


Distribution of Capital Market and Investment Management Products

Presentation to Practising Law Institute  
John C. Cocchiarella  
February 2010



---

---

---

---

---

---


---

---

Private Offerings

- ◆ General rule -- registration required under Section 5 unless exemption available. More to come.
- ◆ Statutory exemptions:
  - Most common are:
    - Section 4(1) – “Transactions by any person other than an issuer, underwriter, or dealer.”
    - Section 4(2) – “Transactions by an issuer not involving any public offering”
      - “public offering” not defined
    - Section 4(3) – “Transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction)” (subject to certain exceptions).

2



---

---

---

---

---

---


---

---

Private Offerings (continued)

- ◆ Section 4(2) - “private offering” or “private placement” exemption
  - Self-executing
  - SEC rules provide more certainty:
    - Regulation D - general purpose set of rules governing private placements by companies
    - Rules 506 and proposed 507 are most relevant

3



---

---

---

---

---

---

---

---

Private Offerings (continued)

- Factors:
  - Limited number of offerees and purchasers
  - Offerees sophisticated and able to bear risk
  - Character of security offered – nature and size
  - Access to issuer information
  - "Integration" with other offerings
    - May result in offering being deemed "public"
  - No general solicitation or advertising
  - "Investment" or "non-distribution" intent



Private Offerings (continued)

- ◆ Regulation D
  - Provides a non-exclusive safe-harbor under Section 5
  - Available only to issuers
  - Four exemptions:
    - Rules 504 and 505: exemptions for certain small offerings under Section 3(b) of the Securities Act
    - Rules 506: safe harbor under Section 4(2) with no limit on the amount of the offering



Private Offerings (continued)

- Rule 506 – issuer may sell unlimited amount of its securities to an unlimited number of "accredited investors" and 35 nonaccredited investors
- "Accredited investor" – broad definition, includes a variety of institutional investors, certain corporations/trusts/partnerships with total assets in excess of \$5,000,000, and natural persons meeting certain financial tests



Private Offerings (continued)

- ◆ Proposed Rule 507 – issuer would be permitted to sell unlimited amount of its securities to an unlimited amount of "large accredited investors"
- ◆ "Large accredited investor" – similar to "accredited investor" definition but with higher threshold amounts. Includes a variety of institutional investors, certain corporations/trusts/partnerships with *investments* in excess of \$10 million, and natural persons meeting certain financial tests.
  - Hedge funds and other investors relying on Section 3(c)(1) or 3(c)(7) for their Investment Company Act exemption could not rely on the Rule
- ◆ Limited publicity regarding the offering would be permitted, compared with ban on "general solicitation" under Rule 506

7




---

---

---

---

---

---

---

---

Private Offerings (continued)

- ◆ Rule 144A
  - No "general solicitation"
    - Press releases under Rule 135c for reporting issuers (tension with Exchange Act)
    - Offshore press activities under Rule 135e
    - Research blackouts, Rule 139
  - Qualified Institutional Buyers ("QIBs")
    - Generally (i) an institution (insurance company, pension fund, employee benefit plan, corporation, etc.) that owns and invests on a discretionary basis at least \$100 million in securities of issuers that are not affiliated with the QIB, or (ii) an entity all the equity owners of which are QIBs.

8




---

---

---

---

---

---

---

---

Private Offerings (continued)

- QIBs must be institutions, and cannot be individuals, or pools of individuals, no matter how wealthy or sophisticated.
- Slightly different criteria for broker-dealers, banks and thrifts and investment companies.
- "Reasonable belief" standard for broker-dealers. Can rely on third party lists.
- Fungibility issue
  - Rule 144A available for both debt and equity. However, it is not available for transactions in securities of same class as securities listed on an exchange or quoted on NASDAQ.
  - Convertible bonds must have conversion premium of at least 10%.
- "Notice to investors" requirement that seller is relying on Rule 144A

9




---

---

---

---

---

---

---

---

Private Offerings (continued)

- Information furnishing requirement under Rule 144A(d)(4). Satisfied if:
  - Reporting company;
  - Rule 12g3-2(b) exempt; or
  - Security holder has right to obtain on request certain designated information from the issuer.
    - More limited than information reporting issuers must provide: "very brief" and "reasonably current" description of business, products and services, most recent balance sheet, P&L, retained earnings, and similar financial information for two preceding fiscal years.
- Integration/relationship with registered offerings
  - "Black Box": offers and sales in private are made only to QIBs and to no more than two or three "large institutions" that, while not QIBs, are accredited investors under Rule 501.
  - Rule 155 regarding integration of abandoned offerings.



10

---

---

---

---

---

---

---

---

Private Offerings (continued)

- Relationship with Section 4(2)
  - Initial sale to "initial purchaser" is a Section 4(2) private placement.
  - Rule 144A(e) provides that offers and sales of securities pursuant to the rule shall be deemed not to affect the availability of any exemption or safe harbor relating to any previous or subsequent offer or sale of such securities by the issuer or any prior or subsequent holder thereof.
    - Implication is that neither issuer nor initial purchasers should be exposed to liability for subsequent non-complying resales so long as the purchases and sales fit within Section 4(2), Regulation D or Rule 144A, as applicable.



