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SEC Provides Companies with More Flexible Framework to Conduct Concurrent Public and Private Offerings

SEC Confirms Integration Guidance

The Securities and Exchange Commission (the "SEC") staff recently published Compliance & Disclosure Interpretations ("C&DI")[1] in which it confirms interpretive guidance issued by the SEC in a 2007 proposing release (the "Release")[2] regarding the integration of concurrent public and private offerings. The guidance provides companies and their counsel with a more flexible framework to evaluate whether a private offering would be exempt from registration under the Securities Act while a registration statement is on file.[3]

The integration doctrine is designed to prevent an issuer from improperly avoiding registration by artificially dividing a single offering into multiple offerings to take advantage of exemptions under the Securities Act of 1933 (the "Securities Act") that would not be available for the combined offering.[4] The consequence of integrating the private offering with the public offering is that the private offering would need to be registered under the Securities Act.

In the Release, the SEC acknowledged that a company may need to raise capital during the public offering process in order to have sufficient funds to continue to operate until the public offering is completed. It also affirmed its position that the filing of a registration statement is a general solicitation of investors.[5] This position has created uncertainty for companies that seek to conduct a concurrent private offering while there is a registration statement on file with the SEC since the absence of general solicitation and advertising is a fundamental condition to a valid private offering under Section 4(2) of the Securities Act.

The C&DI, confirming the guidance in the Release, provides that

> under appropriate circumstances, there can be a side-by-side private offering under Securities Act Section 4(2) or the Securities Act Rule 506 safe harbor with a registered public offering without having to limit the

[1] *See* the SEC's Compliance and Disclosure Interpretations – Securities Act Sections (last updated, November 26, 2008), Question 139.25.
[2] SEC's integration guidance can be found in the Regulation D Proposing Release, *Revisions of Limited Offering Exemptions in Regulation D, 33-8828* (August 3, 2007), http://www.sec.gov/rules/proposed/2007/33-8828.pdf., pp. 52-56.
[3] *See, e.g.*, C&DI – Securities Act Sections, Question 134.02.
[4] *See* the Release at p. 57.
[5] *See* the Release at p. 54 and, *e.g.*, Division of Corporation Finance no-action letter to Michael Bradfield, General Counsel, Board of Governors of the Federal Reserve System (Mar. 16, 1984).

> private offering to qualified institutional buyers and two or three additional large institutional accredited investors, as under the Black Box (June 26, 1990) and Squadron, Ellenoff (Feb. 28, 1992) no-action letters issued by the Division, or to a company's key officers and directors, as under our so-called "Macy's" position.[6]

In the Release, the SEC also clarified that a company can have a valid private placement if the investors are identified by means other than the registration statement. The C&DI specifically provides that "in the specific situation of concurrent public and private offerings, *only* the guidance set forth in the … Release … applies"[7] (emphasis added).

Pre-Release Integration Analysis

In the Release, the SEC confirmed its position that the filing of a registration statement does not, in itself, eliminate a company's ability to engage in a concurrent private offering, whether it is commenced before or after the filing of the registration statement.[8] It is well established practice, based on the *Black Box* and *Squadron, Ellenoff* no-action letters, that a company may conduct a concurrent private placement without it being integrated with the ongoing public offering.[9] However, the SEC's position under *Black Box / Squadron, Ellenoff* has been narrowly construed to limit offers and sales in the concurrent private offering to qualified institutional buyers ("QIBs")[10] and no more than two or three large institutional accredited investors.

Current Integration Analysis

Whether a particular securities offering should be integrated with another offering still requires an analysis of the specific facts and circumstances of the offerings.[11] The C&DI reiterated that the analysis should focus on how the investors in the private offering are solicited – whether by the registration statement or through some other means that would not otherwise foreclose the availability of the Section 4(2) exemption.[12] The Release provides

> that the determination as to whether the filing of the registration statement should be considered to be a general solicitation or general advertising that would affect the availability of the Section 4(2) exemption for such a concurrent unregistered offering should be based on a consideration of whether the investors in the private placement were solicited by the registration statement or through some other means that would otherwise not foreclose the availability of the Section 4(2) exemption.[13]

The SEC explained that companies and their counsel should not focus exclusively on the status of the investors as QIBs or institutional accredited investors or the number of such investors participating in the offering. Rather, companies should analyze whether the offering is exempt under Section 4(2) of the Securities Act on its own, including whether securities were sold to private placement investors through the means of a general solicitation in the form of the registration statement.

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[6] *See, e.g.*, C&DI – Securities Act Sections, Question 139.25.
[7] *See, e.g.*, C&DI – Securities Act Sections, Question 139.25.
[8] *See* the Release at p. 55; *see also* C&DI – Securities Act Sections, Question 139.25.
[9] *See, e.g.*, Division of Corporation Finance no-action letters to Black Box Incorporated (June 26, 1990) and Squadron Ellenoff, Pleasant & Lehrer (Feb. 28, 1992).
[10] "Qualified institutional buyer" is defined in Rule 144A(a)(1) under the Securities Act.
[11] The five-factor integration analysis outlined in Securities Act Release No. 4552 (Nov. 6, 1962) and in Rule 502(a), should continue to be used to test whether two or more otherwise exempt offerings should be treated as a single offering to determine whether an exemption is available. *See, e.g.*, C&DI – Securities Act Sections, Question 139.25. Companies can also continue to rely on (i) the Rule 155(c) safe harbor and conduct a private offering after, among other things, withdrawing the registration statement, waiting 30 days after the effective date of withdrawal and providing updated disclosure material to the investors, and/or (ii) Regulation S to conduct an offering outside the United States.
[12] *See, e.g.*, C&DI – Securities Act Sections, Question 139.25.
[13] *See* the Release at p. 55.

