U.S. Regulation of the International Securities and Derivatives Markets, § 7.01, INTRODUCTION

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.01 (11th and 12th Editions 2014-2017)
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Cross-border securities offerings are regularly conducted without registration under the Securities Act, in reliance on exemptions for private offerings and for transactions conducted outside the United States—and often in reliance on both exemptions at once. This chapter discusses the exemption for private offerings, while Chapter 8 discusses the exemption for transactions conducted outside the United States.

Offerings by issuers are exempt from registration under § 4(a)(2) of the Securities Act if they are "[t]ransactions by an issuer not involving any public offering." These are usually referred to as "private placements" or "private offerings." Over more than half a century, a substantial body of case law and SEC regulatory practice has developed concerning private placements by U.S. issuers and the resale of privately placed securities. [1] Standardized procedures and documentation have also evolved to allow private placements to proceed with assurance that the exemption from registration under § 4(a)(2) is available.

Private offerings have come to represent a significant portion of total U.S. financing activity, particularly since the SEC adopted Rule 144A under the Securities Act in 1990. [2] Many U.S. issuers rely on the private offering exemption to sell specialized securities that are tailored for the investing institutions. In such cases, the ability to resell the securities in a liquid market is not a primary consideration. Where liquidity is important to investors, however, the price the issuer receives in a private offering has historically been lower than in a public transaction, and investors often require the issuer to provide "registration rights"—a prompt avenue to resell in the public market *via* either a subsequent resale registration statement or a subsequent registered A/B exchange offer—as a condition to purchase. While Rule 144 now provides most purchasers of securities in a private placement the ability to resell publicly one year (or, in the case of reporting companies, six months) after purchase, registration rights are still for a number of reasons not uncommon in Rule 144A offerings. [3]

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Foreign issuers, on the other hand, often seek to place privately in the U.S. institutional market the same kinds of securities that they sell in their domestic markets or in international markets. They also seek the same pricing as they receive in those markets. The market for such private offerings by foreign issuers is well established and includes a broad range of U.S. institutional investors, reflecting the growing liquidity in overseas public markets and the growth of cross-border investing generally.

The principal reasons for the complexities of the private offering process, and for the lack of liquidity in the U.S. private offering market, are legal and regulatory. There have been two main areas of legal and regulatory focus to facilitate private offerings: providing issuers and participating financial institutions with certainty that an offering is exempt from registration under § 4(a)(2) of the Securities Act; and providing investors with flexibility to resell securities purchased in a private offering to increase liquidity. While these developments affect private offerings generally, they are particularly relevant to foreign issuers considering the U.S. private offering market.

With respect to providing certainty regarding the § 4(a)(2) exemption, since 1974, the SEC has provided safe harbor rules, now included in Regulation D under the Securities Act, for private offerings by issuers. While most U.S. private offerings to institutions by foreign issuers are made in reliance on § 4(a)(2) itself rather than Regulation D, [4] the safe harbor procedures provide important guidance on how to conduct U.S. private offerings.

Securities purchased in U.S. private offerings are viewed as "restricted" under SEC rules and thus may not be immediately resold publicly in the U.S. secondary market. [5] Since 1972, the SEC has provided a safe harbor under Rule 144 that permits unlimited resales of restricted securities in the public market by

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non-affiliates of the issuer after an initial holding period, which is currently six months for securities of an SEC-reporting issuer (provided the issuer has filed its required periodic reports under § 13 or 15(d) of the Exchange Act), [6] and one year for securities of other issuers. [7]

U.S. investors can immediately resell restricted securities into markets outside the United States and to qualified private placement investors in the United States, provided they satisfy certain conditions. Resales outside the United States of restricted securities of a foreign issuer were first approved by the SEC in a series of no-action letters beginning in the late 1980s, [8] and since 1990, they have been permitted by Regulation s under the Securities Act. [9] This is important for equity securities of foreign issuers because the home market generally has more depth, and the securities can in effect be sold in the "regular way" in that market.

Before the adoption of Rule 144A, resales of restricted securities to qualified U.S. investors had long been conducted under a legal analysis developed by the U.S. private bar and referred to as the "Section 4(1 ½) exemption." [10] In 1990, the SEC adopted Rule 144A, a safe harbor permitting resales to large institutional investors. The growing reliance on Rule 144A for U.S. institutional resales has led to the development of standardized practices for "Rule 144A offerings." Rule 144A offering practices differ from those in traditional § 4(a)(2) private

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placements, which prevailed before the advent of Rule 144A and are still sometimes conducted today. Rule 144A offerings are typically conducted on an underwritten basis, with terms and conditions substantially identical to those applicable to public offerings. In the case of debt securities, the investment banks that act as initial purchasers and resell in reliance on Rule 144A negotiate the terms of the securities to be offered, while a traditional private placement may involve direct and often protracted negotiations between the issuer and the ultimate investors.

