Client Alert

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Private Offerings: Questions that Might Frequently be Asked Sometime Soon

Although the SEC's final rule relaxing the ban on general solicitation in certain Rule 506 offerings and Rule 144A offerings was highly anticipated, the final rule leaves open or raises a number of interesting questions.

Below, we provide our perspective on a number of these based on the final rule:

Rule 506 Offerings

Can an issuer conduct a contemporaneous Rule 506(b) offering and Rule 506(c) offering?

Generally, no. If the issuer offers the same security, it would not be possible to prevent the general solicitation used in connection with Rule 506(c) from tainting the contemporaneous Rule 506(b) offering. However, it may be possible to conceive of contemporaneous offerings if the issuer offered different securities, such as a non-convertible preferred stock in one offering and common stock in the other offering, and if the investors in the two offerings were different—for example, preferred stock being offered to an existing venture or private equity investor (or other investors with which the issuer has a pre-existing substantive relationship), while common stock is being offered to a broader range of investors in a separate offering using general solicitation. Rule 502(a) of Regulation D sets forth the traditional "five factor" test that issuers should consider in determining whether offers and sales should be integrated for the purposes of the exemptions under Regulation D.

Can an issuer conduct a Rule 506(c) offering followed by a Rule 506(b) offering?

Yes, once a Rule 506(c) offering has been completed, the issuer can conduct a Rule 506(b) offering. As always, with offerings taking place in close proximity to one another, it will be important to undertake an integration analysis. Given that the Rule 506(c) offering involved general solicitation, it will be prudent to let some period of time elapse between the two offerings. Of course, a Rule 506(c) offering can follow a completed Rule 506(b) offering. Rule 502(a) of Regulation D provides a safe harbor from integration of Regulation D offerings made six months before or six months after an offering.

Can an issuer conducting a Rule 506(c) offering use a press release that does not comply with Rule 135c?

Yes, since general solicitation and general advertising may be used in a Rule 506(c) offering, the press release announcing the offering need not comply with the restrictions of Rule 135c.

Can an issuer begin an offering as a Rule 506(b) offering and modify the offering, making it a Rule 506(c) offering?

Presumably, an issuer could begin a private offering as a Rule 506(b) offering, and change course and rely on Rule 506(c). On the other hand, an issuer would likely not be able to switch course from a Rule 506(c) offering to a Rule 506(b) offering given the presence of general solicitation or general advertising in connection with the Rule 506(c) offering.

Can an issuer rely on the Section 4(a)(2) exemption in connection with a Rule 506 offering?

An issuer can rely on the Section 4(a)(2) exemption in conjunction with or as an alternative to a Rule 506(b)-exempt offering, because the Rule 506(b) offering involves no general solicitation. However, an issuer cannot rely on the Section 4(a)(2) exemption in connection with a Rule 506(c)-exempt offering, given that general solicitation has been used, and general solicitation of investors would not be consistent with an offering exempt based on Section 4(a)(2) because it is a transaction "by an issuer not involving any public offering Nothing in Title II of the JOBS Act or the SEC's rulemaking under Title II changed the analysis as to whether a transaction does not involve a "public offering" under Section 4(a)(2).

In connection with a "traditional" or Rule 506(b) offering, would the issuer be required to undertake investor verification steps beyond those customarily used?

No, where general solicitation is not used, an issuer can rely on traditional means of confirming that investors are accredited investors.

In the context of a Rule 506(c) offering, if an issuer relies on a third-party verification service, is the issuer still responsible for verification?

The issuer must establish a reasonable belief that the investors in the offering are accredited investors. As a result, the issuer must conduct diligence on the third-party service, and seek to understand the process that will be used by the third-party verification service for verification of accredited investor status.

Rule 144A Offerings

Does the use of general solicitation in connection with a traditional Rule 144A offering affect the issuer's sale to the initial purchaser?

No, the SEC has clarified that even where general solicitation is used in connection with resales under Rule 144A, the private sale made by the issuer to the initial purchaser in reliance on the Section 4(a)(2) exemption is not affected.

Must an issuer conducting a Rule 144A offering comply with Rule 135c in connection with press releases?

No, since general solicitation is permissible, an issuer need not comply with the Rule 135c requirements.

Can general solicitation be used in connection with a Rule 144A/Regulation S offering?

Yes, the SEC's adopting release notes that a Regulation S offering will not be integrated with a Rule 506(c) or Rule 144A offering. The use of general solicitation will not constitute "directed selling efforts" in respect of the Regulation S offering.

Does the SEC set out a verification process to ascertain QIB status?

No.

Secondary Transfers

Can general solicitation be used in connection with resales made in reliance on Rule 4(a)(1-1/2)?

