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***Private Placement or Public Offering?***

***"General Solicitation” Turns a Private Offering into an Unregistered Public Offering!***

An “Offering” occurs any time a company (an “Issuer”) sells its own equity interest (stock, LLC interest, or LP interest), in exchange for cash, services, property, or for the equity interest in another company. An Offering can be public or private.

**Public Offering vs Private Offering - Distinction**

Public Offerings must be registered with the SEC and the states, while Private Offerings don’t need to be registered. (Though notice filings are required for Private Offerings). Public Offerings must use a full-blown public prospectus as the disclosure book, which must be filed with, and cleared by, the SEC and the states before use. Private Offerings must generally use a “Private Offering Memo” as the disclosure book, which is not required to be filed with, or cleared by, the SEC or states.

Private Offerings require an exemption notice filing with the SEC and the states, and the preparation and distribution of a disclosure document (Private Offering Memo). They also must comply with all of the conditions of the exemption (including dollar limits, investor number limits, investors’ income or net worth requirements, limits on the manner of solicitation, including the prohibition on public solicitation.)

**Differences in Contacting Investors in Private vs. Public Offering**:

***A Private Offering*** is one made to people who:

* Are your friends, family and business colleagues,
* With whom you have a pre-existing relationship,
* With your company (the issuer) has a pre-existing relationship,
* With whom your other officers or directors have a pre-existing relationship,
* Whom you already knew before the issuer’s offering them an investment in the company, or in advance of discussing the investment with them,
* To whom you have been privately introduced by a close contact such as a professional service provider like an accountant, lawyer, friend, close business colleague, or perhaps on a very limited basis, through a private introduction from one of your other investors,
* To whom you have been introduced by a registered broker-dealer, who have a pre-existing relationship with a registered broker, or
* Are professional venture capital investors, or professional institutional investors who, as their business invest in securities of other issuers.

The following contacts ***do not qualify as proper private placement contacts***, and could be deemed an unregistered public offering:

* Offers and sales made people to whom you have been introduced by a money finder, unregistered broker, financial consultant, investment banker, if those introducing people are not registered as a broker-dealer,
* Offers and sales from a “list of accredited investors” (purchased list, or confirmed list, or website list, all not permitted if you don’t know them in advance.)
* Offers made as a result of an email blast to a list of people you don’t know, or a list from someone else’s address book, or
* Contacts made through an “invest here” button on your own, or someone else’s, website.

***A Public Offering*** is one made:

* To people you don’t know by way of cold calling, or
* To your entire customer list, or
* By mass email, or otherwise on the Internet, to people you may or may not know, or
* On your website or someone else’s, or
* In a magazine, newspaper or newsletter, or
* By way of a press release,
* To all the X People in Y Group, even though you are a member of Y group or know someone from it: Each of the following would be, or has been deemed to be, an illegal public offering: “All the Doctors in [city] in North Carolina”, or “all the realtors in Chicago”, “all the radiologists in townX”, to “all the partners in a large law firm”, “all the Executives in a trade association”, “all the attendees of a conference”.
* By one of the above done by someone acting on your behalf, such as a finder or a broker or a business broker.

In order to comply with the strict letter of the law, you must get to know the person in advance of offering them an investment in your company. Your relationship should be of “sufficient length and duration in order that the Issuer can determine the financial sophistication of the investor and suitability of the investment”.

There is a gray area between public and private offerings: If you offer to people you don’t know, but who are introduced to you by someone you do know, that’s probably fine, if it is a limited, calculated, private introduction. However, someone you know giving you their entire rolodex, would not be acceptable.

If the person you know who introduces you to someone they know, who introduces you to someone that they know, it’s probably too far removed.

**Regulation D Prohibition on Public Solicitation**

Under the federal securities laws (Regulation D, Rule 502(c)(1) and (2)) it is a violation of the private placement exemption under Reg D Rule 506, to obtain an investor through a seminar invitation or newspaper ad. (Most states’ securities laws are consistent with the federal rules.)