A consensus has also developed within the private securities bar as to appropriate documentation with respect to Rule 144A offerings. [11] In connection with traditional private placements, the private bar has generally required letters from each purchaser (often referred to as nondistribution letters or investment letters) to negate the presence of a distribution subject to Securities Act registration, but these are not required from purchasers under Rule 144A. [12] Other similar requirements developed by the private bar, such as large minimum denominations, the use of legended physical securities and stop-transfer procedures, are also not necessary in connection with an offering made exclusively to "qualified institutional buyers," or "QIBs," under Rule 144A. [13] Regulation M under the Exchange Act specifically exempts Rule 144A offerings from limitations on trading during a distribution, [14] and securities sold in Rule 144A offerings are eligible for clearing at The Depository Trust Company ("DTC"), the principal U.S. clearing organization, which further facilitates trading under Rule 144A. Aftermarket trading in Rule 144A debt securities is also required to be reported to the Financial Industry Regulatory Authority, Inc. ("FINRA"), through the Trade Reporting and Compliance Engine ("TRACE"). [15]

Some concerns about the U.S. private placement market remain for non-U.S. issuers. Some foreign issuers are reluctant to submit to customary market practices incidental to a U.S. private offering, which even if limited to institutional investors and carried out under Rule 144A can involve procedures that

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foreign issuers find intrusive, including extensive "due diligence" inquiries and the need for accountants' and lawyers' negative assurances as to the quality of disclosure provided to initial investors. The requirement under Rule 144A that a nonreporting issuer covenant to provide certain information to purchasers and prospective purchasers in secondary market transactions has also sometimes raised questions for foreign issuers. Notwithstanding these concerns, offerings under Rule 144A by foreign issuers have been a popular approach to the U.S. markets since the Rule's adoption.

Footnotes

1 *See* § 7.02 for a discussion of certain of the principal precedents and SEC rules regarding private placements.

2 According to a published summary of capital markets activity in the United States, in 2015, there were 535 private placements of debt and equity in the U.S. market that raised a total of U.S.$137.0 billion. By comparison in 2015, there were 4,000 SEC-registered public offerings of debt and equity in the U.S. market that raised a total of approximately U.S.$2.1 trillion. Securities Industry and Financial Markets Association ("SIFMA"), 2016 Fact Book.

3 *See* § 7.05 for a discussion of registration rights.

4 *See* § 7.02[2].

5 Rule 144(a)(3) under the Securities Act defines "restricted securities" as, *inter alia*,

> (i) securities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering, (ii) securities acquired from the issuer that are subject to the resale limitations of Rule 502(d) under Regulation D or Rule 701(c), (iii) securities acquired in a transaction or chain of transactions meeting the requirements of Rule 144A, (iv) securities acquired from the issuer in a transaction subject to the conditions of Regulation CE, and (v) equity securities of domestic issuers acquired in a transaction or chain of transactions subject to the conditions of Rule 901 or Rule 903 under Regulation s.

Securities (other than equity securities of domestic issuers) offered in offshore offerings pursuant to Regulation s are not regarded as "restricted securities." For a discussion of resale restrictions applicable to securities originally sold under Regulation s under the Securities Act, *see* § 8.02.

6 Rule 144(c) under the Securities Act. Timely filing of current reports on Form 8-K (for domestic issuers) or reports on Form 6-K (for foreign private issuers) is not a requirement for this purpose.

7 Rule 144(d) under the Securities Act. The current holding period has been in effect since 2008. *See* SEC Release No. 33-8869 (Dec. 6, 2007). The holding period was originally three years and in 1997 was reduced to one year (subject to conditions relating to current public information, volume of sales, manner of sale and filing of Form 144) or two years (after which these conditions ceased to apply).

8 *See, e.g.*, *French Privatization Program* (avail. Apr. 17, 1987); *College Ret. Equities Fund* (avail. Feb. 18, 1987).

9 Rule 904 of Regulation s under the Securities Act. Resales under Regulation s are discussed in § 7.04[5].

10 *See* § 7.04[3]. *See generally Law of Private Placements (Non-Public Offerings) Not Entitled to Benefits of Safe Harbors—A Report*, 66 BUS. LAW, 85 (2010) (a Report by the Committee on Federal Regulation of Securities, ABA Section of Business Law); *The Section 4(1 ½) Phenomenon: Private Resales of "Restricted" Securities*, 34 BUS. LAW, 1961 (1979) (a Report to the Committee on Federal Regulation of Securities from the Study Group on Section 4(1 ½) of the Subcommittee on 1933 Act) ("*The Section 4(1 ½) Phenomenon*"); SEC Release No. 33-6806 (Oct. 25, 1988).

