

Corporate Finance Alert

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SEC Staff Issues Interpretations on General Solicitation Prohibition

The staff of the SEC Division of Corporation Finance (Staff) recently issued new Compliance and Disclosure Interpretations (CDIs) and an interpretive letter regarding the general solicitation prohibition in securities offerings conducted under Rule 506(b) of Regulation D, which exempts such offerings from Securities Act registration. Some of the CDIs confirm or reiterate existing views, while others provide new flexibility with respect to the communications and activities allowed under the prohibition.

The new CDIs and the interpretive letter reflect the Staff's continued willingness to provide interpretive guidance regarding the general solicitation prohibition, even in light of the availability of the exemption found in Rule 506(c) of Regulation D that allows for the use of general solicitation.

Highlights of the new CDIs include the following:

- **Factual Business Information.** The Staff clarified that the general solicitation prohibition does not prevent issuers from publicly disseminating factual business information. Under the CDI, factual business information generally is limited to information about the issuer, its business, financial condition, products or services, or advertisements about its products or services, provided that such information is not presented in a manner that constitutes an offer of securities. The Staff stated, however, that projections, predictions, forecasts, opinions with respect to a security's valuation, or past performance of a fund generally would not be factual business information. The Staff's position in the new CDI appears to be analogous to the Securities Act Rules 168 and 169 safe harbors for factual business information and forward-looking information disseminated by an issuer that is proposing to file, or has filed, a Securities Act registration statement for a public offering.
- **Pre-Existing Substantive Relationship and Investment Advisers.** A pre-existing substantive relationship with prospective offerees, which has long been one way of demonstrating the absence of general solicitation in a Rule 506 offering, may be established by registered investment advisers. The Staff's previous guidance generally focused on only relationships by broker-dealers, suggesting to some that only broker-dealers could be used to establish pre-existing substantive relationships. The Staff also stated in the new CDI that it is possible for issuers to establish these relationships as well, but that, absent a prior business relationship or a recognized legal duty to the offerees, it would be more difficult to do so.

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- “Pre-existing” means that the prospective offeree’s relationship with the registered investment adviser or broker-dealer must have been established before the investment adviser’s or broker-dealer’s participation in the offering.

The Staff, however, clarified that the new CDIs regarding pre-existing substantive relationships do not overrule the Lamp Technologies, Inc. No-Action Letter (May 29, 1997) (Lamp No-Action Letter). The Lamp No-Action Letter permits an individual who qualifies as an accredited or sophisticated investor to purchase securities in an offering by an Investment Company Act Section 3(c)(1) or 3(c)(7) private fund, after the end of a waiting period, even if the pre-existing relationship with such individual is formed only after the investment adviser’s or broker-dealer’s participation in the offering, so long as such private offering is made on a semicontinuous basis (quarterly or annually).

- “Substantive” means possession of sufficient information to evaluate the prospective offeree’s financial circumstances and sophistication to establish the offeree’s status as an accredited investor or sophisticated investor. The Staff stated in the new CDI that self-certification, without any other information about the prospective offeree, is not enough to be “substantive.”
- **Angel Investors Networks.** It is possible for introductions to prospective offerees who are members of “angel investors” networks or other informal, personal networks of experienced investors to be relied upon by issuers in establishing a reasonable belief that these members are sufficiently sophisticated and experienced to participate in the offering. The Staff noted, however, that whether there has been a general solicitation remains a facts and circumstances determination.

- **Demo Days or Venture Fairs.** The Staff stated that demo days or venture fairs do not necessarily constitute a means of general solicitation. If an issuer’s presentation at a demo day and venture fair constitutes an offer of securities, the presentation may not be a general solicitation if attendance is limited to:

- persons with pre-existing substantive relationships with the issuers or the event organizer; or
- persons who have been contacted by members of angel investors networks or similar informal, personal networks of experienced investors.

In addition to the new CDIs, the Staff issued an interpretive letter (Citizen VC, Inc., Aug. 6, 2015) to a venture capital firm regarding its policies and procedures for establishing a pre-existing substantive relationship with prospective offerees over the Internet. In the letter, the Staff emphasized that the most important factor in establishing a “substantive” relationship is possessing sufficient information to evaluate the prospective offeree’s sophistication and financial experience and conducting such an evaluation. The Staff also stated that there is no specific duration of time or particular short form accreditation questionnaire that could be relied upon solely to create such a relationship.

The new CDIs are available here: <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#256.23>.

The Citizen VC interpretive letter is available here: <http://www.sec.gov/divisions/corpfin/cf-noaction/2015/citizen-v-c-inc-080615-502.htm>.

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