The Release explains that if a company files a registration statement and then offers and sells securities in a private offering to an investor that becomes interested in the transaction because of the registration statement, then the registration statement will have served as a general solicitation and the Section 4(2) exemption would not be available for the private offering.[14] However, if the prospective "investor became interested in the concurrent private placement through some means other than the registration statement that did not involve a general solicitation and otherwise was consistent with Section 4(2), such as through a substantive, pre-existing relationship with the company or direct contact by the company or its agents outside of the public offering effort, then the prior filing of the registration statement generally would not impact the potential availability of the Section 4(2) exemption for that private placement and the private placement could be conducted while the registration statement for the public offering was on file with the Commission."[15]

The Release explains that if prospective investors

> (1) were not identified or contacted through the marketing of the public offering and (2) did not independently contact the issuer as a result of the general solicitation by means of the registration statement, then the private placement could be conducted in accordance with Section 4(2) while the registration statement for a separate public offering was pending.[16]

Examples of a substantive pre-existing relationship include: (i) vendors, customers and suppliers of the company, (ii) existing investors and business partners, and (iii) existing brokerage customers of the placement agent. The guidance does not affect the ability of companies to continue to rely on the views expressed by the SEC in the *Black Box / Squadron, Ellenoff* letters.[17] The guidance, however, calls into question the relevance of these letters by providing greater flexibility for companies to raise capital in a private offering from a larger group of investors. The fundamental issue to consider is how were the investors located rather than the number and type of investor. Companies and placement agents should maintain careful records to demonstrate the lack of a general solicitation.[18]

In the past, companies had less flexibility to conduct a concurrent public and private offering. If a company can demonstrate that there was a pre-existing substantive relationship between the company or placement agent and the investors or that investors were not found through the registration statement or related marketing activities, the concurrent Section 4(2) private offering would not be integrated with the public offering.

The guidance provides companies with clarity and a better framework to evaluate capital raising alternatives.[19] Companies will no longer be limited to conducting a private offering to QIBs and two or three additional large investors while a registration statement is on file. When the equity markets improve, this flexibility should allow companies to file a registration statement or restart a stalled offering with fewer concerns about constraints on their financing options.

Other Integration Scenarios

The Release also affirmed that, consistent with Securities Act Rule 152, the SEC "will not take the view that a completed private placement that was exempt from registration under Securities Act Section 4(2) should be integrated with a public offering of securities that is registered on a subsequently filed registration statement," even if the company is contemplating filing a registration statement for a public offering at the same time that it is

[14] *See* the Release at p. 56.
[15] *See* the Release at p. 56 and C&DI – Securities Act Sections, Question 139.25.
[16] *See* the Release at p. 56.
[17] *See* the Release at note 126.
[18] A company may want to use an investor questionnaire that confirms how the investor was located and how its interest in the investment arose.
[19] *See* the Release at p. 53.

conducting a Section 4(2) private placement.[20] Companies still must avoid any pre-filing communications regarding the contemplated public offering that could render the Section 4(2) exemption unavailable.[21]

A company still cannot begin an offering as a private placement and complete that offering pursuant to a registration statement or commence a registered offering and seek to complete that offering through a private placement, except in those circumstances specified in Securities Act Rule 155.[22] A company cannot withdraw a registration statement and immediately thereafter complete the same offering without registration in reliance upon the Section 4(2) private offering exemption. The filing of a registration statement for a specific securities offering (as contrasted with a generic shelf registration) constitutes a general solicitation for that securities offering, rendering Section 4(2) unavailable for the same offering.[23]

Private Offering Proposals Still To Be Considered

The Release also proposes amendments to Regulation D, which the SEC recently announced that it plans to address in 2009, including amendments to: (i) shorten the time frame for the integration safe harbor for Regulation D offerings from 6 months to 90 days (which would permit an issuer to rely on the safe harbor once every fiscal quarter) in order to provide issuers with greater flexibility to conduct more frequent offerings to meet unpredictable financing needs;[24] (ii) adopt new Rule 507 to permit exempt offerings to a newly defined category of "large accredited investors" with limited advertising; and (iii) add alternative investments-owned standards to the current accredited investor definition.

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[20] *See* the Release at pp. 53-54. The guidance affirms the position of the Division of Corporate Finance in the no-action letter to *Verticom, Inc.* (Feb. 12, 1986).
[21] *See* the Release at p. 54, note 124.
[22] *See* the Release at p. 53, note 122.
[23] *See* C&DI – Securities Act Sections, Question 134.02.
[24] *See* the Release at p. 59, note 136. The five-factor integration test would continue to apply, providing issuers with flexibility when they want to conduct separate offerings within the 90-day time frame.