Resales of restricted securities may now also be effected under § 4(a)(7) of the Securities Act, added to the

Securities Act in December 2015. Although subject to certain limitations not thought by the private bar to be applicable to § 4(1 ½) resales, the non-exclusive safe harbor provided by § 4(a)(7) should be particularly useful in resales of restricted securities to accredited investors that are natural persons rather than institutional investors.

11 *See* § 7.04.

12 *See* § 7.02[3].

13 *See* text accompanying *infra* Note 80.

14 Rule 102(b)(7) under Regulation M. Prior to the adoption of Regulation M in 1996, Rule 10b-6 under the Exchange Act imposed limitations on trading by distribution participants in private placements that were considered distributions for purposes of Rule 10b-6. *See* SEC Release No. 34-38067 (Dec. 20, 1996); § 7.10.

15 FINRA Rule 6750 requires that information about aftermarket Rule 144A transactions be publicly disseminated immediately upon FINRA's receipt of the transaction report. *See* SEC Release No. 34-70345 (Sept. 6, 2013).

U.S. Regulation of the International Securities and Derivatives Markets, § 7.02, INSTITUTIONAL PRIVATE PLACEMENTS

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[1] Securities Act § 4(a)(2)

The legal basis for private placements and for subsequent resales among institutions and dealers derives from the exemptions from registration found in §§ 4(a)(1), 4(a)(2) and 4(a)(3) of the Securities Act. Section 4(a)(1) exempts from the registration requirements of the Securities Act "[t]ransactions by any person other than an issuer, underwriter or dealer"; § 4(a)(2) exempts "[t]ransactions by an issuer not involving any public offering"; and § 4(a)(3) exempts transactions by a dealer not acting as an underwriter. [16] The Securities Act defines an underwriter to include "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking." [17] One key to these exemptions lies in the twin concepts of a "public offering" and a "distribution" of securities: if there is no public offering, there is no distribution within the meaning of the Securities Act; and, if there is no distribution, there can be no underwriter, so that if there is no public offering, the issuer can find an exemption for its offers and sales under § 4(a)(2), the dealer under § 4(a)(3) and all others under § 4(a)(1) of the Securities Act.

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Whether a public offering has occurred may depend not only on the nature of the issuer's initial offer and sale of securities to a purchaser but also on the nature of subsequent reoffers and resales. If a purchaser from an issuer (or under prevailing SEC positions, any purchaser in a chain of sales from the issuer) resells in such a manner that the securities are distributed to the public, the selling party may be an underwriter and thus not be entitled to an exemption under § 4(a)(1) (or § 4(a)(3) in the case of dealers) and the issuer may not be entitled to an exemption under § 4(a)(2). [18]

What constitutes a "public offering" and, therefore, a distribution for purposes of the securities laws has been the subject of intense discussion. Starting immediately after the adoption of the Securities Act, requests for guidance concerning the § 4(a)(2) exemption were sufficiently numerous to prompt the General Counsel of the SEC to attempt a clarification of the "public offering" concept in 1935. The General Counsel's opinion established that 25 offerees were generally permissible in a private offering, and also enumerated four factors that the SEC would take into account in determining the existence or absence of a public offering. Those factors were (i) the number of offerees and their relationship to each other and to the issuer, (ii) the number of units offered, (iii) the size of the offering and (iv) the manner of the offering. [19]

After a number of conflicting lower court decisions, in 1953 the U.S. Supreme Court in *SEC v. Ralston Purina Co.* [20] attempted to clarify the scope of the private offering exemption by declaring that a public offering was one in which the investors required the protections applicable to public offerings; private offerings were those in which such protections were not needed: "[T]he applicability of [§ 4(a)(2)] should turn on whether the particular class of persons affected needs the protection of the [Securities] Act. An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering.’" [21]

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The Court in *Ralston Purina* determined that "[§ 5] would seem to apply to a 'public offering' whether to few or many." [22] Consequently, the Court did not fix a maximum number of offerees that would ensure the absence of a public offering. [23] Although *Ralston Purina* continues to be the seminal judicial pronouncement concerning private offerings, its effect was as much to increase the number of potential factual considerations appropriate to a § 4(a)(2) analysis as to focus the inquiry on the nature of prospective investors. [24]

The concept of investors "able to fend for themselves" was not as obvious as it seemed at first blush. The courts ruled that sophistication alone was not necessarily sufficient to ensure availability of the exemption; [25] a prospective investor's relationship with the issuer, based on factors such as employment, family or economic bargaining power, could be sufficient. [26] In addition, the burden to prove the availability of the exemption is placed on the person seeking to take advantage of it [27] and failure to satisfy the burden results in strict liability for the "seller." [28]

Notwithstanding the uncertainties regarding the private offering exemption under § 4(a)(2), the securities bar developed procedures and documentation for offerings before and after *Ralston Purina* that sought to take advantage of the

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exemption. The focus of these procedures was on the factors highlighted, albeit not consistently or uniformly, by the SEC and the courts, including the manner of offering, the number, wherewithal and sophistication of offerees and the relationship between the offerees and the issuer.

