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The U.S. SEC's Elimination of the Prohibition Against General Solicitation and General Advertising: Practical Implications for Non-U.S. Issuers Seeking to Add a U.S. Tranche to Offerings

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On July 10, 2013, the U.S. Securities and Exchange Commission (the "SEC") approved final rules (the "Rules") that eliminate the prohibition against general solicitation and general advertising in certain offerings of securities pursuant to Rule 506 of Regulation D ("Reg D") and Rule 144A under the Securities Act of 1933, as amended (the "Securities Act") (*see WSLR, August 2013, page 7*). The Rules became effective on September 23, 2013.[1]

This article analyzes the practical implications of the new rules for offerings of securities that include a U.S. tranche, such as:

- a Rule 144A offering into the U.S. market, side by side with a public offering in the United Kingdom and/or other European markets;
- a rights offering in which there are substantial U.S. shareholders, or where there is a desire to sell to U.S. persons as part of a standby underwriting commitment; or
- a so-called "4(1½) offering," which will be undertaken in circumstances where Rule 144A is technically not available.

While the Rules apply to both Rule 144A and Reg D offerings, this article focuses principally on Rule 144A offerings, as there are various other requirements that now apply to Reg D offerings (including the so-called "bad actor provisions") that need to be considered if Reg D will be relied upon. In our experience, a significant proportion of offerings by non-U.S. companies into the United States do not rely on Reg D *per se*.

Background

Issuers traditionally have relied on the exemptions provided by Rule 144A[2] and/or Rule 506[3] of Reg D in

connection with the U.S. tranche of their offerings. Prior to the effectiveness of the Rules, under Rule 506, issuers were not permitted to engage in any form of "general solicitation" or "general advertising"[4] in connection with an offer or sale of securities under Reg D. Further, prior to the effectiveness of the Rules, one of the conditions of Rule 144A was that the securities be "offered" (as well as sold) only to persons reasonably believed to be "qualified institutional buyers" ("QIBs"), and, therefore, any broad general solicitation or general advertising could be viewed as an offer to all recipients, including recipients that are not QIBs, thereby falling foul of the requirements of Rule 144A.

The Jumpstart Our Business Startups ("JOBS") Act directed the SEC to amend, and the Rules amend, Rule 144A and Rule 506 to permit general solicitation and general advertising, so long as the *ultimate purchasers* of the securities are 1) reasonably believed to be QIBs, for purposes of Rule 144A, or 2) "accredited investors" (as defined in Rule 501), and the issuer takes reasonable steps to verify such status, for purposes of Rule 506.

Practical Implications of the Rules

Technically, Wider Universe of Offerees, with No Limit on the Method of Communication

Technically, as long as the ultimate purchasers are reasonably believed to be QIBs or accredited investors, as applicable, the Rules permit issuers to engage in offering-related communications with a wider universe of offerees (and not just with QIBs or accredited investors). Moreover, these communications can be made via any medium — e-mails, cold calls, advertisements and press releases posted in newspapers, the Internet, the television or the radio, as well as via press conferences or seminars.

In practice, however, we do not expect that market participants will take advantage of the flexibility to use general solicitation and general advertising in Rule 144A offerings. Issuers conducting offerings with a Rule 144A component typically engage global investment banks that will agree to underwrite the offering and will rely on an extensive distribution network that can easily identify QIBs in the United States.

In contrast, Rule 506 offerings — which are typically conducted by smaller issuers or by investment funds that tap a range of high-end investors, including individuals as well as institutions that may not qualify as QIBs — could benefit from the flexibility, as issuers will find it easier to locate accredited investors through widespread communication.

Offerings and Related Communications Still Subject to Anti-Fraud Provisions

Communications made to prospective investors will continue to be subject to the anti-fraud provisions under the U.S. federal securities laws, including Rule 10b-5 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Therefore, issuers and their advisers should continue to consider the content as well as the scope of distribution of any communications in connection with the offering. Traditional restrictions on publicity impose discipline on the process by which information is disseminated, and maintaining some of these procedures should make it easier to ensure that investors continue to base their investment decisions on material that has been vetted, *e.g.*, a prospectus or offering memorandum or an intention to float announcement, rather than management statements appearing in the media.