The SEC has followed that prohibition through to internet solicitations, emails and website solicitations, as well.

**For a Private Offering, avoid public solicitation as follows:**

* **No general solicitation** permitted: No mass mailings, No cold calls to people you don’t know, no newspaper ads, no **planted news** articles where you initiate the news story (if the reporter calls you, let’s discuss parameters of what you can say). If a 3rd party publishes information about investments in general and names in issuer, the 3rd party publication must be a broadly based, unselective summary of many offerings by many issuers (and example would be MAR Hedge – but a No Action as not been sought for MAR Hedge), and see also the Richard Daniels No Action-Letter (1984)
* **No Internet solicitation** permitted, unless you already know the investor.
* **No website access** to investors, unless they are your pre-existing investors in this offering, or in another offering related to this issuer, or they already have the requisite pre-existing relationship.
* **“Pre-existing relationship”** **is one method of avoiding public solicitation:** Pre-existing relationship with any Private Offering investors.
  + The relationship must be “pre-existing” and “substantive”, and of **“sufficient length and duration”** that you know them well enough that you can evaluate their financial position and suitability for investment.
  + First discussion you have with the person cannot be out this offering. See, “Ovation Cosmetics, Inc.”, SEC No-Action Letter (February 6, 1976) Relationship must be in place before the terms of this offering are created and before the offering starts.
  + “Substantive” means that the relationship has previously involved a discussion of the investor’s financial goals and objectives.
  + Rule of thumb in the broker-dealer world is a 6 month relationship.
  + For issuers doing their own offerings, can be less than 6 months, but still must satisfy the relationship test.
  + Document the substantive relationship between issuer and investor. See Woodtrails-Seattle, Ltd. SEC No-Action Letter (August 9, 1982)
  + Ask yourself: Do I know this person? How well?
* **Pre-existing relationship with a person who has a close relationship with Issuer**: In some cases, the pre-existing relationship can be with someone you know and trust, who is not getting paid a fee for the introduction. (Let’s discuss if you have this situation, as you lose control over disclosure and management of information flow, if it’s not one of your own officers)
* **An unsolicited investor** contacts the issuer with interest in that security, without having learned of the issuer through public solicitation. This is a more risky type of investment to take, as the Issuer is basing a legal conclusion on the investor stating how he has not been made aware of the Issuer.
* **A paid broker-dealer** (registered) who has a pre-existing relationship with the investor, or a paid money finder (if the finder is registered with the SEC and states to be permitted to solicit investors.) who has a pre-existing relationship with the investor. Make sure that the broker-dealer or registered finder does not violate the prohibition on general solicitation. They must go only to those with whom they have pre-existing relationship.

**SEC No Action Letters on General Solicitation:**

* Lamp Technologies (5/97 and 5/98), IPO.Net (7/96) and ACE.Net, No Action Letters; Internet Solicitations allowed to a **password-protected list of pre-qualified accredited investor subscribers** to listing service. ***SEC announced at the ABA Meeting in July, 2000 in New York, that IPO.Net and Lamp ONLY apply to issuers or hedge fund operators who are registered broker-dealer firms, or who have a subsidiary registered broker- dealer firm, and that those No Action Letters do not apply to issuers who are not affiliated with a registered broker-dealer firm. ACE.Net only applies to Rule 504 offerings of <$1,000,000.***
* Mobile Biopsy, LLC No Action Letter (8/99): SEC **prohibits** issuer solicitation to list of persons that it thinks **might be accredited** (“all doctors in North Carolina”), and after indication of interest, requiring certification of accredited status after solicitation.
* Wilmer Cutler No Action Letter (10/98) No Action: Offshore funds performing “Ten Commandments” in the US, will not be deemed to be engaged in a public offering.
* The SEC has refused to grant No Action to requests for solicitations to “affinity groups”, such as professional affiliation, member of industry group, group of hobbyists, residence in same area or even same building.
* See “General Solicitation Remains A Murky Inconsistency”, September 2005 http://www.bowne.com/securitiesconnect/details.asp?storyID=1174