Even though the private offering market continued to operate, the SEC was pressured by market participants and the private bar, in light of the unease produced by the case law under § 4(a)(2) and the draconian liability that could result if the exemption were not available—rescission by all purchasers—to provide certainty as to the availability of the exemption. In response, the SEC in 1974 adopted a nonexclusive "safe harbor" rule for private offerings. [29] Eight years later, the SEC adopted Regulation D under the Securities Act, a more comprehensive, but still nonexclusive, safe harbor rule. [30]

[2] Regulation D

Rule 506 under Regulation D provides a safe harbor from registration for offers and sales by issuers. Prior to the SEC's implementation of § 201(a) of the Jumpstart Our Business Startups Act (the "JOBS Act") in 2013, one of the conditions for reliance on the safe harbor was that neither the issuer nor any person acting on its behalf could offer or sell securities under Regulation D by any form of general solicitation or general advertising. Section 201(a) of the JOBS Act directed the SEC to amend Rule 506 to permit general solicitation or general advertising in offerings under the Rule, subject to certain additional conditions. As a result, the SEC adopted changes to Rule 506 that left the existing safe harbor unchanged, but redesignated it as Rule 506(b), and added a new safe harbor in Rule 506(c), under which a private offering may make use of general solicitation and general advertising. [31] These safe harbors cannot be used for transactions other than offers and sales by an issuer. [32] Securities acquired in an offering

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made under Regulation D are "restricted" for purposes of the Securities Act registration requirements. [33]

[a] General Requirements

To qualify for the safe harbor under Rule 506(b), all of the following conditions must be met:

- Neither the issuer nor any person acting on its behalf may offer or sell the securities by any form of general solicitation or general advertising. [34]
- Sales may only be made to "accredited investors" plus up to 35 persons who are not accredited investors. There is no limitation on the number of "accredited investors" to which sales may be made. [35]

- If any purchaser is not an accredited investor, then (i) the issuer must "reasonably believe" that each such purchaser "has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment" [36] and (ii) each such purchaser must receive prior to sale certain information specified by the regulation,

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which is broadly similar to that required to be provided in an SEC-registered offering. [37]

- The issuer must exercise "reasonable care" to ensure that the purchasers of the securities are not underwriters within the meaning of § 2(a)(11) of the Securities Act (also referred to as "statutory underwriters")—that is, that they are not taking with a view to, or offering or selling for the issuer in connection with, a distribution of the securities. [38]
- The issuer must file a notice of the offering on Form D [39] with the SEC no later than 15 days after the first sale of securities in the offering. [40]

The safe harbor under Rule 506(c) differs from the safe harbor under Rule 506(b) in five respects:

- The requirement that there be no general solicitation or general advertising does not apply. [41]

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- Sales may only be made to accredited investors. [42]
- The issuer must check a box on Form D to indicate whether it is relying on either Rule 506(b) or Rule 506(c). [43] Some comments on the proposed rule suggested that an issuer might check both boxes—for example, if general solicitation is contemplated but might not be used, or to protect against losing the exemption as a result of inadvertent solicitation. [44] The adopting release specifies that the issuer must check one box or the other. [45] It would appear, however, that an issuer can amend a Form D for an offering to select 506(b) after having selected 506(c) in a prior Form D filing for that offering or vice versa, assuming all other conditions are met.
- The requirement that certain information concerning the issuer be furnished to any investor other than accredited investors [46] does not apply, because only accredited investors may participate. [47]
- The issuer must take "reasonable steps to verify" that the purchasers are accredited investors. [48] This is an independent procedural requirement, and it must be met even if in fact all offerees happen to be accredited investors.

[b] Required Reasonable Steps to Verify Accredited Investors in Rule 506(c) Offerings

The "reasonable steps to verify" that an issuer must take in a Rule 506(c) offering was the subject of extensive comment and is discussed at length in the adopting release. The release explains that it is a "principles-based" requirement, resting on "an objective determination by the issuer (or those acting on its behalf), in the context of the particular facts and circumstances of each purchaser and transaction." [49] Issuers should consider a number of factors, and the

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release discusses three examples: the nature of the purchaser, the information the issuer has about the purchaser, and the nature and terms of the offering. [50]

The final rule includes a safe harbor specifying acceptable, but nonexclusive, methods to verify the accredited investor status of natural persons. [51] The addition of the safe harbor was widely sought in the comment process following the proposed rule and is consistent with the SEC's decades-long practice of providing safe harbors from § 5 violations in light of the draconian consequences (in particular, a strict liability rescission right for purchasers) for those violations.