Publicity Guidelines

At the commencement of the offering process, legal advisers to the issuer and to the underwriters typically prepare publicity guidelines to ensure that any offering into the United States can benefit from exemptions from SEC registration. Historically, these publicity guidelines have included prohibitions on any communications during the offering process that could be viewed as general solicitation or general advertising.

Those portions of the publicity guidelines will no longer be relevant, although we anticipate that, as a result of the liability considerations outlined above, as well as to deal with publicity-related restrictions in other jurisdictions, deal teams will be reluctant to significantly modify the publicity guidelines. We do anticipate, however, that publicity guidelines relating to the content of press releases in connection with offerings, and website postings, will be relaxed (as discussed below).

Press Releases

Prior to the effectiveness of the Rules, press releases in connection with offerings under Rule 144A were subject to strict requirements of Rule 135c and Rule 135e under the Securities Act. For example, Rule 135c stipulates that the names of the underwriters not be specified in press releases in relation to unregistered offerings. In addition, Rule 135c does not permit the inclusion of statements from management in relation to the offering.

As a result of the Rules, press releases in connection with offerings under Rule 144A will no longer have to comply with such requirements. However, in light of the liability considerations highlighted above, we believe that issuers and their legal advisers should limit as far as possible the content of press releases and ensure that the content is consistent with the prospectus or offering memorandum for the offering.

Website Filters/Click-Through Mechanisms

Issuers typically post their offering-related materials behind website filters and use click-through mechanisms (which typically require certifications from persons seeking to access the materials, including as to their non-U.S. resident status) to avoid general solicitation/general advertising-related issues.

As a result of the Rules, we do not believe that such website filters/click-through mechanisms will continue to be required.

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Underwriting/Purchase Agreements

Underwriting/purchase agreements for Rule 144A offerings typically contain representations and covenants from both the issuer and the underwriters/initial purchasers that the securities have not been and will not be offered or sold in the United States by means of any general solicitation or general advertising. While the Rules would appear to preclude the need for these representations and covenants, in light of "blue sky" considerations for non-reporting issuers (discussed below), we believe that the continued use of such representations and covenants will need to be considered.

Underwriting/purchase agreements for Rule 144A offerings also typically contain representations and covenants to the effect that the securities have not been and will not be offered or sold within the United States to any person that is not reasonably believed to be a QIB. We anticipate that the "offer" prong of these representations and covenants will be deleted.

Underwriting/purchase agreements typically also contain representations and covenants from the issuer that no marketing activities in relation to the offering have been conducted without the underwriters'/initial purchasers' consent. We believe that underwriters/initial purchasers will continue to require the inclusion of these representations and covenants, consistent with their approach in recent years in the context of relaxed rules in SEC-registered offerings.

In addition, to the extent issuers engage in widespread communication in connection with an offering, underwriters may seek indemnification for statements in such communications.

Interaction with Other Laws and Market Practice

Prohibition on 'Directed Selling Efforts' under Regulation S

For purposes of the U.S. securities laws, the non-U.S. portion of an offering is conducted in accordance with Regulation S under the Securities Act. One of the requirements of Regulation S is that no "directed selling efforts"[5] be made in the United States in connection with the offering. This requirement precludes, for example, the placing of an advertisement in a publication "with a general circulation in the United States" that refers to the offering.

The SEC has reiterated in the Adopting Release on the Rules that concurrent offshore (*i.e.,* non-U.S.) offerings conducted in compliance with Regulation S will not be integrated with U.S. domestic unregistered offerings conducted in compliance with Rule 144A or Rule 506, as amended. Therefore, the use of general solicitation or general advertising in the context of an offering under Rule 144A or Rule 506(c) will not constitute "directed selling efforts" for purposes of the Regulation S portion of an offering.

General Solicitation and General Advertising in 'Rule 144A Direct' Offerings

In some jurisdictions, such as the United Kingdom, an equity offering is typically structured as a direct sale of securities from the issuer to the ultimate investor under Section 4(a)(2), although the offering is otherwise compliant with Rule 144A (these offerings are referred to as "Rule 144A direct" offerings). This is due to Rule 144A being a "resale" exemption (there are two sales involved in the exemption — a first sale from the issuer to the underwriter and a second sale from the underwriter to the ultimate investor), and additional stamp duty would arise in such dual-sale scenarios.

