

Corporate Finance Alert

Skadden

Skadden, Arps, Slate, Meagher & Flom LLP

July 11, 2013

If you have any questions regarding the matters discussed in this memorandum, please contact one of the attorneys listed on page 4 or your regular Skadden contact.



Follow us on Twitter
@SkaddenArps

Beijing
Boston
Brussels
Chicago
Frankfurt
Hong Kong
Houston
London
Los Angeles
Moscow
Munich
New York
Palo Alto
Paris
São Paulo
Shanghai
Singapore
Sydney
Tokyo
Toronto
Vienna
Washington, D.C.
Wilmington

SEC Adopts Significant Amendments to Private Placement Rules

SEC Approves Final Rules to Remove the Ban on General Solicitation and Advertising for Certain Private Placements and to Disqualify Bad Actors from Private Placements Under Rule 506 and Proposes Other Related Rule Amendments

On July 10, 2013, the SEC adopted final rules to implement the JOBS Act mandate to eliminate the prohibition against the use of general solicitation and general advertising in private offerings made in reliance on Rule 506 of Regulation D or Rule 144A under the Securities Act. In connection with the final rules, the SEC issued proposed rules that would, if adopted, enhance its ability to evaluate market practices in Rule 506 offerings and provide, as needed, additional investor protections as the Rule 506 market evolves. Finally, the SEC also adopted rules to disqualify “bad actors” from Rule 506 offerings, as required by the Dodd-Frank Act.

The final and proposed rules have the potential to transform the private placement market. The rules attempt to strike a balance between facilitating capital formation and protecting investors, while implementing Congressional mandates. Based on the number and tenor of the public comments received during the rulemaking process and comments made during the SEC's open meeting on July 10, 2013, the debate over whether these measures will indeed strike the correct balance is sure to continue.

Final Rules Removing the Ban on General Solicitation and Advertising for Certain Private Placements

The SEC adopted final rules that amend the safe harbor from Securities Act registration provided by Rule 506 to remove the prohibition against general solicitation and general advertising, provided that the issuer has taken reasonable steps to verify that all purchasers of the securities are accredited investors and the issuer reasonably believes all of those purchasers to be accredited investors. The amendments to Rule 144A permit securities to be offered to persons other than qualified institutional buyers (QIBs), including by means of general solicitation or general advertising, provided that the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believes are QIBs.

Practice Note

Issuers conducting a Rule 144A offering no longer will be subject to the limitations in Rule 135c of the Securities Act when drafting press releases related to the offering. Press releases will be able to contain commentary and quotes from company management.

The amendments to Rule 506 and Rule 144A were adopted largely in the form proposed on August 29, 2012. However, in response to commenters' requests for more guidance on the types of verification that would be considered reasonable under new Rule 506(c), the final rule, in addition to confirming that "reasonable steps" to verify investor status will be an objective determination by the issuer based on the SEC's principles-based guidance, includes a non-exclusive list of methods that issuers may use to satisfy the verification requirement for individual investors. The non-exclusive list is a welcome change that should provide helpful guidance for ensuring that the verification process has been satisfactorily conducted. The non-exclusive list includes, most prominently, the following:

- reviewing statements that evidence sufficient income, such as copies of any IRS form that reports the income of the purchaser and obtaining a written representation that the purchaser will likely continue to earn the necessary income in the current year;
- reviewing statements that evidence sufficient net worth, such as a combination of bank statements and a consumer report from at least one nationwide consumer reporting agency; and
- receiving a written confirmation from a registered broker-dealer, SEC-registered investment adviser, licensed attorney or certified public accountant that such entity or person has taken reasonable steps to verify the purchaser's accredited status.

The final rules, available [here](#), become effective 60 days after publication in the Federal Register, which can be expected shortly. Until effectiveness of the new rules, however, the current versions of Rule 506 and Rule 144A remain in effect, which means that issuers may not use general solicitation or general advertising in a Rule 506 or Rule 144A offering. A copy of the relevant SEC fact sheet can be found [here](#).

Proposed Rules to Enable the SEC to Monitor Developments in the New Rule 506 Market

The SEC issued for public comment proposed rules that are intended to enhance the SEC's understanding of market practices in Rule 506 offerings and to address investor concerns related to the removal of the prohibition against general solicitation in Rule 506.

The proposed rules, none of which would impact Rule 144A offerings, would require:

- the filing of a Form D in Rule 506(c) offerings before the issuer engages in any general solicitation;
- the filing of a closing amendment to Form D after the termination of any Rule 506 offering;
- the inclusion of certain legends and cautionary statements in written general solicitation materials used in Rule 506(c) offerings;
- the submission to the SEC, on a temporary and nonpublic basis, of written general solicitation materials; and
- the disqualification of an issuer from relying on Rule 506 for one year for future offerings if the issuer, or any predecessor or affiliate of the issuer, did not comply, within the last five years, with Form D filing requirements in a Rule 506 offering.

