

## New SEC Guidance on General Solicitation

Last Thursday the SEC issued guidance on what constitutes general solicitation. This guidance is helpful to companies trying to conduct Rule 506 offerings.

Thanks to the JOBS Act, we now have two types of Rule 506 offerings. Those that cannot be generally solicited and those that can. This might sound harmless but if you generally solicit your offering you have to collect additional information from your investors. Like their personal tax returns and personal financial statements. Most companies try to avoid this because it is not well accepted in the investment community to provide this information to companies. This might change over time but right now companies are shying away from generally soliciting their offerings.

If you are conducting a securities offering, exercise extreme caution with what you are doing. Each securities law exemption has its own narrow pathway of compliance. If you have identified Rule 506(b) as your securities law exemption, you cannot generally solicit your offering.

I have quoted the SEC's new general solicitation guidance in full below, and I have emphasized in bold the parts of the guidance that I think are helpful. But before we dive into the details of the guidance, why does this guidance matter? What is at stake?

This guidance matters because it is fresh and clear guidance from the SEC on what it considers general solicitation. If you have generally solicited your securities offering, or are considered to have generally solicited your offering by the SEC, and you were trying to conduct a Rule 506(b) offering--you may not have a securities law exemption. Not having a securities law exemption is not something you want to discover--because your personal assets are potentially at stake.

If you either have generally solicited your offering, or are considered to have generally solicited your offering, then:

- You have to collect additional verification information from your accredited investors, so that you can verify that they are accredited investors. This means--you have to ask your investors for copies of their tax returns or their personal financial statements.
- You can't have had any non-accredited investors in your offering.
- If you have already been conducting your offering in line with Rule 506(b), and not been collecting the additional verification information--you will have to go back to investors who already invested in your round and ask them for that additional information. If they are not willing to give it you, you will have to give them their money back.
- If you have already filed a Form D indicating your reliance on Rule 506(b), you will have to amend the Form D to indicate reliance on Rule 506(c). This may trigger regulatory inquiries.

Here are what I consider to be the key takeaways from the new SEC guidance:

- You can distribute factual business information, but you cannot condition the public mind of arouse public interest in a securities offering without the SEC considering you to have generally solicited your offering.
- Factual business information generally does not include predictions, projections, forecasts or opinions with respect to valuation of a security.
- Demo Days do not necessarily constitute general solicitation.
- You have to have "substantive, pre-existing" relationship with someone before you pitch them.
- A "pre-existing" relationship is one that the issuer has formed with an offeree prior to the commencement of the securities offering.
- A "substantive" relationship is one in which the issuer (or a person acting on its behalf) has sufficient information to evaluate, and does, in fact, evaluate, a prospective offeree's financial circumstances and sophistication, in determining his or her status as an accredited or sophisticated investor.
- Angel groups are helpful in establishing substantive, pre-existing relationships.

### **What If You Pitch Someone You Later Find Out Can't Invest Because They Are Not Accredited? Did You Blow Your Rule 506(b) Offering?**

Say you pitch an old friend on your new startup. You believe your friend to be accredited based on his prior startups and jobs, his known angel investments, the house he lives in, his appearance of means. You also know him to be a sophisticated, astute judge of business opportunities.

But, after your friend says yes, he will invest, you find out that he is not accredited. He no longer works--and thus you can't rely on the income test. And his house can't count toward the \$1M net worth test. Plus, you find out he gave most of his money to his kids, and only has \$800,000 in cash in a bank account.

So, your friend can't invest, because he is not accredited.

However, you didn't blow your 506(b) offering because: (i) he was an old friend, and (ii) he was sophisticated.

### **What Should You Do?**

Study this guidance carefully if you are trying to conduct a Rule 506(b) offering, and exercise extreme caution. It is relatively easy to inadvertently generally solicit your offering.

### **Public Policy Recommendation**

Congress should repeal the ban on general solicitation, and I mean--really repeal it. The JOBS Act repeal didn't do the trick because the SEC issued the verification guidance. The world would be

better off without the complexities of the Rule 506(b) vs. Rule 506(c) dichotomy. And we need rules that are less complex, and not so restrictive when it comes to startup companies.

This blog post is for informational purposes and does not constitute legal advice.

### Question 256.23

**Question:** Rule 502(c) prohibits an issuer or any person acting on the issuer's behalf from offering or selling securities by any form of general solicitation or general advertising when conducting certain offerings in reliance on Regulation D. Does the use of an unrestricted, publicly available website to offer or sell securities constitute a general solicitation for purposes of Rule 502(c)?

**Answer:** Yes. As the Commission stated in [Securities Act Release No. 7856](#) (Apr. 28, 2000), **the use of an unrestricted, publicly available website constitutes a general solicitation and is not consistent with the prohibition on general solicitation and advertising** in Rule 502(c) if the website contains an offer of securities. However, Rule 506(c) — which does not require compliance with Rule 502(c) — may be available to issuers when offering or selling securities through unrestricted, publicly available websites or other forms of general solicitation. [August 6, 2015]

### Question 256.24

**Question:** What information can an issuer widely disseminate about itself without contravening Rule 502(c)?

**Answer:** Information not involving an offer of securities may be disseminated widely without violating Rule 502(c). **For example, factual business information that does not condition the public mind or arouse public interest in a securities offering is not an offer and may be disseminated widely.** Information that involves an offer of securities through any form of general solicitation would contravene Rule 502(c). [August 6, 2015]

### Question 256.25

**Question:** What is factual business information?

**Answer:** What constitutes factual business information depends on the facts and circumstances. Factual business information typically is limited to information about the issuer, its business, financial condition, products, services, or advertisement of such products or services, provided the information is not presented in such a manner as to constitute an offer of the issuer's securities. **Factual business information generally**

**does not include predictions, projections, forecasts or opinions with respect to valuation of a security, nor for a continuously offered fund would it include information about past performance of the fund.** (Release No. 33-5180). [August 6, 2015]

#### **Question 256.26**

**Question:** Does an offer of securities in a Regulation D offering to a prospective investor with whom the issuer, or a person acting on the issuer's behalf, has a pre-existing, substantive relationship constitute a general solicitation in contravention of Rule 502(c)?

