects of the Amended Rules

Recently, the Staff of the Division of Corporation Finance of the Securities and Exchange Commission (the "SEC") issued 11 new Compliance and Disclosure Interpretations ("CDIs") relating to the recently adopted amendments to Rule 144A and Rule 506, which permitted general solicitation and general advertising ("general solicitation") in all Rule 144A offerings and select Regulation D offerings under Rule 506.¹ Among other points raised in the new guidance, the CDIs confirm the ability of offering participants (in addition to the issuer) to engage in general solicitation in Rule 144A offerings and address aspects of amended Rule 506 relating to transitioning between different types of Rule 506 offerings, issuers availing themselves of the Section 4(a)(2) exemption under the Securities Act of 1933, as amended (the "Securities Act") after commencing a Rule 506 offering and the verification of accredited investors.²

Guidance Relating to Rule 144A

Amended Rule 144A allows for offers to be made, including by means of general solicitation, to anyone, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are qualified institutional buyers. In the new CDIs, the SEC Staff confirmed that in Rule 144A offerings where the securities were initially sold to financial intermediaries in exempt transactions under Securities Act Section 4(a)(2) or Regulation S, general solicitation may be conducted by not only the issuer but also the initial purchasers and other distribution participants involved in the


Furthermore, the SEC Staff stated that the amendments to Rule 144A permitting the use of general solicitation by the issuer and other distribution participants have no effect on how directed selling efforts under Regulation S are analyzed in concurrent Rule 144A and Regulation S offerings.

Guidance Relating to Rule 506

Amended Rule 506(c) allows for offers to be made, including by means of general solicitation, to anyone, provided that the issuer has taken “reasonable steps to verify” that the purchasers are accredited investors and the securities are sold only to persons that are accredited investors. In the new CDIs, the SEC Staff provided the following guidance on these requirements and other aspects of amended Rule 506.

*General solicitation renders subsequent use of Section 4(a)(2) unavailable*

The SEC Staff confirmed that to the extent an offering being conducted in accordance with Rule 506(c) fails to meet the conditions thereof and the issuer has engaged in general solicitation during the course of the offering, the private offering exemption afforded by Section 4(a)(2) is not available to the issuer as a result of the general solicitation conducted. The SEC Staff emphasized that the permitted use of general solicitation in Rule 506(c) offerings is limited to Rule 506(c) only and does not extend to Section 4(a)(2) under the Securities Act. As we previously cautioned, it is imperative that an issuer be mindful that once it elects to proceed with a Rule 506(c) private placement and begins engaging in activity that constitutes general solicitation, it will be difficult if not impossible to reverse course, since an issuer generally cannot avail itself of the other private placement safe harbors and Section 4(a)(2) once general solicitation has occurred.

*Transitioning between different types of Rule 506 offerings*

The CDIs include the following clarifications relating to an issuer’s ability to transition between different types of Rule 506 offerings and the Form D filing requirements required as a result:

- An issuer’s decision to begin relying on Rule 506(c) following its effective date on September 23, 2013 for a previously commenced Rule 506 offering constitutes a change in the information provided in a previously filed Form D and requires the issuer to amend its Form D reflecting the change in reliance (note that if the issuer continues the offering but instead decides to rely on Rule 506(b), no Form D amendment is required).

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3 Even though Section 4(a)(2) private placements remain subject to the prohibitions on general solicitation, the SEC stated in the adopting release that the general solicitation permitted in Rule 144A resales from the initial purchaser to qualified institutional buyers will not affect the availability of the exemption or Regulation S for the initial sale of securities by the issuer to the initial purchaser.

4 It is important to note that the SEC stated in the adopting release of the amended rules that offshore offerings conducted in compliance with Regulation S will not be integrated with concurrent domestic unregistered offerings that are conducted in compliance with amended Rules 144A or 506. With respect to the effect of general solicitation used in Rule 144A or Rule 506(c) offerings on directed selling efforts specifically, the SEC pointed to language in its Regulation S adopting release from 1990 in which the SEC stated that “[o]ffering activities in contemporaneous...offerings exempt from registration will not preclude reliance on the [Regulation S] safe harbors.” See footnote 177 of SEC Release No. 33-9415 (July 10, 2013).
An issuer may subsequently decide to rely on Rule 506(c) after initially relying on Rule 506(b) (no general solicitation) for an offering as long as the transition is made prior to any sales in the offering and the conditions of Rule 506(c) (permitting general solicitation) are satisfied with respect to all sales of securities in the offering.