Specifically, Rule 506(c) provides a nonexclusive list of methods to verify accredited investor status for natural persons that will be deemed to satisfy the verification requirement. These are (a) review of specified documentation showing that a person meets the income test in the definition of accredited investor, [52] (b) review of specified documentation showing that a person meets the net worth test, [53] (c) reliance on written confirmation from a third party that it has verified the person's accredited investor status [54] and (d) reliance on certification from an existing investor who previously invested in a Rule 506(b) offering by the issuer. [55] The issuer may not rely on the Rule 506(c) safe harbor if it or its agent has knowledge that the purchaser is not an accredited investor. [56]

In addition to the new Rule 506(c), the SEC simultaneously adopted Rule 506(d) (pursuant to § 926 of the Dodd-Frank Act), which removes the protection of the Rule 506 safe harbor from offerings in which a "bad actor" participates. [57]

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Rule 506(d) applies if certain categories of persons are subject to certain disqualifying events.

The categories of persons are:

- the issuer, any predecessor, any affiliated issuer and any promoter;
- any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer;
- any beneficial owner of 20% or more of the issuer's outstanding voting equity securities;
- with respect to an issuer that is a pooled investment fund, any investment manager of the issuer;
- any person paid (directly or indirectly) to solicit purchasers in connection with sales in the offering (*e.g.*, a placement agent); and
- with respect to any such investment manager or solicitor, (i) any general partner or managing member and (ii) any director, executive officer or other officer participating in the offering of the investment manager, the solicitor or a general partner or managing member of the investment manager or solicitor. [58]

Disqualifying events include:

- criminal convictions in connection with purchases or sales of a security, making false filings with the SEC or that arise from conducting business as an underwriter, broker-dealer, investment adviser or paid solicitor;
- injunctions and court orders related to engaging in or continuing conduct or practices relating to such activities;
- final orders of certain federal and state regulators that either bar a person from engaging in securities, insurance, banking or similar activities (or from association with an entity regulated by the regulator issuing the order), or that

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  are based on a violation of any law or regulation prohibiting fraudulent, manipulative or deceptive conduct;
- SEC cease-and-desist orders arising from a violation of § 5 of the Securities Act or *scienter*-based antifraud provisions of the federal securities laws;
- certain other SEC orders (including suspension, revocation of registration or limitations on activities as a broker-dealer or investment adviser);

- suspension, expulsion or being barred from association with a national securities exchange or association for improper conduct;
- filing or being named as an underwriter in a registration statement as to which a stop or suspension order was issued, or being the subject of an investigation to determine whether such an order should be issued; or
- U.S. Postal Service false representation orders and certain temporary restraining orders or injunctions. [59]

The time periods for disqualification generally address conduct arising from between five and ten years prior to the date of the Rule 506 sale, although in certain cases an event will only be disqualifying if the injunction, order, investigation or similar event is in effect and continuing at the time of the Rule 506 sale.

Rule 506(d) limits disqualification to triggering events that occur after effectiveness of the Rule (September 23, 2013), although the issuer will still be required to disclose past events that would be disqualifying if they had occurred after the effective date to purchasers in advance of sales under Rule 506 (unless the issuer can establish that it did not know and reasonably could not have known of the existence of those past disqualifying events). Although this will still require issuers to determine whether any pre-adoption disqualifying events exist for purposes of disclosure, the change has helped to address at least some of the concerns raised by commenters as to market participants who may have voluntarily entered into consent decrees or who would otherwise be disqualified based on prior conduct, but who were not in a position to know of the consequences under revised Rule 506.

Rule 506(d) also includes a waiver provision, under which a waiver of disqualification may be granted by the SEC upon a showing of good cause. [60]

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Rule 506(d) sets out a "reasonable care" exception, under which an issuer will not lose the benefit of the Rule 506 safe harbor, despite the existence of a disqualifying event, if it can show that it did not know and, in the exercise of reasonable care, could not have known of the disqualification. The adopting release indicates the issuer will be expected to conduct a factual inquiry to rely on this exception and makes clear that the steps an issuer must take to be deemed to have exercised "reasonable care" will vary according to the particular facts and circumstances. [61] The release notes issuers will likely have in-depth knowledge of their own directors and officers, and that additional inquiry "by means of questionnaires or certifications, perhaps accompanied by contractual representations, covenants and undertakings, may be sufficient in some circumstances, particularly if there is no information or other indicators suggesting bad actor involvement." [62] The release also notes the SEC's expectation that market participants, such as placement agents and broker-dealers, will develop procedures to assist issuers in gathering the necessary information. Finally, for continuous, delayed or long-lived offerings, the release notes that the requirement to exercise reasonable care will include updating the factual inquiry on a "reasonable" basis, but that, in appropriate cases, periodic updating should suffice. [63]

