

Private Equity Alert

SEC Adopts Final Rules Permitting General Solicitation in Private Offerings

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On July 10, 2013, the SEC at an open meeting (i) adopted final rules eliminating the prohibition against general solicitation and general advertising (hereinafter referred to as a general solicitation) in certain securities offerings conducted pursuant to Rule 506 of Regulation D under the Securities Act, (ii) adopted final rules preventing felons and other bad actors from participating in private placement offerings, and (iii) proposed rules imposing additional requirements for issuers engaging in general solicitation. The final rules relating to lifting the ban on general solicitation and preventing felons and other bad actors from participating in private placement offerings will be effective 60 days after publication in the Federal Register. The proposed rules relating to the additional requirements are open for comments, which may be submitted on or before 60 days after publication in the Federal Register.

Final Rules Eliminating the Prohibition Against General Solicitation

New Rule 506(c) was adopted substantially as proposed by the SEC in August 2012. Upon the effective date, an issuer may choose to rely on new Rule 506(c) to engage in a general solicitation in respect of its offering of securities provided it takes reasonable steps to verify that sales of securities in the offering are made solely to accredited investors. Rule 506(c) is not exclusive and an issuer may conduct a private placement offering of securities as in the past in reliance on Rule 506(b) without engaging in a general solicitation.

- **Non-Exclusive List of Methods to Verify Accredited Status of Natural Persons.** The final Rule 506(c) adds a non-exclusive list of methods for verifying the accredited investor status of natural persons:
 - *Income:* review IRS forms that report income (e.g., W-2, Schedule K-1, Form 1040) for the two (2) most recent years, and obtain a written representation that the person has a reasonable expectation of reaching the same income level in the current year.
 - *Net worth:* review documentation, dated within the prior three (3) months, showing assets (e.g., bank statements, brokerage statements, appraisal reports) and liabilities (e.g., a credit report), as well as a written

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- Weil was ranked #1 in announced global private equity deals for 2012 with approximately 16.3% market share and \$67 billion in deal value according to Bloomberg
- Weil was one of only three firms ranked in the top band for private equity in *Chambers Global 2012* and one of only three firms ranked in the top band for private equity buyouts in *IFLR 2013*
- Weil won 2013 IFLR Americas Award for Private Equity Team of the Year
- Weil advised Fidelity National Financial, Inc. and Thomas H. Lee Partners, L.P. in connection with the \$2.9 billion acquisition of Lender Processing Services, Inc.
- Weil advised Thomas H. Lee Partners, L.P. in connection with its acquisition of CompuCom Systems, Inc., a leading IT services and solutions specialist
- Weil advised CCMP Capital Advisors, LLC and its portfolio company Milacron LLC, a global plastics industry leader, in connection with Milacron's acquisition of Mold-Masters Ltd., a leading global hot-runner manufacturer
- Weil advised OMERS Private Equity on its £390 million acquisition of Civica plc, the specialist systems and business process services provider
- Weil advised Charterhouse Capital Partners LLP on its acquisition of Germany-based Armacell Group, a manufacturer of engineered foams and the world leader in the market for flexible technical insulation materials
- Weil advised Providence Equity Partners LLC in connection with its acquisition of Miller Heiman, Inc.
- Weil advised Berkshire Partners, LLC in connection with its acquisition of a majority interest in SRS Distribution Inc., the fourth largest residential roofing distributor in the US
- Weil advised HgCapital in connection with its €303 million disposition of ATC Group BV, an Amsterdam-based fiduciary and administration services company

representation from the person that all liabilities necessary to make the net worth determination have been disclosed.

- *Written confirmation*: obtain a written confirmation from registered broker-dealer, SEC-registered investment adviser, licensed attorney, or CPA that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the last three (3) months and has determined that such purchaser is an accredited investor.
- *Pre-Rule 506(c) accredited investors*: for a natural person who invested in an issuer's 506(b) offering prior to the effective date of new Rule 506(c) and invests in a subsequent Rule 506(c) offering conducted by the same issuer, obtain a certification from such person that he or she qualifies as an accredited investor (rationale is that a pre-existing relationship exists between issuer and purchaser).
- **Reasonable Steps to Verify Accredited Status of Entities.** Rule 506(c) does not provide a similar non-exclusive list for verifying the accredited investor status of entities. In the adopting release, the SEC acknowledges that the reasonable steps to verify the accredited status of entities will necessarily differ from the non-exclusive list provided for natural persons, and offers a few examples:
 - Reviewing on FINRA's BrokerCheck website the membership status of an investor that claims to be accredited because it is a broker-dealer.
 - Reviewing publicly available information about a company in filings with federal, state, or local regulatory authorities.
 - Reviewing a 501(c)(3) organization's Form 990 series return filed with the IRS, which discloses the organization's total assets.
- **Principles-Based Facts and Circumstances Method of Verification.** As noted in the adopting release, an issuer may alternatively use a principles-based facts and circumstances method of verification taking into account:

