CARLTON FIELDS

How to Use Electronic Media to Access Accredited Investors Under the New SEC Rules

September 18, 2013

Effective September 23, 2013, pursuant to new SEC Rule 506(c), issuers of securities are allowed to reach "accredited investors" through general solicitation as long as they take adequate precautions to a) limit the offering to accredited investors and document the reasonable steps they have taken to verify that all investors whose subscriptions are accepted in the offering are accredited investors; and b) make timely notice filings with the SEC. A technical summary of the requirements of Rule 506(c) is included as Appendix A. This white paper discusses common methods of digital advertising as applied to capital raising for emerging businesses. **IN GENERAL**
The purposes of communications to prospective investors are: **a)** to convey accurately sufficient information about the opportunity and the inherent risks to enable prospective investors to make informed decisions about whether to invest; and,
b) to avoid making material misstatements or failing to provide information, the absence of which makes the statements of the issuer of securities materially misleading. This standard has historically applied to U.S. capital formation activities, and there is much legal literature to help guide the content development of your electronic media-communications. Before launching your offering, you should review your existing online presence (websites and social media) to make sure prospective investors will not be misled by the information you have posted. **EMAIL BLAST**
Various email marketing providers have established large opt-in email address lists that can be sorted to deliver messages to a targeted audience for a fee. The advantage of hiring a compliant provider is that its addressees have agreed to receive email blasts from these vendors (opt-in) so emails sent in this fashion comply with anti-spam laws. You should interview prospective email marketing providers to determine whether their database is a target-rich environment for the type of individual that would be a likely investor in your offering. The title of the email might be **Accredited Investors Only - Investment Opportunity in Nanotechnology Company**. An investment summary would be attached to the email and the body of the email could contain the following language:
Accredited investors are invited to invest in NANOTECH SOLUTIONS INC., which designs, develops, markets and sells devices utilized by the aviation industry to perform diagnostics on

aircraft hulls. We have begun to ship test units to three leading aircraft airframe manufacturers and plan to use the funds we raise from this offering to increase our marketing, sales, and engineering headcounts. This will enable us to develop additional products using our patented technology, and to market them to manufacturers of aircraft interiors. An investment summary of our company and the terms of this offering are attached. The investment summary would set forth:

- The number and price of the shares offered;
- The total number of shares outstanding prior to and after offering;
- A summary description of the business;
- The addressable market for current products and products in development;
- Summary information concerning competitive advantages and disadvantages;
- Management team;
- Select information regarding operating data, if applicable; and
- Who to contact for further information.

This exercise requires a balance between providing enough accurate information to gather a critical mass of good prospective investors, and protecting sensitive information that can unwittingly expose an advantage to competitors. In developing an effective email marketing campaign, it is important to measure cost against conversion rates. The provider should be able to supply information regarding its prior experience in campaigns of this type. That information should include the number and percentage of emails that have been opened, and the number and percentage of opened emails that have clicked through to the Investment Summary. A hyperlink in the body of the email and the Investment Summary will bring readers to a landing page that will enable them to provide you with relevant information concerning their accredited investor status, occupation, interest in your industry, and contact information. The completed forms should be linked to an email address of someone on your management team who will receive incoming indications of interest in the investment opportunity. At this point, you would begin a dialog with the prospective investor offline. This dialog is intended to ensure they understand what will be required of them to establish that they are, in fact, accredited investors, and to substantiate that they have a strong interest in making investments of the type you are offering. Once their suitability and interest are confirmed, it is time to provide the prospective investors with a PowerPoint overview, an offering memorandum and a subscription documents booklet. The offering memorandum sets forth in greater detail the items highlighted in the investment summary. It also provides substantial discussion about the risks inherent in the investment and the historical financial statements of your business. You may wish to consider requiring recipients of this document to sign a non-disclosure and no-use agreement before sending the PowerPoint overview and offering memorandum to them. **BANNER**

ADVERTISING

Banner advertising on relevant industry sites can be extremely effective in reaching prospective investors with a high level of interest in your company's product or service. A banner ad consists of an image and a relatively short amount of text that prompt those with an interest to click the ad to navigate to a landing page. In this case, the landing page would contain the investment summary, which asks the prospective investor to fill out the information request form described above. Banner ads are usually placed through direct contact with a site owner. Pricing may be periodic, regardless of the number of clicks obtained, or on a pay-per-click basis. **BLOG POST**

Special interest blogs that accept user posts can provide target-rich environments. Use a modified version of the investment summary that directs the reader to a web address where the full version and the information request form appears. **ONLINE BROKER–DEALER**

When the rule changes were announced, the SEC anticipated that websites would develop services that, for a fee, matched interested investors with companies offering investment opportunities. To understand how these sites would function, we can look to equity model crowd funding websites like CircleUp.com. At the time your offering is made, you should research which sites are licensed and operating, and the likelihood that their use will result in success. **GOOGLE ADWORDS**

Google AdWords is a pay-per-click service provided by Google. You apply to Google for an advertisement campaign that will post your ad at the head of a search using select keywords. You develop your selected keywords by analyzing Google-supplied lists of searches per month for given terms and bidding campaigns to maximize click-through per dollar of charges. Google provides free support to design your campaign, and provides extensive diagnostics through Google Analytics. Again, a click on the ad would bring prospective investors directly to the investment summary page and information request form prompt. **SOCIAL MEDIA**

You can use your LinkedIn, Instagram, and Facebook accounts to let your followers know there is an opportunity to invest in your company, provided they qualify as accredited investors. Facebook provides the option to sponsor posts at a small cost so the post appears prominently on the timelines of your followers for an extended period of time. There is also software available to help you identify accounts that should be exposed to your message. **ANGEL INVESTOR NETWORKS**

Various organizations have formed groups or loose associations of angel investors that, to some extent, invest together in private placements of securities. Be mindful of any industry limitations, geographical limitations, and investment themes of the particular groups.