11

---

---

---

---

---

---

---

---

Private Offerings (continued)

- ◆ Growth of Alternative Settlement Systems
  - Platforms for trading in Rule 144A ("for life") securities
  - OPUS-5, GSTRUE, 144A Plus, BestMarkets
  - Platforms enable shareholder tracking to ensure that issuers do not trip Exchange Act numerical limits
  - The PORTAL Alliance, formed in November 2007 among NASDAQ and sponsors of the other platforms
    - intended to create a single, industry-wide platform for the private offering, trading, shareholder tracking and settlement of Rule 144A-for-life securities.



12

---

---

---

---

---

---

---

---

Private Offerings (continued)

- Rule 144
  - Rule permits under certain circumstances the public resale of securities that were privately placed by the issuer or an affiliate of the issuer, including securities purchased pursuant to Rule 144A, or securities owned by affiliates of an issuer without registration.
  - Amendments effective February 2008 liberalized the Rule considerably
  - Rule is available for resales as follows:
    - If restricted securities are held for at least six months prior to the sale, and the seller has not been an affiliate for at least 3 months, then only the Rule's public information requirement applies
    - If restricted securities are held for at least six months prior to the sale, and the seller is an affiliate, the securities may be sold, provided that
      - Affiliate equity securities are always subject to manner of sale and volume restrictions.
      - Affiliate fixed income securities not subject to manner of sale restrictions, but are subject to volume limitations. The volume limitations have been recently increased to 10% of a particular tranche in any three-month period.

13




---

---

---

---

---

---

---

---

Private Offerings (continued)

- Rule 144 (continued)
  - "Affiliate" status is facts and circumstances test. Factors include:
    - Percentage ownership (especially relative to other owners)
    - Board representation
  - Broker-dealers involved in Rule 144 trades will not be considered "underwriters" for liability purposes if rule is followed.

14




---

---

---

---

---

---

---

---

Private Offerings (continued)

- ◆ The Future of Registration Rights
  - A shorter holding period of only six months could theoretically have the effect of rendering Exxon Capital exchange offers largely irrelevant.
    - Reporting companies are commonly granted a period in excess of six months during which to effect the exchange offer.
  - In practice, little has changed.
  - Affiliates, including private equity buyers, and broker-dealers in "sticky offerings," will continue to need a registration statement in some certain circumstances.

15




---

---

---

---

---

---

---

---

Private Offerings (continued)

- ◆ Regulation S
  - Territorial approach
    - Rule 901 provides that Securities Act registration applies only to offers and sales of securities made in the US and not to offshore transactions.
  - Safe harbors
    - "Issuer" (and "distributor"/underwriter) safe harbor under Rule 903
    - Resale safe harbor under Rule 904
  - General conditions
    - Offshore transaction – An offer or sale is made in an "offshore transaction" if (i) the offer is not made to a person in the US; and either (A) at the time the buy order is originated, the buyer is outside the US or the seller reasonably believes that the buyer is outside the US or (B) the transaction is executed in, on or through a physical trading floor of an established foreign securities exchange.
    - Cannot target identifiable groups of US citizens living abroad (e.g., armed forces).

16




---

---

---

---

---

---

---

---

Private Offerings (continued)

- ◆ Regulation S (continued)
  - No "directed selling efforts" into the US. Prohibitions include:
    - No offering materials can be mailed to non-QIB investors in the US;
    - No promotional seminars in the US (other than roadshows to QIBs);
    - Advertising in US (though routine commercial advertising okay);
    - Research not in compliance with Rule 139 or other types of research directed at non-QIBs in the US.

17




---

---

---

---

---

---

---

---

Private Offerings (continued)

- Issuer safe harbor – Rule 903
  - Category 1
    - Securities of foreign issuers with no "substantial US market interest";
      - Rule has very prescriptive tests for equity and debt to determine whether there is a "substantial US market interest".
    - All securities of foreign issuers, and certain securities of domestic issuers, that are offered and sold in overseas directed offerings;
    - Securities backed by the full faith and credit of a foreign government; and
    - Securities of both foreign issuers and domestic issuers offered and sold to employees of the issuer and its affiliates pursuant to certain employee benefit plans established under foreign law.

18




---

---

---

---

---

---

---

---

Private Offerings (continued)

- Issuer safe harbor – Rule 903 (continued)
  - Category 2
    - All securities not eligible for Category 1 that are equity securities of a reporting foreign issuer, or debt securities of a reporting issuer or debt securities of a non-reporting foreign issuer with substantial US market interest.
  - Category 3
    - Everything else. In effect:
      - All securities of non-reporting domestic issuers;
      - Equity securities of non-reporting foreign private issuers with substantial US market interest; and
      - Equity securities of reporting domestic issuers.