- The nature of the purchaser and the type of accredited investor that the purchaser claims to be.
- The amount and type of information that the issuer has about the purchaser.
- The nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, the terms of the offering, and the minimum investment amount.
- **Form D.** Form D will be amended to include a Rule 506(c) check-the-box election and, according to the public statements of the SEC, once elected by an issuer in respect of an offering of securities, the issuer will not be able to switch to, or claim as an alternative, Rule 506(b) as to that offering.
- **Private Investment Entity Status and Regulation S.** Finally, in the adopting release, the SEC (i) stated that private funds may utilize Rule 506(c) and engage in a general solicitation without jeopardizing their status as private investment entities excluded from the definition of “investment company” in the Investment Company Act of 1940 and (ii) reaffirmed that concurrent offshore offerings conducted in compliance with Regulation S will not be integrated with an offering of securities in compliance with Rule 506(c).
- **CFTC and Solicitations in Foreign Jurisdictions.** Private fund sponsors that have registered with the CFTC and rely on CFTC Rule 4.7 or that rely on the CFTC Rule 4.13(a)(3) *de minimis* exemption from registration are subject to certain CFTC regulations that prohibit marketing to the public. The final rules provide no guidance as to whether permitted general solicitations will be deemed to be “marketing to the public” for these purposes. Absent future guidance from the CFTC to the contrary, sponsors relying on CFTC Rule 4.7 or 4.13(a)(3) may not be able to use general solicitation. In addition, sponsors considering an offering that could include foreign investors should be aware that permitted general solicitations in the US may not necessarily be permitted in certain foreign jurisdictions and should therefore examine the local laws of such jurisdictions with respect to private placements and general solicitation.

Final Rules Disqualifying Felons and Other Bad Actors From Rule 506 Offerings

In a separate release, the SEC adopted new Rules 506(d) and 506(e) preventing felons and other bad actors from participating in Rule 506 offerings of securities (*whether under Rule 506(b) or under Rule 506(c)*). As adopted, the disqualifying provisions apply to the bad acts of an issuer and any of its executive officers, investment manager(s), principals, and significant shareholders. Significant shareholder means a shareholder that owns more than 20 percent of the voting securities of the issuer.

- **Disclosure of Preexisting Events.** In adopting these rules the SEC determined not to impose a Rule 506 disqualification based on events preexisting the effective date of the rules. However, in lieu of disqualification, the issuer is required to provide written disclosure to each purchaser of its securities, at a reasonable time prior to sale, of matters that would have triggered disqualification had they occurred before the effective date of the new disqualification provisions. The issuer is obligated to exercise reasonable care in determining whether a disqualification exists. Reasonable care requires a factual inquiry into whether any disqualification exists. The nature and scope of the factual inquiry will depend on the facts and circumstances concerning the issuer and the participants involved.
- **Form D.** Included in the final rules is a requirement that Form D be amended to require a certification that the issuer is not disqualified from relying on Regulation D for one of the reasons stated in Rule 505(b)(2)(iii) or Rule 506(d).

Proposed Rules Amending Regulation D, Form D, and Rule 156

The SEC has proposed amendments to Regulation D, Form D, and Rule 156 under the Securities Act in the context of offerings of securities utilizing general solicitation pursuant to Rule 506(c). The proposed rules, if adopted, would:

- Expand the information issuers must report on Form D, requiring the issuer to report more

- information about itself, the intended uses of offering proceeds, the intended types or methods of general solicitation, and the methods by which accredited investor status will be verified.
- Require the Form D to be filed at least 15 days before general solicitation begins.
 - Require the Form D to be amended within 30 days after an offering is completed or terminated.
 - Disqualify 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 previous five years with all of the Form D filing requirements in a Rule 506 offering. The SEC has proposed to reserve the ability to waive this requirement and has proposed a cure mechanism.
 - Require an issuer utilizing Rule 506(c) general solicitation to include certain legends and disclosures concerning its verification methods in its private placement memorandum.
 - Extend the sales literature anti-fraud guidance included in Rule 156 of the Securities Act (as currently applicable to public mutual funds) to private funds engaged in general solicitation.
 - Require that offering materials of private funds utilizing general solicitation be submitted to the SEC. At the open meeting the SEC stated its intent that submitted offering materials would not be publicly available.

We will continue examining the implications of the final and proposed rules on private fund sponsors and keep you informed of any further developments.

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