Regulation D is a safe harbor: compliance with its requirements assures the availability of the private placement exemption. Because it is a nonexclusive safe harbor, however, failure to comply with its requirements does not preclude reliance on § 4(a)(2) to conduct a good private offering. In fact, issuers and their legal advisers generally follow the guidelines of Regulation D as to the manner of conducting a private offering while not attempting formal compliance with the regulation itself. [64] In particular, foreign issuers, like many U.S. issuers, are

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reluctant to publicly disclose the information required by Form D, including the compensation paid to dealers. [65]

Many of the requirements built into Regulation D mirrored prior practice, and their adoption by the SEC provided such practice with new support, even if not all of the technical requirements of the regulation are followed. Other aspects of Regulation D were new developments. [66] Similarly, many of the procedures and practices that developed to ensure compliance with Regulation D were derived from offering practices that predated the regulation. However, the promulgation of the regulation, due to the specificity of its standards as compared to the vague case law under § 4(a)(2), has created greater consistency in the practices followed in private offerings of securities, whether reliance is placed on Regulation D or on § 4(a)(2) itself.

The guidance provided by Regulation D concerning the types of activities that may constitute general solicitation or general advertising has become standard, and still relevant for issuers that seek to offer or sell securities pursuant to Rule 506(b) or the statutory exemption in § 4(a)(2) of the Securities Act. [67] Although Rule 502(c) nonexclusively identifies certain activities that constitute a general solicitation, [68] many issuers have sought no-action advice from the SEC staff concerning particular situations. The general rule that has emerged from staff positions is that no general solicitation will be found to have occurred if there is a pre-existing relationship between the offeror (or its agent) and offeree,

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sufficient to permit the offeror to evaluate the financial sophistication of the offeree. [69]

Rule 502(d) of Regulation D specifies that the issuer must "exercise reasonable care to assure that the purchasers of the securities are not underwriters"—in other words, that purchasers are not taking securities with a view to distribution. The Rule identifies certain steps that an issuer should consider implementing: (i) reasonable inquiry as to whether the purchaser is acquiring the securities for its own account or the account of another person, (ii) notice to purchasers that the securities in question have not been registered under the Securities Act and cannot be resold unless registered or pursuant to an exemption from registration and (iii) the use of an appropriate legend on the securities. The Rule states, however, that these steps are not the exclusive means of complying with the "reasonable care" test.

The private securities bar has developed a fairly consistent series of procedural steps intended to meet the requirements of Regulation D and also the less certain statutory standard of § 4(a)(2) itself. First, letters, commonly called "investment letters" or "nondistribution letters," are generally required of each buyer. In such a letter, the buyer generally (i) is notified and acknowledges that the securities in question were not registered under the Securities Act, (ii) certifies that it is a sophisticated investor and has received all information it has requested about the investment [70] and (iii) acknowledges that it is not purchasing the securities in question with a view to distribution (within the meaning of the Securities Act). Such letters often also include an agreement by the buyer that in the absence of registration or, in certain cases, a clearly available exemption, [71]

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resales of the securities will only be permitted if accompanied by a legal opinion that the resale in question is exempt or if the resale complies with specified restrictions designed to provide sufficient assurances that an exemption from registration is available. Second, the securities are often either denominated, or offered and sold, in large amounts (in the hundreds of thousands or even millions of dollars) that are usual for institutional private transactions but not characteristic of public offerings to retail investors. Third, the number of offerees, generally other than institutional accredited investors, is often limited. Fourth, if the securities are in physical form, the certificates contain restrictive legends and are often subject to stop-transfer instructions to prevent unapproved resales. Such instructions are a mechanism to apply to subsequent purchasers the transfer restrictions imposed on the original purchasers through investment or nondistribution letters. If the securities are not in physical form, either because they are represented by interests in a global security or because they are part of a paperless, book-entry system, other mechanisms may be used for the same purpose. [72]

Despite an overall fairly standard pattern, the exact combination of procedures used in a particular offering may depend on the circumstances. Not all of these procedures are employed in all § 4(a)(2) offerings. For example, in private offerings of commercial paper, with its short maturities and relative lack of trading, the procedures are usually somewhat curtailed. Most important, if the securities to be offered are Rule 144A-eligible and are offered and sold only to "qualified institutional buyers," or QIBs, as defined in Rule 144A, typically the procedures implemented are quite limited, investment letters are not required and no policing of resales is considered necessary. [73] Even if the securities are not Rule 144A-eligible (because, when issued, they were fungible with securities listed on a U.S. exchange), procedures can also remain relatively limited if the securities are offered and sold only to QIBs and there is a *bona fide* market for these securities outside the United States. [74] The procedures in these cases generally would include a notice that the securities may only be resold outside the United States, investor letters confirming each purchaser's status as a QIB and an agreement by each purchaser to resell shares only outside the United States under Regulation s and not to conduct any hedging activities that would be in

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violation of the Securities Act, as well as procedures designed to restrict deposit of securities acquired during the offering into any American Deposit Receipt ("ADR") facility for a period of 40 days after commencement of the offering.