Appendix A SUMMARY OF REQUIREMENTS FOR RULE 506(C) OFFERING ACCREDITED

INVESTORS ONLY. All of the investors must be Accredited Investors.

- Natural persons who are Accredited Investors are:
  - Persons that had individual income of $200,000 in each of the two most recent years, or $300,000 of joint income with that person's spouse in each of the two most recent years, and a reasonable expectation of reaching that same income level in the most recent year (the "Income Test"); or
  - Persons with individual net worth, or joint net worth together with the person's spouse, in excess of $1 million, not including the investor's primary residence or mortgage indebtedness on the residence up to the value of the residence ("Net Worth Test");
  - Certain entities delineated in Regulation D.

REASONABLE STEPS TO VERIFY. You must not only achieve the result that all of the accepted subscribers in your offering are Accredited Investors, but you must also document how you took reasonable steps to determine all investors were Accredited Investors and retain the documentation following the offering. What steps are reasonable depend on the facts and circumstances and you will need to decide with your counsel what steps should be taken in your case. For example, the use of a website that is available to the general public may require more verification effort than the dissemination to a database of pre-screened Accredited Investors. With respect to natural persons the following are certain measures you should consider and should discuss with your counsel:

- Obtaining W-2s, 1040s and K1s showing whether the investor meets Income Test; or
- Obtaining certification from the reputable accountant or broker-dealer of the investor that shows whether they meet the Income Test or the Net Worth Test.

In cases where entities wish to invest, verification will vary based on the nature of the entity. Companies are responsible to comply with privacy laws in holding and maintaining this information. If you want to use a third party to verify any information, you will need to take steps to make sure they are set up to handle confidential and private information and enter into an appropriate agreement before you supply them the private information. NO INTEGRATION WITH OFFERINGS THAT HAVE NON-ACCREDITED INVESTORS. Generally offerings completed more than six months prior to the first sale in the Rule 506(c) offering or more than six months after the last sale in the Rule 506(c) offering that included one or more non-accredited investors will not taint the 506(c) offering. Also, sales to offshore investors in compliance with Regulation S will not taint the Rule 506(c) offering even if those offshore investors are not Accredited Investors. INFORMATION REQUIREMENTS. You cannot violate the anti-fraud rules by making misstatements or omissions. You will generally want to address the major items that would be included in a prospectus with the exception that your company financial statements need not be audited. You need to keep your website, social media and other communications consistent with your offering materials. Consider

limiting your spokespersons or administrators on all of these other outlets to persons who are also completely familiar with your offering materials and who understand disclosure requirements. LIMITATIONS ON RESALE. The certificates for the securities issued in the offering must be legended and the communications to investors and subscription documents must state that the securities purchased in the Rule 506(c) offering may not be resold without compliance with some applicable exemption. NOTICE FILING WITH SEC. The SEC has proposed requiring a filing on Form D with information about the offering, and submission of all written materials used in the offering, 15 days prior to the first general solicitation and then at specified intervals thereafter. Failure to comply carries a penalty of no further 506 offering activity for 12 months. STATE FILINGS. Various states have a requirement that a notice be filed and a fee paid prior to making offers to residents of that state. So either the offering will by its terms exclude residents of certain states, or the filings and payment of the fees will need to be timely made in those states. You should get a survey of the state requirements as to cost and timing of these filings before making your first general solicitation. REGISTRATION AS A BROKER-DEALER. If any of your team, or a third party, is paid commission or compensation for the sale of securities, they must be registered as a Broker-Dealer. State laws vary on what activities require “issuer dealer” registration and must also be surveyed and considered with your counsel. NO BAD ACTORS. If any of your officers, directors, 20% or more shareholders, placement agents, or brokers for the offering or certain others associated with your offerings have certain criminal convictions, injunctive orders, disciplinary orders, cease and desist orders, suspensions, bar orders, or stop orders, as set forth in the rules, you are not eligible to do a Rule 506(c) offering. You must take reasonable steps (and document them) to make sure there are no “bad actors” associated with your company or the offering. ALREADY PUBLIC COMPANIES. If your company is already public and makes a 506(c) offering, you have more to consider than a private company would making a Rule 506(c) offering. You should address this with your counsel. STRICT COMPLIANCE. Persons relying on Regulation D exemptions other than Rule 506(c) may have fallback exemptions under Section 4(2) or otherwise that will not be available with respect to an offering involving general solicitation. Therefore it is very important that you make sure strict adherence and compliance with the satisfaction of every requirement occurs.

Related Practices

Business Transactions

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