In "Rule 144A direct" offerings, similar to Rule 144A offerings, the underwriters bear the ultimate economic risk of the offering by agreeing to purchase the securities themselves in case they fail to procure purchasers for the securities. Because the underwriters, rather than the issuer, bear the economic risk in these "Rule 144A direct" offerings and the offerings are otherwise compliant with Rule 144A, we believe that such offerings should qualify for the Rule 144A exemption, notwithstanding that they are not true "resales." As a result, general solicitation and general advertisement should be permitted for such offerings.

No General Solicitation and General Advertising in 4(a)(2) or '4(1½)' Offerings

The Rules apply only to offerings conducted in accordance with Rule 144A or Rule 506(c). Therefore, offerings conducted in accordance with Section 4(a)(2) of the Securities Act,[6] typically rights offerings conducted by non-U.S. issuers, will continue to be subject to the existing requirements, which will prohibit the use of general solicitation and general advertising.[7] The distinction in approach between a true Section 4(a)(2) offering and a "Rule 144A direct" offering means that deal teams will need to determine at the outset which exemptions will be relied upon for the U.S. tranche.

Similarly, we believe that the SEC's statement prohibiting public solicitation in a Section 4(a)(2) offering extends to private resales under the interpretive doctrine referred to as the "Section 4(1½) exemption," because the Section 4(1½) exemption is predicated upon the need for a private transaction, and in fact is often relied upon for a Rule 144A-style distribution where Rule 144A is not technically available, for example, because the issuer has listed equity in the United States.

Offerings Relying on So-Called '3(c)(7) Procedures'

Companies that are, or potentially could be, deemed investment companies for purposes of the Investment Company Act of 1940 (the "Investment Company Act") may rely on an exemption provided by Section 3(c)(7) of the Investment Company Act. That exemption is predicated on the absence of any public offering. Offerings that use the so-called "3(c)(7) procedures" to take advantage of the exemption may take advantage of the Rules.

'Blue Sky' Requirements

Section 18 of the Securities Act pre-empts state "blue sky" laws with respect to offerings of "covered securities." This means that offerings of covered securities will not be subject to the registration or qualification requirements of blue sky laws. Covered securities include, among other things, all securities offered and sold in Rule 506 offerings and securities of *reporting issuers* offered and sold in Rule 144A transactions. Therefore, securities offered by *non-reporting issuers* in a Rule 144A transaction would not constitute covered securities. In addition, state statutes generally exempt offers and sales to sophisticated investors by all issuers; however, such exemptions are generally extended only to institutional investors.

Therefore, broad-reaching general solicitation and general advertising in Rule 144A offerings by *non-reporting issuers* to *non-institutional investors* (even though the ultimate purchasers will be institutional investors) may be subject to the registration or qualification requirements of most state blue sky laws.

NOTES

[1] For a copy of the rules, see SEC Adopting Release No. 33-9415, "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings" (July 10, 2013) at http://www.sec.gov/rules/final/2013/33-9415.pdf (the "Adopting Release").

[2] A safe harbor that permits the unregistered resale of securities to "qualified institutional buyers" ("QIBs"), which include institutional investors that own and invest on a discretionary basis at least $100 million in securities of unaffiliated issuers.

[3] A safe harbor that permits the unregistered sale of securities to "accredited investors" (as defined in Rule 501).

[4] General solicitation and general advertising are not defined under the Securities Act. Rule 502(c), however, sets forth non-exclusive examples of general solicitation and general advertising, including "[a]ny advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio" and "[a]ny seminar or meeting whose attendees have been invited by any general solicitation or general advertising," subject to limited exceptions, such as publication of a notice in accordance with Rule 135c and satisfaction of the requirements of Rule 135e in relation to offshore press conferences, meetings with issuer representatives conducted offshore, and press-related materials released offshore. The Adopting Release also notes SEC interpretations that have confirmed that other uses of publicly available media, such as unrestricted websites, also constitute general solicitation and general advertising. On the other hand, the SEC has recognized that general solicitation would not be involved if there existed a substantive pre-existing relationship between the issuer or its agent and a prospective investor.

[5] "Directed selling efforts" means any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for the securities being offered in reliance on Regulation S.

[6] Section 4(a)(2) exempts from registration "transactions by an issuer not involving any public offering."

[7] The Adopting Release states that "[a]n issuer relying on Section 4(a)(2) outside of the Rule 506(c) exemption will be restricted in its ability to make public communications to solicit investors for its offering because public advertising will continue to be incompatible with a claim of exemption under Section 4(a)(2)."

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