[3] Rule 144A Private Placements

Rule 144A under the Securities Act, adopted in 1990, provides a nonexclusive safe harbor from registration for resales to institutions reasonably believed by the seller [75] to be QIBs. The securities may not be "of the same class" as, or fungible with, securities listed on a national securities exchange or traded on a U.S. automated inter-dealer quotation system. [76] The Rule imposes only two procedural requirements: (1) the seller must take reasonable steps to ensure that purchasers are aware that the seller may be relying on the Rule and (2) in the case of issuers (other than foreign governmental issuers) that do not report or furnish information to the SEC under the Exchange Act, purchasers must have a right to obtain prior to sale certain information concerning the issuer of the securities.

Although Rule 144A is a safe harbor only for *resales*, it provides a way for an issuer to conduct a private placement to large institutional investors without the cumbersome measures to police resales that otherwise apply under § 4(a)(2) of the Securities Act or Regulation D thereunder. [77] The Rule provides that an investor or a dealer that reoffers or resells securities in compliance with the Rule is not engaged in a distribution and is not an underwriter. Rule 144A is premised on the theory that QIBs can "fend for themselves" and therefore do not need the protections of the registration requirements of the Securities Act; accordingly, sales made only to QIBs are not considered to be distributions. Moreover, because QIBs are considered to be familiar with resale restrictions, sales to them are thought to pose little risk that they could lead to a subsequent distribution. Because resales to QIBs under the Rule are not themselves distributions, and pose little risk of leading to subsequent distributions, they are not public

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offerings, and an investor or dealer taking restricted securities purchased from an issuer and reselling them to QIBs is not an underwriter. Thus, the § 4(a)(1) exemption is available for investors (other than dealers) selling in compliance with the Rule, and the § 4(a)(3) exemption is available for dealers. [78] Finally, since the resales are not public offerings, they are consistent with the requirement that an issuer's reliance on § 4(a)(2) or Regulation D be supported by reasonable care to assure that the purchasers of the securities are not underwriters. [79]

Consequently, Rule 144A, although it technically applies only to resales and not to offers and sales by issuers, effectively permits a simplified form of private offering by an issuer. It codifies a form of resale of privately placed securities in a manner that permits the use of simplified procedures both upon an issuer's initial sale and upon such resales. The procedures described above in connection with § 4(a)(2) and Regulation D private placements, including investment letters, limitations on the number of potential offerees (at least outside the safe harbor of Regulation D) and the use of legends, stop-transfer and other procedures that affect pricing and liquidity, are generally not required—either for the initial issuance if the securities are to be resold only under Rule 144A, or for any subsequent resales relying on the Rule. [80] A key effect of this simplification is the enhanced marketability on original issuance of securities that may be resold in reliance on Rule 144A.

One of the objectives of Rule 144A was to make primary offerings of foreign securities available to U.S. institutions in the U.S. market through intermediaries (rather than forcing such investors to go to overseas markets) by making the private offering market in the United States more attractive to foreign issuers. [81] The absence of significant procedural limitations on trading under Rule 144A has increased the willingness of foreign issuers to offer their securities in the United States, both in separate offerings and in conjunction with larger, global offerings. Indeed, a firm commitment offering targeted to QIBs in the United States under Rule 144A is conducted very much like an underwritten public offering except that purchasers are restricted to large institutional investors. [82] Preliminary offering memoranda are often circulated, standard documentation is used, and road shows are conducted to give eligible investors the chance to hear from and question management.

[a] Qualified Institutional Buyer

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The criteria for eligibility as a QIB depend on the type of institution involved. [83]

(i) Any institution in one of the following categories is a QIB if it owns, or invests on a discretionary basis, at least $100 million in securities:

a) a corporation (other than a U.S. or foreign bank or thrift), [84] a partnership, [84.1] a not-for-profit organization qualified under U.S. federal tax law, [85] or a "Massachusetts or similar business trust"; [86]

b) an insurance company; [87]

c) a public or private employee benefit plan or a trust fund for the benefit of such plans; [88] or

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d) an entity registered under applicable U.S. federal statutes as an investment adviser, an investment company, a small business investment company, a business development company or a small business development company. [89]