**Answer:** No. The existence of such a pre-existing, substantive relationship is one means, but not the exclusive means, of demonstrating the absence of a general solicitation in a Regulation D offering. See Securities Act Release No. 6825 (Mar. 15, 1989), at fn. 12. Accordingly, an offer of the issuer's securities to the person with whom the issuer, or a person acting on its behalf, has such a relationship would not constitute a general solicitation and, therefore, would not be in contravention of Rule 502(c). [August 6, 2015]

#### **Question 256.27**

**Question:** Are there circumstances under which an issuer, or a person acting on the issuer's behalf, can communicate information about an offering to persons with whom it does not have a pre-existing, substantive relationship without having that information deemed a general solicitation?

**Answer:** Yes. The staff is aware of long-standing practices where issuers and persons acting on their behalf are introduced to prospective investors who are members of an informal, personal network of individuals with experience investing in private offerings. For example, we acknowledge that groups of experienced, sophisticated investors, such as "angel investors," share information about offerings through their network and members who have a relationship with a particular issuer may introduce that issuer to other members. Issuers that contact one or more experienced, sophisticated members of the group through this type of referral may be able to rely on those members' network to establish a reasonable belief that other offerees in the network have the necessary financial experience and sophistication. Whether there has been a general solicitation is a fact-specific determination. **In general, the greater the number of persons without financial experience, sophistication or any prior personal or business relationship with the issuer that are contacted by an issuer or persons acting on its behalf through impersonal, non-selective means of communication, the more likely the communications are part of a general solicitation.** [August 6, 2015]

#### **Question 256.28**

**Question: Is someone other than a broker-dealer able to form a pre-existing, substantive relationship with a prospective offeree as a means of establishing that a general solicitation is not present in a Regulation D offering?**

**Answer: Yes.** We believe investment advisers registered with the Securities and Exchange Commission may be able to form a pre-existing relationship with prospective offerees that are clients of the adviser. As fiduciaries, such advisers owe their clients the duty to provide only suitable investment advice. To fulfill the obligation, an adviser must make a reasonable determination that the investment advice provided is suitable for the client based on the client's financial situation and investment objective, such that a substantive relationship could exist. [August 6, 2015]

### **Question 256.29**

**Question:** What makes a relationship “pre-existing” for purposes of demonstrating the absence of a general solicitation under Rule 502(c)?

**Answer: A “pre-existing” relationship is one that the issuer has formed with an offeree prior to the commencement of the securities offering** or, alternatively, that was established through either a registered broker-dealer or investment adviser prior to the registered broker-dealer or investment adviser participation in the offering. See, e.g., the *E.F. Hutton & Co.* letter (Dec. 3, 1985). [August 6, 2015]

### **Question 256.30**

**Question: Is there a minimum waiting period required for an issuer, or a person acting on its behalf, to establish a pre-existing, substantive relationship with a prospective offeree in order to demonstrate that a general solicitation is not involved?**

**Answer: No.** While there is no minimum waiting period, the issuer must establish such a relationship prior to the commencement of the offering, or, if the relationship was established through either a registered broker-dealer or investment adviser, the relationship must be established prior to the time the registered broker-dealer or investment adviser began participating in the offering. The staff, however, has allowed a limited accommodation for offerings by private funds that rely on the exclusions from the definition of “investment company” set forth in Sections 3(c)(1) and 3(c)(7) of the Investment Company Act. This limited accommodation permits an individual who qualifies as an accredited or sophisticated investor to purchase, after the end of a waiting period, securities in private fund offerings that were posted on a website platform prior to the investor's subscription to the platform, in view of the fact that private fund offerings are made on a semi-continuous basis (quarterly or annually). See the *Lamp Technologies, Inc.* letter (May

29, 1997). [August 6, 2015]

### **Question 256.31**

**Question:** What makes a relationship “substantive” for purposes of demonstrating the absence of a general solicitation under Rule 502(c)?

**Answer:** A “substantive” relationship is one in which the issuer (or a person acting on its behalf) has sufficient information to evaluate, and does, in fact, evaluate, a prospective offeree’s financial circumstances and sophistication, in determining his or her status as an accredited or sophisticated investor. Self-certification alone (by checking a box) without any other knowledge of a person’s financial circumstances or sophistication is not sufficient to form a “substantive” relationship. [August 6, 2015]

### **Question 256.32**

**Question:** Can anyone other than registered broker-dealers and investment advisers form a pre-existing, substantive relationship with a prospective offeree as a means of establishing that a general solicitation is not involved in a Regulation D offering?

**Answer: Yes.** The Commission has stated that:

Generally, staff interpretations of whether a “pre-existing, substantive relationship” exists have been limited to procedures established by broker-dealers in connection with their customers. This is because traditional broker-dealer relationships require that a broker-dealer deal fairly with, and make suitable recommendations to, customers, and, thus, implies that a substantive relationship exists between the broker-dealer and its customers. [The Commission has] long stated, however, that the presence or absence of a general