19




---

---

---

---

---

---

---

---

Private Offerings (continued)

- Issuer safe harbor – Rule 903 (continued)
  - With each category, offering and transactional restrictions get cumulatively more stringent.
- So-called Section 4(1½) exemption
  - Prior to Rule 144A, practitioners adapted portions of Regulation D, the issuer safe harbor to Section 4(2), and other private placement procedures to create a set of procedures to permit limited resales of restricted securities. These might include:
    - Non-distribution letters from purchaser agreeing to resale restrictions with representations and warranties as to its sophistication and investment intent;
    - No registration opinions;
    - Legended securities;
    - Stop transfer instructions; and
    - Large denominations.
  - Concept is largely for secondary private offerings.

20




---

---

---

---

---

---

---

---

Private Offerings (continued)

- ◆ Other relevant considerations
  - Trading restrictions
    - Regulation M
      - Governs market activities of issuers, selling security holders, underwriters and other participants in securities offerings. Goal is prevention of market manipulation during securities "distributions".
      - "Distributions" (as distinguished from ordinary trading transactions), whether or not subject to registration, are subject to the regulation. Look at "magnitude" of offering and "special selling efforts". Look at:
        - Number and nature of road shows in US
        - Presence of substantial selling efforts outside the US
        - Number of QIBs or other offerees and investors in US
        - Size and proportion of offering being sold in US
        - Selling concessions

21




---

---

---

---

---

---

---

---

Private Offerings (continued)

- Regulation M (continued)
  - Rule 144A offerings exempt
  - Applicability when Institutional Accredited Investor involved, esp. when traded on home country market of foreign issuer
  - "Actively traded security" exemption
  - Investment grade non-convertible/asset-backed securities exempt
- NASD/FINRA Rules
  - Rule 144A transactions (and other private placements) are exempt from FINRA Rule 5110 (formerly NASD Rule 2710, the corporate financing rule).
  - Rule 144A transactions are exempt from the Papilsky Rules (regarding fixed-price offerings) and FINRA Rule 5130 (formerly Rule 2790 on "free-riding and withholding").
- Blue sky
  - "QIB" exemption in most states. However, need to be careful for Regulation D offerings.

22



---

---

---

---

---

---

---

---

Private Offerings (continued)

- Investment Company Act
  - Private offerings by foreign funds.
    - Section 7(d) – Jurisdiction over foreign investment companies
    - Section 3(c)(1) – 100 person exclusion
    - Section 3(c)(7) – "Qualified Purchaser" exclusion
- Trust Indenture Act
  - Registration rights
- Legal investment
  - Limitations, either contractually or by statute, on a QIB's ability to hold Rule 144A securities.

23



---

---

---

---

---

---

---

---

Clearance and Settlement Issues

- ◆ Traditional Euro-debt or equity offering without US tranche
  - Euroclear and Clearstream
- ◆ Global offerings contemplating US tranche
  - Single registered-form global security
  - Registered form and bearer global certificates
  - Two registered-form global securities
- ◆ DTC eligibility
  - For Rule 144A non-investment grade debt and preferred stock, common stock and convertible debt and preferred stock to be eligible, had to be PORTAL eligible until February 2009.

24



---

---

---

---

---

---

---

---

## Disclosure Considerations

- ◆ Offering memoranda in private deals
  - Can take many forms, depending on issuer and focus of marketing effort.
  - Especially when there are registration rights, closely follow SEC form requirements.
  - Guiding principle, especially if substantial Rule 144A tranche, is Securities Act notion of "materiality".
  - Risk factors
  - Projections
    - Rule 144A v. Section 4(2)
    - Accounting comfort considerations
    - Jurisdictional considerations:
      - Luxembourg Stock Exchange prohibition
      - London Stock Exchange encourages
      - Hong Kong Stock Exchange requires

25



---

---

---

---

---

---

---

---

## Public Offerings

- ◆ Registration under the Securities Act
  - General rule is absent an exemption, every offer of securities must be registered pursuant to Section 5 of the Securities Act.
  - IPO v. follow-on offering (either shelf or standalone)
  - Block trades
  - Forms include S-1, F-1, S-11, S-3, N-2, etc.
  - Pre-filing period, filing date, waiting period, effective date, post-effective period
  - SEC review process
  - FINRA review process
  - "Traditional" v. WKSJ shelf

26



---

---

---

---

---

---

---

---

## Public Offerings (continued)

- ◆ Securities Offering Reform
  - Went into effect December 1, 2005
  - Goal was to modernize the offering process in light of advances in technology and better Exchange Act reporting
  - Practice has evolved to treat unregistered offerings (e.g., 144A/Reg S offerings) in a similar way as registered offering
  - Confirmed that prospectus liability attaches at time of sale
  - The concept of the Free Writing Prospectus
    - What does "free writing prospectus" mean in the unregistered context?
  - Need to Convey Information at Time of Sale
    - Issues
      - Greater flexibility?
      - Need to deliver final offering documents at all

27



---

---

---

---

---

---

---

---