

**A FRIENDLY REMINDER TO SPONSORS:
DON'T BE FOOLED INTO USING SOCIAL MEDIA TO PROMOTE YOUR
REGULATION D PRIVATE PLACEMENTS**

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The business world is abuzz with social media networking and the many ways it can be leveraged to promote business growth. Real estate sponsors, promoters, and other issuers that conduct securities offerings in reliance on a Regulation D exemption (typically Rule 506) should remember not to get so caught up in the frenzy that they forget one of the hallmark restrictions of raising capital in a Regulation D private placement—the Rule 502(c) prohibition against general solicitation and advertising. Set forth below is a basic overview of Rule 502(c) and its application in the emerging online world of social media.

1. *What does Rule 502(c) prohibit?* Rule 502(c) provides, in relevant part, that neither an issuer nor any person acting on its behalf may offer or sell securities under Regulation D using any form of general solicitation or general advertising, including an advertisement, article, notice or other communication published in any newsletter, magazine, or similar media or broadcast over television or radio. While Regulation D was adopted over a decade before the Internet began to blossom, it is generally accepted that the Rule 502(c) prohibition encompasses e-mails, web sites, social media networks, and other forms of online communication.

2. *Does this prohibition apply to all forms of marketing and advertising?* No, the prohibition does not apply to all solicitations and advertising outright, but rather applies only to general communications used in connection with an offer or sale of securities. In applying Rule 502(c) to a particular communication, there are two questions: (i) is the communication general (i.e., to a widespread and anonymous audience), and (ii) does it constitute an offer or sale of a security? The first element is easier to analyze. In the context of social networking sites such as Twitter, LinkedIn, Facebook, MySpace, and others, a post on one of these sites is likely going to be deemed a general solicitation or advertisement since these sites, generally speaking, provide unrestricted access to the entire world.

Whether a communication might be deemed an offer or sale of a security can be a much trickier issue. Don't bother looking for a precise definition of "general solicitation or general advertising" because those terms are not specifically defined anywhere in the Securities Act of 1933 or any other federal securities statute, rule, or regulation. The best available guidance in this gray area of the law stems from a series of SEC no-action letters issued throughout the 1980s, and even those do not always reach consistent conclusions. In a nutshell, if a communication appears on its face to be intended to entice an investor to invest in a sponsor's offering, then that communication is at risk of being deemed an offer to sell a security. Further, even a generic advertisement not referencing a particular offering (e.g., a "tombstone" advertisement for a recently closed offering) could be found to violate Rule 502(c) if a primary purpose of the advertisement is to condition the market for future private offerings by the sponsor or its affiliates.

Here is a redacted version of an actual “tweet” that arguably violates Rule 502(c):

... letting people know that we are raising a new round of funding, up to \$500K, contact me if you’re interested.

3. *How do I fix a Rule 502(c) violation?* Unfortunately, short of reversing the polarity of the Earth like Superman did to save Lois Lane, there is no way to definitively cure this type of violation. Once the rule has been violated, the Regulation D exemption is blown, and once the Regulation D exemption is gone, so too are the offering’s NSMIA exemptions at the state level. A sponsor who discovers a Rule 502(c) violation can pursue several strategies to control risk and mitigate damage (e.g., making rescission offers, obtaining contractual representations from investors that they were not solicited to invest by any general solicitation or advertisement, demonstrating a pre-existing, substantive relationship with investors), but the sponsor shall nonetheless remain materially exposed to potential liability for having sold unregistered securities without a valid exemption.

4. *Accept the reality there is a lot of noncompliance in the marketplace.* A common plea from sponsors is that “everyone else seems to be doing this, so why can’t we?” There is no question that ten minutes of Internet research can yield dozens of examples of prohibited general solicitations and advertisements, but that is no excuse to compromise one’s commitment to securities compliance and jeopardize the ability to rely on the Regulation D exemption for your capital-raising efforts.