

RAISING CAPITAL UNDER THE NEW SEC RULE 506(C)

Effective September 23, 2013, issuers can use general solicitation and advertising in an offering of its securities provided that each and every purchaser is an accredited investor ("Rule 506(c)"). To satisfy its obligation to verify an investor's accredited investor status, an issuer can:

- if accreditation is based on income, request copies of IRS forms such as Form W2, Form 1099 and/or Schedule K-1 showing annual compensation for the two most recent years, and a written representation that the investor reasonably expects to earn the same level of compensation for the current year; or
- if accreditation is based on net-worth, request copies of bank statements, brokerage statements and other statements of securities holdings, certificates of deposits, tax assessments and appraisal reports issued by independent third parties to verify an investor's assets, a copy of a consumer report from either Expedia, Equifax or Transunion to verify an investor's liabilities, and a written representation that the investor has disclosed all liabilities (all documents should be dated no later than three months before the date of purchase of the offered securities);
- request written confirmation of the investor's accredited investor status from a registered broker-dealer, registered investment adviser, an attorney or a certified public accountant, each of whom has verified such investor's status no later than three months before the date of purchase of the offered securities; or
- for investors who had previously purchased the issuer's privately placed securities, a certification that such investors remain eligible as accredited investors.

If a purchaser of the offered securities subsequently turns out not to be an accredited investor, the offering will not lose its exemption from registration if the issuer can prove that it has taken reasonable steps to verify accreditation (such as the safe harbor steps described above) and did not know, at the time of the purchase, that the investor is not an accredited investor. To determine whether the steps taken to verify an investor's accredited investor status are reasonable, issuers should analyze the facts and circumstances of the purchaser and the transaction on a case-by-case basis.

General Advertising and General Solicitation

Issuers can now use print advertisements, television and radio broadcasts, seminars where attendees have been invited by general solicitation or advertising, unrestricted websites, and other publicly available media while raising capital and in between financing rounds. Prior to Rule 506(c), issuers who want to privately raise capital cannot use general solicitation or advertising whose effect is to "condition" the market such as freely accessible websites containing "prospectus like" information. Issuers who maintain such websites had to restrict the general public's access by requiring user registration and assigning passwords only to verified accredited investors. Under Rule 506(c), investors can now

*by Gisella Rivera & David Khalily, Corporate Group
Meltzer, Lippe, Goldstein & Breitstone, LLP*

freely access such websites allowing lower capitalized companies easier access to the capital markets since they do not have to incur the cost of a password restricted website and the related administrative burdens.

This is not to say that issuers can adopt an "anything goes" attitude. Issuers should be aware that statements made in general solicitation or general advertising are subject to the general anti-fraud provisions of U.S. securities laws which provide that (a) no issuer may employ any device, scheme, or artifice to defraud, (b) make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or (c) engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Issuers who fail to comply with Rule 506(c) will not be able to rely on any other private placement exemption because general solicitation and advertising are not permitted in such other exempt offering of securities. Issuers who choose to use general solicitation and advertising should pay particular attention to the safe harbor verification methods described above. For issuers who have decided not to rely on Rule 506(c), such issuers should refrain from any and all general solicitation or advertising, which may include a take-down of any freely accessible websites, for at least six months prior to a capital raise.

"Bad Actor" Rules

An issuer cannot rely on Rule 506(c) in any offering of its securities if any of its affiliates, control persons, officers, directors, underwriters, placement agents, promoters or agents (each, a "covered entity") become subject to a disqualifying event as a "bad actor" after September 23, 2013. "Bad actor" acts include, without limitation, felony and misdemeanor convictions in connection with the purchase and sale of securities, and violations of any laws that prohibit fraudulent, manipulative or deceptive conduct. An issuer must disclose to purchasers any past disqualifying event of its covered entities, unless the issuer did not and reasonably could not have known such an event had occurred. Accordingly, an issuer must conduct appropriate due diligence to ensure that none of its covered entities have been subject to disqualifying events, and if any of them are and the issuer can and chooses to rely on Rule 506(c), that such disqualifying events are properly disclosed to purchasers.

Conclusion

Rule 506(c) liberalizes offerings while creating a new regulatory framework. Issuers seeking to use general solicitation and advertising to expand their investor base are advised to consult with their securities counsel prior to offering securities in reliance with Rule 506(c).