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Further Interpretive Guidance on General Solicitation Prohibition

On August 6, 2015, the staff of the SEC Division of Corporation Finance (“Staff”) issued new Compliance and Disclosure Interpretations (“CDIs”)¹ and an interpretive letter² regarding the general solicitation and general advertising prohibition in securities offerings under Rule 506(b). Some of the CDIs provided by the Staff confirm existing practice, while others expand communications and activities previously thought forbidden under the prohibition. In some cases, the Staff’s analysis in the CDIs is predicated on the facts and circumstances of the particular offering.

Background

Issuers seeking to avoid registration under the Securities Act of 1933, as amended (the “Securities Act”), have traditionally relied on the Regulation D safe harbor under Section 4(a)(2). To qualify for that exemption, among other things, an issuer (or any person acting on its behalf) is prohibited under Rule 502(c) from offering or selling securities through any form of “general solicitation or general advertising.” Determining precisely which activities constitute general solicitation or general advertising has been for many years a source of consternation for issuers, sponsors, and legal practitioners alike.

Although the JOBS Act, through its adoption of Rule 506(c), provides a method whereby issuers may utilize general solicitation and general advertising in their securities offerings, to qualify for that exemption, issuers must take reasonable steps to verify that all investors in such offering are accredited investors. In contrast, under Rule 506(b), general solicitation and general advertising remain prohibited, but offers and sales may be made by the issuer to investors it *reasonably believes* are accredited investors. The enhanced requirements to verify accredited investor status (e.g., production of personal tax returns and other sensitive financial information) have dampened the public’s enthusiasm to embrace the new exemption under Rule 506(c). Nonetheless, there has been a renewed focus by the SEC to shed light on what specific activities constitute a “general solicitation or general advertising” under Rule 502(c).

Further Interpretive Guidance

Highlights of the Staff guidance are as follows:

- *Pre-Existing Substantive Relationship*. The Staff has concluded in the past that a “substantive relationship” exists where it “would enable the issuer (or a person acting

1 See CDIs (August 6, 2015) (available at <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>).

2 See *Citizen VC, Inc.*, SEC Interpretive Letter (August 6, 2015) (available at <http://www.sec.gov/divisions/corpfin/cf-noaction/2015/citizen-vc-inc-080615-502.htm>).

on its behalf) to be aware of the financial circumstances or sophistication of the persons with whom the relationship exists or that otherwise are of some substance and duration.”³ Self-certification (i.e., checking the box) as to investor status is not enough to create a substantive relationship. A “pre-existing” relationship exists where it is established prior to the consummation of an offering. Prior to this guidance, a waiting period was imposed on investors (generally 30 days as espoused in the *Lamp Technologies, Inc.*, SEC No-Action Letter (May 29, 1997)) prior to accepting subscriptions to ensure a pre-existing relationship had been established with such investor. **The new interpretive guidance eliminates this 30-day waiting period.**

- *Who Can Form Pre-Existing Relationships with Prospective Offerees.* In addition to a broker-dealer, an investment adviser registered with the SEC can form a pre-existing substantive relationship with a prospective offeree that is a client of the adviser. Moreover, third parties other than broker-dealers and SEC registered investment advisers can form pre-existing substantive relationships with prospective offerees depending on the facts and circumstances. Finally, the Staff has recognized that in limited circumstances issuers may develop pre-existing, substantive relationships with prospective offerees.⁴ However, the Staff states that it is more difficult for an issuer to establish such a relationship in the absence of a prior business relationship or a recognized legal duty to offerees.
- *Angel Investor Networks.* The Staff acknowledges the existence of personal networks of individuals with experience investing in private offerings. The Staff recognizes members of these networks share information and may introduce issuers to investors within the network. The Staff has concluded that issuers who are introduced to members of these networks through a referral by a member to whom the issuer has a pre-existing relationship may be able to rely on the network to establish a reasonable belief that other offerees in the network have the requisite experience and sophistication. The Staff cautions, however, that the greater the number of persons lacking financial sophistication contacted by the issuer through impersonal means, the more likely the SEC will find the communication to be part of a general solicitation.
- *Factual Business Information Can Be Widely Disseminated.* The Staff confirmed that the general solicitation prohibition does not extend to the dissemination of general business information, which includes information about an issuer, its business, financial condition, products, services or advertisements of such products or services, provided the information is not presented in a way which would constitute an offer of the issuer’s securities.
- *Publicly Available Website.* The Staff confirmed the SEC position that an unrestricted, publicly available website would constitute a general solicitation if the website contains an offer of securities.

In addition to the foregoing, the Staff issued an interpretive letter regarding a venture capital firm’s policies and procedures to establish a substantive, pre-existing relationship with prospective investors over the Internet. According to the incoming letter to the SEC,

3 See *Mineral Lands Research & Marketing Corp.*, SEC No Action Letter (December 4, 1985).

4. See *Woodtrails - Seattle, Limited*, SEC No-Action Letter (August 9, 1982).



the venture capital firm has established an online venture capital investment platform. Investors admitted on the platform are pre-qualified, accredited and sophisticated in seed, early-stage, emerging growth and late-stage private companies. The portions of the website that include offering materials of particular issuer companies are password protected and any visitors to the website who seek access must complete an accredited investor questionnaire, which is then vetted by the venture capital firm. The firm indicates in its letter that it will then initiate a “relationship establishment period,” which includes, among other things: (1) connecting with the prospective investor offline to discuss such investor’s investment experience and sophistication; (2) utilizing third party credit reporting services to confirm the investor’s identity and to gather additional financial information; and (3) fostering offline and online interactions with the investor to answer questions about the website, the venture capital firm and potential investments. The relationship establishment period is not limited by a specific time period. The incoming letter also states that the firm’s relationship with new members will pre-exist any offering of securities.

The Staff concluded that the proposed policies and procedures for establishing a substantive, pre-existing relationship by the venture capital firm over their password protected website would suffice, and consequently, the offer and sale of interests in special purpose vehicles (which in turn will invest in particular private companies), would not constitute a general solicitation within the meaning of Rule 502(c) of Regulation D. The Staff emphasized that the quality of the relationship between issuer (or its agent) and an investor is the most important factor in determining whether a “substantive” relationship exists. According to the Staff, the best way to ensure such a relationship exists is to evaluate an investor’s sophistication, financial circumstances and ability to understand the nature and risks of the securities being offered. The Staff also agreed that no specific duration of time or particular form of accredited investor questionnaire can be relied upon to establish such a relationship.

Questions or Assistance:

If you would like to discuss the foregoing in further detail, please contact Peter Bilfield at (203) 324-8151, or pbilfield@goodwin.com, or Michael Cummings at (203) 324-8173, or mcummings@goodwin.com.

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