Private funds also would be required to include a legend disclosing that the securities being offered are not subject to the protections of the Investment Company Act of 1940 and to include additional disclosures in written general solicitation materials that include performance data so that potential investors are aware that there are limitations on the usefulness of such data. The SEC also would amend Rule 156 under the Securities Act, which interprets the antifraud provisions of the federal securities laws in connection with sales literature used by investment companies, to apply to the sales literature of private funds and has solicited comment on whether to mandate additional manner and content restrictions on written general solicitation materials used by private funds.

Comments on the proposed rules, available [here](#), are due within 60 days after publication in the Federal Register, which can be expected shortly. A copy of the relevant SEC fact sheet can be found [here](#).

Final Rules Disqualifying Bad Actors From Private Placements Under Rule 506

The SEC approved final rules that disqualify securities offerings involving certain “felons and other “bad actors”” from reliance on the safe harbor provided by Rule 506 of Regulation D.

These “bad boy” disqualification provisions will prohibit issuers and others (such as underwriters, placement agents and the directors, executive officers and certain other officers and certain larger beneficial owners of the issuer) from participating in Rule 506 offerings if they have been convicted of, or are subject to court or administrative sanctions for, securities fraud or other violations of specified laws. The new rules, which do not apply to Rule 144A offerings, were adopted largely as proposed on May 25, 2011, except they will apply only to triggering events occurring after effectiveness of the new rules (with pre-existing events subject to mandatory disclosure) and reflect limited changes to the list of disqualification events and covered persons in response to comments. Of particular note, investment managers to pooled investment funds and their principals were added to the list of covered persons.

With more than 90 percent of the offerings made under Regulation D relying on Rule 506, the new rules could have a significant impact on the way private offerings are marketed. For example, an issuer will not be able to rely on the Rule 506 safe harbor if a director of the issuer or an executive officer or other officer of the issuer who is participating in the offering is subject to a disqualifying event, such as a criminal conviction involving making a false filing with the SEC within 10 years before the proposed sale of securities. Also, because the ineligibility of an offering to be conducted in accordance with Rule 506 will result in the loss of “covered security” status under Section 18(b)(4) (D) of the Securities Act, the offering (absent an available state law exemption) would be subject to registration in each state where an offer/sale is made, which might be impractical.

The final rules, available [here](#), become effective 60 days after publication in the Federal Register, which can be expected shortly. A copy of the relevant SEC fact sheet can be found [here](#).

* * *

A more detailed memorandum on the final and proposed rules will follow shortly.

Attorney contacts appear on the next page.

Attorney Contacts**New York****Richard B. Aftanas**

212.735.4112
richard.aftanas@skadden.com

Gregory A. Fernicola

212.735.2918
gregory.fernicola@skadden.com

David J. Goldschmidt

212.735.3574
david.goldschmidt@skadden.com

Stacy J. Kanter

212.735.3497
stacy.kanter@skadden.com

Laura A. Kaufmann Belkhat

212.735.2439
laura.kaufmann@skadden.com

Phyllis G. Korff

212.735.2694
phyllis.korff@skadden.com

Andrea L. Nicolas

212.735.3416
andrea.nicolas@skadden.com

Yossi Vebman

212.735.3719
yossi.vebman@skadden.com

Dwight S. Yoo

212.735.2573
dwight.yoo@skadden.com

Michael J. Zeidel

212.735.3259
michael.zeidel@skadden.com

Frankfurt**Stephan Hutter**

49.69.74220.170
stephan.hutter@skadden.com

Katja Kaulamo

49.69.74220.130
katja.kaulamo@skadden.com

Hong Kong**Edward Lam**

852.3740.4771
edward.lam@skadden.com

Z. Julie Gao

852.3740.4850
julie.gao@skadden.com

Jonathan B. Stone

852.3740.4703
jonathan.stone@skadden.com

Alec P. Tracy

852.3740.4710
alec.tracy@skadden.com

London**James P. Healy**

44.20.7519.7042
james.healy@skadden.com

James A. McDonald

44.20.7519.7183
james.mcdonald@skadden.com

Danny Tricot

44.20.7519.7071
danny.tricot@skadden.com

Pranav L. Trivedi

44.20.7519.7026
pranav.trivedi@skadden.com

Los Angeles**Michelle Gasaway**

213.687.5122
michelle.gasaway@skadden.com

Jonathan B. Ko

213.687.5527
jonathan.ko@skadden.com

Gregg A. Noel

213.687.5234
gregg.noel@skadden.com

Palo Alto**Thomas J. Ivey**

650.470.4522
thomas.ivey@skadden.com

Gregg A. Noel

650.470.4540
gregg.noel@skadden.com

Sydney**Adrian J. S. Deitz**

61.2.9253.6015
adrian.deitz@skadden.com

Washington, D.C.**Brian V. Breheny**

202.371.7180
brian.breheny@skadden.com

Washington, D.C. counsel Andrew J. Brady and New York associate Pallas A. Comnenos assisted in the preparation of this memorandum.