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# Impact of the Elimination of the Prohibition Against General Solicitation and General Advertising on Capital Markets Transactions

On July 10, 2013, the SEC adopted final rules under Section 201(a) of the Jumpstart Our Business Startups Act (the "JOBS Act") eliminating the prohibition against general solicitation and general advertising (referred to collectively below as "general solicitation") in private offerings made in reliance on Rule 144A and Rule 506 of Regulation D under the Securities Act of 1933, as amended (the "Securities Act"). The amendment to Rule 144A permits offers of securities to persons other than "qualified institutional buyers" ("QIBs"), as long as the securities are sold only to persons reasonably believed to be QIBs. The amendment to Rule 506 permits an issuer to engage in general solicitation or general advertising, provided that all purchasers are accredited investors and the issuer takes reasonable steps to verify that the purchasers are accredited investors.

The SEC also adopted final rules relating to the disqualification of "bad actors" from Rule 506 offerings and proposed certain amendments to Regulation D, Form D and Rule 156 under the Securities Act.

We focus below on the practical impact of the elimination of the ban on general solicitation on Rule 144A and Rule 506 offerings by corporate issuers. For a discussion of the impact of the new and proposed rules on offerings by private funds, see our memorandum "How will the SEC's New Reg D Rules Affect Offerings by Private Funds?" at: *http://www.paulweiss.com/media/1717486/17july13_sec.pdf*.

In brief, it is unclear whether practice in capital markets transactions will change significantly as a result of the amendments, both because of the continuing impact of the SEC's antifraud rules and because general solicitation may not be necessary as a practical matter to facilitate execution of these offerings.

## Rule 144A Offerings

Rule 144A provides an exemption from registration under the Securities Act for *resales* of restricted securities where the securities are offered and sold only to QIBs. Although Rule 144A does not include an express prohibition against general solicitation, *offers* of securities under Rule 144A currently must be limited to QIBs, which has the same practical effect.

Restrictions on general solicitation typically are addressed by publicity restrictions imposed on the issuer and its affiliates at the outset of the offering. These restrictions are supported by provisions in the

applicable purchase agreement or placing agreement, as well as standard requirements for "no registration" opinions from U.S. securities counsel.

In the United States, due largely to the fungiblity condition (which precludes a listed issuer from relying on Rule 144A for offerings of listed equity), Rule 144A is relied upon principally for offerings of high yield debt securities. Outside the United States, equity, investment grade debt and high yield securities routinely are offered as part of global and other cross-border capital markets transactions to U.S. investors, and most of these are denominated as "Rule 144A offerings."

***Elimination of Prohibition Against General Solicitation.*** The amendment to Rule 144A eliminates the requirement that *offers* be limited to QIBs. As amended, Rule 144A requires only that *sales* be limited to QIBs or to purchasers that the seller and any person acting on behalf of the seller reasonably believe are QIBs. The net effect of the change is that Rule 144A offering may be conducted using general solicitation (notwithstanding that the first leg of the Rule 144A offering from the issuer to the intermediary may be a Section 4(a)(2) placement).

The new general solicitation rules will also allow a private placement under Rule 144A to occur concurrently with or immediately following a public offering in a manner that would not otherwise be permitted. For example, an issuer that is considering an initial public offering would be free to file a registration statement without being precluded from discussing private investment opportunities with a potential investor, even if that investor became aware of the issuer only because of the filing.

Under the new rules, companies will be able to prepare a press release regarding a Rule 144A offering without being subject to Rule 135c limitations on the contents of the press release.

***Practical Considerations.*** The extent to which participants in pure Rule 144A offerings will take advantage of the liberalization of the general solicitation restrictions is unclear. Issuers and intermediaries can be expected to move cautiously at least in the near term, both because of concerns over liability and because general marketing activities (beyond customary investor roadshows) may not be particularly helpful in the context of capital markets transactions that target QIBs.