Given that this exemption relies on the interplay of the Section 4(a)(1) and the Section 4(a)(2) exemptions and that the JOBS Act did not amend Section 4(a)(2), general solicitation should not be used in connection with resales made in reliance on Rule 4(a)(1-1/2).

Do the changes to Rule 506 affect exemptions available for resales of restricted securities?

No. The changes to Rule 506(c) would not affect resales, because Rule 506 is available only to issuers.

Offerings in Close Proximity

Can an issuer conduct a Rule 506(c) offering in close proximity to its initial public offering?

Issuers and their counsel always have been concerned with "gun jumping" prior to the filing of an IPO registration statement. A private placement made pursuant to Section 4(a)(2)/Rule 506(b) shortly before the filing of an IPO should be considered closely; however, given that such an offering does not involve general solicitation, the risk that the offering would be viewed as "gun jumping" is low. However, an issuer conducting a Rule 506(c) offering in close proximity to the filing of an IPO might be more problematic, given that the general solicitation (especially if the Rule 506(c) offering involves the sale of the same security as that offered in the IPO) may be viewed as "gun jumping." In the case of emerging growth companies, the JOBS Act specifically permits test-the-waters communications with institutional accredited investors and QIBs prior to or after the filing of a registration statement; however, general solicitation used in a Rule 506(c) offering may also raise concerns for any test-the-waters discussions.

Can an issuer complete a private offering while it is pursuing an IPO?

Yes, through guidance in SEC Release No. 33-8828 (August 3, 2007), no-action letters and C&DIs, the SEC and its Staff has clarified that an issuer that is conducting a public offering may conduct a concurrent private placement provided that, among other things, the issuer has not solicited the offerees in the private placement using the registration statement. Presumably, this analysis is made simpler now that general solicitation may be used in connection with a Rule 506(c) offering. Of course, the longstanding principle still applies that an offering that commences as a private offering must be completed as a private offering, and an offering that commences as a public offering must be completed as a public offering, except in those circumstances specified in Rule 155 (see note 122 in SEC Release No. 33-8828).

Can an issuer use Rule 506(c) in connection with a PIPE transaction?

From time to time, a reporting company may decide to conduct a private placement, or PIPE transaction. An issuer that conducts a PIPE transaction generally relies on the Section 4(a)(2) exemption and the Rule 506 safe harbor. One of the principal advantages associated with a PIPE transaction is that the issuer will not be required to announce the transaction until definitive agreements have been executed. This prevents any investor from "front-running" in anticipation of the offering. The placement agent will have approached potential investors confidentially about the PIPE transaction. An already public company will likely be reluctant to use general solicitation in connection with a PIPE transaction, because announcing the potential private offering may have an

effect on its stock price. Also, once an announcement is made, an issuer may be more reluctant to terminate a deal if the pricing is not favorable. Therefore, it is unlikely that Rule 506(c) will be used.

In a PIPE transaction, the issuer will disseminate a press release announcing the execution of definitive agreements (prior to the filing of a resale registration statement). This press release complies with Rule 135c and does not name the placement agent. If the press release strictly complies with Rule 135c, the issuer can be certain that it will not have conducted a general solicitation and prior to the filing of the resale registration statement can "re-open" the PIPE transaction and sell additional securities in a private placement. Now, perhaps, an issuer and its counsel may be more comfortable with a press release that does not comply with 135c, given that additional interest in the PIPE transaction that results from the filing of the press release would not restrict the issuer from completing an additional private offering in reliance on Rule 506(c).

From time to time, selling stockholders may transfer their securities in a private offering structured as a PIPE transaction. Since this transaction cannot be completed in reliance on Rule 506(c), general solicitation cannot be used.

How would Rule 152 apply to a private offering completed prior to the filing of a registration statement?

Rule 152 clarifies that a completed private offering will not be integrated with a subsequent public offering. Generally, issuers that conduct a PIPE transaction, or private offering wherein resale registration rights are offered to the private investors, rely on Rule 152 in connection with the filing of a resale registration statement. When Rule 152 was adopted, the private offering would not have involved a general solicitation. Should the analysis change for Rule 506(c) offerings, where general solicitation is used? It is unclear whether Rule 152 would be available in connection with an offering in which general solicitation is permitted.

Conclusion

There are many more scenarios that one can envision will arise in connection with private and public offerings, especially as the lines between private and public continue to blur following the relaxation of the ban on general solicitation. We will update or supplement these questions on our Jumpstarter blog from time to time.

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Authors

Anna T. Pinedo
New York
(212) 468-8179
apinedo@mofo.com

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