An issuer may subsequently decide to rely on Rule 506(b) after initially relying on Rule 506(c) for an offering as long as the issuer did not engage in any form of general solicitation (which is not permitted in a Rule 506(b) offering) and the other conditions of Rule 506(b) are satisfied with respect to all sales of securities in the offering.

Furthermore, to the extent a Form D has already been filed, an issuer’s decision to transition its reliance from Rule 506(b) to Rule 506(c), and vice versa, in accordance with the above guidance constitutes a change in the information provided in a previously filed Form D and requires the issuer to amend its Form D to reflect the change in reliance to Rule 506(b) or Rule 506(c), as applicable.

Verification of accredited investor status

In order to take advantage of the ability to conduct general solicitation permitted by Rule 506(c), issuers must take reasonable steps to verify that purchasers are accredited investors and all purchasers of the securities are accredited investors at the time of the sale of securities. The SEC adopted a principle-based method of verification of accredited investor status that looks at a variety of factors, including the nature of the purchasers, publicly and/or privately available information about the purchaser and the nature and terms of the offering. Rule 506(c) also includes a list of four non-exclusive verification methods that issuers may use to verify that a natural person is an accredited investor. The CDIs include the following guidance relating to these verification methods:

- In the situation where an issuer takes reasonable steps to verify the status of a purchaser and forms a reasonable belief that the purchaser is an accredited investor at the time of sale, an issuer will not lose its ability to rely on Rule 506(c) if it is subsequently determined that the purchaser in fact was not an accredited investor.

- The verification requirement in Rule 506(c) is a standalone requirement that must be satisfied independently from the requirement that all purchasers be accredited investors and in the situation where an issuer does not take reasonable steps to verify the accredited investor status of all purchasers in an offering, it may not rely on the Rule 506(c) exemption notwithstanding the fact that all of the purchasers in the offering are in fact accredited investors.

- The SEC Staff clarified that when using the net worth verification method to determine accredited investor status (i.e., one of the four non-exclusive verification methods which is found in Rule 506(c)(2)(ii)(B)), the relevant documentation reviewed must be dated within the prior three months of the sale of the securities in the Rule 506(c) offering (additionally, the SEC Staff pointed out that (A) even though using one of the non-exclusive methods is not required, if used the specific requirements must be satisfied and (B) the issuer may, in the alternative, use the principles-based method of verification if the documentation is older than three months).

- When using written confirmations from licensed attorneys or certified public accountants as a third-party verification method to determine accredited investor status (i.e., one of the four non-exclusive verification methods which is found in Rule 506(c)(2)(ii)(C)), there are no jurisdictional
limitations and the attorneys or certified public accountants providing the written confirmations may be licensed or registered within or outside of the United States.

- The SEC Staff confirmed that the existing investor verification method to determine accredited investor status (i.e., one of the four non-exclusive verification methods which is found in Rule 506(c)(2)(ii)(D)) is limited to existing investors who purchased securities as accredited investors in the same issuer’s Rule 506(b) offering before September 23, 2013 and still hold the securities (e.g., this verification method cannot be used to verify the status of an investor in a new limited partnership even though the investor purchased securities of a prior limited partnership sponsored by the same general partner of the new issuer).

Conclusion

The new CDIs provide a number of helpful clarifications and confirmations on aspects of the amended rules relating to general solicitation, transitioning between different types of Rule 506 offerings and investor verification under Rule 506(c). As private placement practice under the recently amended rules permitting general solicitation continues to develop we will continue to keep you apprised of further SEC Staff guidance on these and other aspects of amended Rules 144A and 506.

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Authors:

Joshua Coleman
Stuart Gelfond
Kaihli M. Ross

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or the attorneys listed below:
Contacts:

New York
Andrew B. Barkan  +1.212.859.8468  andrew.barkan@friedfrank.com
Daniel J. Bursky  +1.212.859.8428  daniel.bursky@friedfrank.com
Stuart H. Gelfond  +1.212.859.8272  stuart.gelfond@friedfrank.com
Valerie Ford Jacob  +1.212.859.8158  valerie.jacob@friedfrank.com
Michael A. Levitt  +1.212.859.8735  michael.levitt@friedfrank.com
Paul D. Tropp  +1.212.859.8933  paul.tropp@friedfrank.com
Joshua Wechsler  +1.212.859.8689  joshua.wechsler@friedfrank.com

Washington, D.C.
Richard A. Steinwurtzel  +1.202.639.7120  richard.steinwurtzel@friedfrank.com

London
Joshua Coleman  +44.20.7972.9198  joshua.coleman@friedfrank.com
Robert P. Mollen  +44.20.7972.9604  robert.mollen@friedfrank.com