The antifraud provisions of the U.S. securities laws, including Rule 10b-5, will continue to apply to all statements made by issuers and initial purchasers in connection with Rule 144A offerings. (In contrast to traditional private placements, where investors are expected to conduct their own diligence, Rule 144A offerings are conducted on a basis closely aligned to SEC registered offerings in terms of diligence by the intermediary, disclosure opinions and concerns about the robustness of the offering materials.) As a result of concerns over liability for materials on which investors may claim they relied, it seems likely that the standard Rule 144A marketing documentation will continue to be limited to an offering memorandum (or prospectus in the case of Rule 144A tranches of European public offerings), an investor presentation for the roadshow and any pricing announcements, and that issuers and intermediaries will be reluctant, at

least in the near term, to circulate other marketing or advertising materials. Concerns over potential reliance on material that has not been properly scrutinized (or verified in the case of materials used in offerings with offshore components) are the same as those that underlie concerns with non-deal roadshows, even if limited to QIBs.

***Blue Sky Considerations.*** Securities offered in reliance on Rule 144A by issuers that do not have a class of securities listed on a national securities exchange are not "covered securities" (meaning the Securities Act does not preempt state securities law registration/qualification requirements with respect to those securities). As a result, the securities are subject to registration or qualification under state blue sky laws, absent an available exemption. Traditional 144A offerings generally have qualified for exemptions from these blue sky filing requirements and it appears that the amendment to Rule 144A, permitting offers to non-QIBs, will not, as a general matter, limit the availability of such exemptions.

***Non-144A Offerings and Cross-border Considerations.*** For any offering that is not technically a Rule 144A offering, the amendment will not be available, and traditional procedures for these offerings will likely continue to be observed. This is important for many global offerings denominated as "Rule 144A offerings" that technically do not rely on Rule 144A because the intermediary is "procuring purchasers" and relying on Section 4(a)(2) (the general private placement exemption) rather than buying the securities as principal and reselling them under Rule 144A. In addition, there are a range of offerings for which an issuer cannot rely on Rule 144A (for example, because of the fungibility condition or because the issuer is unable or unwilling to provide the requisite information to holders of securities), which are structured so as to rely on a market interpretation of the exemptions from Securities Act registration. These so-called Section 4(1½) offerings, which typically are directed only at QIBs, rely on a series of procedures and restrictions drawn from practice established to take advantage of other Securities Act exemptions.

In the case of offerings undertaken principally outside the United States, there will be pressure to relax the publicity constraints that often impose what today, given the global nature of traditional and social media platforms, often are viewed as highly artificial distinctions between (permissible) publicity that is targeted offshore versus (impermissible) publicity that is targeted to U.S. audiences.

***Concurrent Regulation S Offerings.*** The adopting release reiterates the SEC's view that concurrent offshore offerings that are conducted in compliance with Regulation S will not be integrated with domestic unregistered offerings that are conducted in compliance with Rule 144A—*i.e.*, if an issuer makes a domestic offering under Rule 144A and a contemporaneous offshore offering under Regulation S, general advertisements with respect to the domestic offering will not necessarily constitute "directed selling efforts" for the Regulation S offering.

## Regulation D Offerings

Under the existing safe harbor exemptions of Regulation D, an issuer relying on Rule 506 may offer and sell securities to "accredited investors," but may not engage in any general solicitation or general advertising in doing so. The final rules create new Rule 506(c), which provides an additional exemption from registration for offerings marketed using general solicitation or general advertising, provided that:

- the issuer take reasonable steps to verify that the purchasers of the securities are accredited investors; and

- all of the ultimate purchasers of the securities are accredited investors, either because they come within one of the enumerated categories of persons that qualify as accredited investors, or the issuer reasonably believes that they do, at the time of sale.

Consistent with the SEC's proposed rules, the final rules do not require issuers to use specified methods of verification and instead sets forth a principles-based method of verification. However, in response to commenters' requests, the final rules provide a non-exclusive list of methods of verifying accredited investor status that, if used, are deemed to satisfy the verification requirement in Rule 506(c). These methods include verification of income based on Internal Revenue Service filings, verification of net worth based on certain financial statements, certain third-party confirmations and certification of pre-existing accredited investor status.

The final rules do not change the definition of "accredited investor" in Rule 501 of Regulation D, and do not eliminate the integration requirement of Rule 502(a) or the restrictions on resale contained in Rule 502(d). Issuers wishing to make exempt offerings without engaging in general solicitation or general advertising can still claim the exemption under Rule 506(b), and would not be subject to the requirement to take "reasonable steps" to verify accredited investor status.

In addition to the final rules discussed above, the SEC proposed amendments to Regulation D, Form D and Rule 506, including a potentially onerous requirement that the issuer file a Form D fifteen days before engaging in a general solicitation for a Rule 506(c) offering.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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