# Opportunities and Pitfalls of the New Offering Rules

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On July 10, 2013, the SEC substantially changed the rules for conducting unregistered offerings in reliance on Rule 506 of Regulation D by:

- Lifting the ban on general solicitation and advertising in offerings where all of the purchasers are accredited investors, so long as the issuer has taken reasonable steps to verify that the purchasers are accredited (new Rule 506(c)); and

- Disqualifying offerings involving felons and other "bad actors" in specified positions.

The first of these changes was mandated by the Jumpstart Our Business Startups Act, or JOBS Act, enacted in April 2012, and the second fulfills a requirement of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. At the same time as these two long-anticipated rules were adopted, the SEC proposed new rules that would, among other things, enhance Form D disclosures and filing obligations for issuers of all types and regulate the disclosure of performance data for private investment funds.

The new rules create opportunities for issuers to locate investors directly and are also expected to facilitate the development of online offering platforms run by registered broker-dealers. This, it is hoped, will be useful to smaller companies that may have difficulty attracting the interest of more traditional investment bankers and venture capital firms and could draw more individual accredited investors into the private company investment sphere. In addition, other issuers, such as private investment funds, may find online offerings to be an efficient way of raising capital and disseminating information to prospective accredited investors. Finally, issuers not intending to conduct a general solicitation may rely on the rule as a backstop in the case of inadvertent public disclosure, or to avoid having to make difficult decisions as to whether their regular communications rise to the level of general solicitation when they are conducting an unregistered offering. Use of general solicitation in reliance on new Rule 506(c) must be noted on the issuer's Form D filing.

In exchange for this new latitude, issuers must exercise greater vigilance in determining whether their investors are accredited, if there is a general solicitation. The SEC adopted a principles-based approach, stating that the degree and type of diligence would vary with the nature of the investor, the information that the issuer has about the investor, and the nature and terms of the offering. In addition, the SEC created safe harbors, allowing issuers to rely on certain types of information for individual investors and permitting reliance on determinations made by third parties, such as registered broker-dealers,

investment advisers, accountants and attorneys. If there is no general solicitation, issuers need not change their due diligence practices for verifying whether investors are accredited.

Whether or not there is a general solicitation, issuers and other parties involved in the offering must be careful to determine that the offering will not be disqualified as a result of the bad actor provisions. While these provisions will presumably affect only a small number of offerings, the disqualification could arise from unexpected quarters, including a predecessor or affiliated issuer, a 20% beneficial owner, a director or executive officer, a non-executive officer participating in the offering process, a person compensated for soliciting investors, or a general partner, managing member or investment manager of an investment fund. Matters adjudicated prior to the adoption of the bad actor provisions will not disqualify an offering but must be disclosed to investors. The Form D to be filed by the issuer includes a certification that there is no bad actor disqualification.

For private investment funds, the new rules offer the assurance that general solicitation in accordance with new Rule 506(c) will not be deemed to be a public offering that would prevent reliance on the Section 3(c)(1) or 3(c)(7) exclusions from the Investment Company Act of 1940, as amended. Private investment funds, particularly hedge funds, should be mindful of the fact that the SEC's proposed rules would impose new disclosure requirements on them and should consider adopting these disclosures proactively.

The new rules also permit the use of general solicitation in Rule 144A offerings, so long as all of the purchasers are qualified institutional buyers, and clarify that general solicitation made in a Rule 506(c) or Rule 144A offering will not constitute "directed selling efforts" in the United States that would jeopardize a Regulation S offering outside the United States.

On balance, the new offering rules appear to offer more opportunities than due diligence pitfalls, but they come with a willingness on the part of the SEC to explore new regulation and mandated disclosures for unregistered offerings.

## About the Author

Bonnie J Roe is a partner in the Corporate group of Cohen & Gresser LLP, where she represents publicly and privately held companies and investment funds. Ms. Roe has over thirty years of experience advising public and private companies on securities law compliance, corporate governance and acquisitions. She has served as counsel for issuers, underwriters and placement agents in connection with public and private offerings, including PIPE transactions and cross-border offerings. Ms. Roe was named as one of New York's *Super Lawyers* for Securities & Corporate Finance in 2011 and 2012 and is mentioned in Who's Who in America and Who's Who in American Law.

## About Cohen & Gresser

Founded in 2002, Cohen & Gresser LLP has been recognized in *Chambers USA*, *Legal 500*, and *Benchmark Litigation* and was recently named to *The National Law Journal*'s 2013 "Midsize Hot List." The firm has offices in New York and Seoul and has grown to over fifty lawyers in four practice groups: Litigation and Arbitration; Corporate Law; Intellectual Property and Technology; and White Collar Defense, Regulatory Enforcement and Internal Investigations. Its attorneys are graduates of the nation's best law schools and have exceptional credentials, and its clients include Fortune 500 companies and major financial institutions throughout the world.

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