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HALOS Bill Seeks to Remove Uncertainty That May Burden Investor Forums and Similar Events

Last week, U.S. Senator Christopher Murphy (D-Conn.) was joined by a bipartisan group of Senators and Congressmen that introduced legislation seeking to clarify the ability of entrepreneurs to pitch their businesses at investor forums and similar events without running afoul of regulations that restrict general solicitation.

Pursuant to the Jumpstart Our Business Startups Act or "JOBS Act," the Securities and Exchange Commission amended its rules in 2013 to allow the use of general solicitation in soliciting investors in certain private placements. If a company uses general solicitation in seeking investment by accredited investors, the new rules require the company to take reasonable steps to verify that each investor making an investment is an "accredited investor." The verification process would generally require individual or "angel" investors to disclose to the company, either directly or through certain permitted third parties, personal financial information regarding the investor's income or assets. The Helping Angels Lead Our Startups Act or "HALOS Act" would require the SEC to amend its rules to clarify that communications made at investor forums and similar events would generally not constitute general solicitation.

BACKGROUND

The vast majority of private placements by startup companies are completed in reliance on Rule 506 ("Rule 506") of Regulation D of the Securities Act of 1933.

According to the SEC, over \$173 billion was raised in Rule 506 offerings during 2012. Rule 506 was originally adopted by the SEC as a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act, which exempts transactions by a company not involving any public offering from the registration requirements of Section 5 of the Securities Act. Prior to the effectiveness of new rules mandated by the JOBS Act in 2013, companies could not offer or sell securities in a Rule 506 offering through any form of general solicitation. Under the new rules, a company may utilize general solicitation in a Rule 506 offering if the company takes reasonable steps to verify that investors purchasing securities are accredited investors.

The new rules include a non-exclusive list of methods that a company may use to verify the accredited investor status of individuals, provided that the company does not have knowledge that the individual is not an accredited investor. These methods include the following:

- in regard to whether the individual is an accredited investor on the basis of income, reviewing any Internal Revenue Service form that reports the individual's income for the two most recent years and obtaining a written representation from the individual that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year;

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- in regard to whether the individual is an accredited investor on the basis of net worth, reviewing one or more of the following types of documentation with respect to the individual's assets and liabilities dated within the prior three months and obtaining a written representation from the individual that all liabilities necessary to make a determination of net worth have been disclosed:
 - with respect to assets: bank statements; brokerage statements and other statements of securities holdings; certificates of deposit; tax assessments; and appraisal reports issued by independent third parties; and
 - with respect to liabilities: a consumer report from at least one of the nationwide consumer reporting agencies;
- obtaining a written confirmation from one of the following persons or entities that the person or entity has taken reasonable steps to verify that the individual is an accredited investor within the prior three months and has determined that the individual is an accredited investor:
 - a registered broker-dealer;
 - an investment adviser registered with the SEC;
 - a licensed attorney who is in good standing under the laws of the jurisdictions in which he or she is admitted to practice law; or
 - a certified public accountant who is duly registered and in good standing under the laws of the place of his or her residence or principal office; or
- in regard to any individual who purchased securities in a company's Rule 506 offering prior to September 23, 2013 (the effective date of the new rules) and continues to hold those securities, that company obtaining a certification by that individual at the time of sale of new securities by that company that he or she qualifies as an accredited investor.

The use by startup companies of investor forums and similar events in pitching their businesses has become an increasingly important tool over many years, particularly due to the expanding role of angel investors and the desire by trade associations, universities and others to help facilitate capital formation. SEC guidance as to whether, and to what extent, business pitches at investor forums constitute general solicitation has been limited and inconsistent. This, coupled with the lack of any clarifying guidance regarding investor forums in adopting its most recent new rules required by the JOBS Act, has caused significant uncertainty as to the status of investor forums. In addition, potential further complications are posed by the currently proposed SEC rules that would enhance certain filing requirements for Rule 506 offerings made through the use of general solicitation. For more information regarding these proposed rules, see our alert titled "SEC Adopts Final Rules Allowing General Solicitation In Private Placements But Takes Other Significant Actions That May Impact Fundraising" dated July 17, 2013.

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THE HALOS ACT

The HALOS Act would require the SEC to amend its rules so that the prohibition against general solicitation would not apply to a presentation or other communication made by or on behalf of a company which is made at an event:

- sponsored by:
 - the United States or any territory thereof, by the District of Columbia, by any State, by a political subdivision of any State or territory, or by any agency or public instrumentality of any of the foregoing;
 - a college, university or other institution of higher education;
 - a nonprofit organization;
 - an angel investor group;
 - a venture forum, venture capital association or trade association; or
 - any other group, person or entity as the SEC may determine by rule;
- where any advertising for the event does not reference any specific offering of securities by the company;
- the sponsor of which:
 - does not make investment recommendations or provide investment advice to event attendees;
 - does not engage in an active role in any investment negotiations between

the company and investors attending the event; and

- does not charge event attendees any fees other than administrative fees; and
- where no specific information regarding an offering of securities by the company is communicated or distributed by or on behalf of the company, other than:
 - that the company is in the process of offering securities or planning to offer securities;
 - the type and amount of securities being offered;
 - the amount of securities being offered that have already been subscribed for; and
 - the intended use of proceeds of the offering.

The extent to which the above pending legislation will become law is unknown, and amendments made by Congress before enactment and clarification through rule making by the SEC afterward may result in significant changes to the provisions described above. We will continue to monitor the progress of this legislation. Please do not hesitate to contact us with any questions.

Wiggin and Dana attorneys William Kilgallen and Frank Marco worked with the Angel Capital Association and Senator Murphy's office in providing assistance on the drafting of the bill.

This publication is a summary of legal principles. Nothing in this article constitutes legal advice, which can only be obtained as a result of a personal consultation with an attorney. The information published here is believed accurate at the time of publication, but is subject to change and does not purport to be a complete statement of all relevant issues.