(ii) A securities dealer registered under the Exchange Act is a QIB if it owns, or invests on a discretionary basis, at least $10 million in securities. Even if it does not meet this threshold, it is a QIB when it acts in a "riskless principal transaction" for a QIB—where it buys a security and makes a simultaneous offsetting sale of such security to a QIB. [90]

(iii) A registered investment company is a QIB if it is part of a "family" of registered investment companies that in the aggregate owns, or invests on a discretionary basis, at least $100 million in securities. This alternative is available to an investment company that does not meet the investment threshold on its own, as described in paragraph (i)(d) above. Under the Rule, a family of investment companies means any two or more investment companies registered under the Investment Company Act (other than a unit investment trust investing solely in shares of other registered investment companies) that have the same investment adviser, or depositor in the case of unit investment trusts. [90.1] Advisers or depositors that are majority-owned subsidiaries of the same parent or of one another will be considered to be the "same" adviser or depositor. [91]

(iv) A U.S. or foreign bank, thrift or equivalent institution is a QIB if it owns, or invests on a discretionary basis, at least $100 million in securities and it also has net worth of at least $25 million. [92] The SEC imposed the net worth test on the grounds that U.S. banks and thrifts, because they are federally insured, "effectively are able to purchase securities using public funds." [93] It extended the net worth

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test to foreign banks and thrifts and equivalent institutions for competitive reasons. [94]

(v) Any entity is a QIB if all of its equity owners are QIBs. [95]

The SEC has clarified that a purchase under the Rule by an insurance company on behalf of one or more of its separate accounts that are not registered, or required to be registered, under the Investment Company Act will be deemed to be a purchase by the insurance company. [96] It is not sufficient, in the case of a sale to an investment adviser or other fiduciary acting with discretion on behalf of another institution, that the adviser or fiduciary be a QIB—both the adviser or other fiduciary and the underlying account must meet the Rule's requirements.

The Rule generally requires that securities holdings be valued at cost, unless the institution reports its holdings on the basis of market value and no current information regarding the cost of the securities has been published (in which case the securities may be valued at market). The Rule also specifies that the securities holdings of an entity's consolidated subsidiaries may be included in the calculation only if they are managed by the entity and that the securities may not be included at all if the entity is itself a majority-owned subsidiary included in the consolidated financial statements of another entity, unless the entity is an Exchange Act-reporting company.

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Securities issued or guaranteed by the United States and its instrumentalities, [97] securities held on margin and securities loaned out to borrowers [97.1] are permitted to be included in calculating the amount of securities investments by an institution, whereas bank deposit notes and certificates of deposit, loan participations, [98] repurchase agreements, securities subject to repurchase agreements, borrowed securities and short positions in securities [98.1] as well as currency, interest rate and commodity swaps may not be so included. [98.2] A broker-dealer may not include allotment securities in its calculation. [98.3]

Rule 144A specifies that sellers can rely on certain means identified in the Rule to establish that a prospective purchaser satisfies the securities ownership requirement. [99] The most widely used method among U.S. broker-dealers to establish that a prospective purchaser is a QIB is to rely on a "QIB list" maintained by a commercial service. [100]

[b] Nonfungible Securities

A security's eligibility for resale under Rule 144A is determined when the security is issued. A security is not eligible for resale under Rule 144A if when

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issued it is "of the same class" as securities listed on a U.S. national securities exchange or quoted in a U.S. automated inter-dealer quotation system. The fungibility test of Rule 144A is intended to prevent the creation of "side-by-side" public and private markets in the same security, which could divert resales of the securities away from the public market with possible adverse implications for the public market's liquidity and volatility. [101] Securities of a particular class that are issued prior to the listing of that class (such as securities held by significant shareholders of an issuer at the time of its IPO, often referred to as "founder shares") are eligible for resale under Rule 144A if they can be specifically identified.

Rule 144A is not available with respect to the securities of any open-end investment company, unit investment trust or face-amount certificate company that is or is required to be registered under § 8 of the Investment Company Act. [102]

Convertible and exchangeable securities present specific issues under the nonfungibility requirement. In general, securities that are convertible into or exchangeable for securities that are listed on a U.S. national securities exchange or quoted on a U.S. automated interdealer quotation system are not considered to be fungible with such listed or quoted securities if such convertible or exchangeable securities had an effective conversion premium of 10% or more when issued. [103] In addition, warrants to purchase such U.S. listed or quoted securities are not considered fungible with such securities if the warrants are exercisable for at least three years after issuance and had an effective exercise premium of 10% or more when issued. [104] Listed or quoted ADRs are considered fungible with the class of securities that underlies them. [105] Mandatorily exchangeable

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securities, which involve the issuance by issuer A of a debt security mandatorily exchangeable at its maturity into a security, generally common stock, of issuer B (or, at A's election, its cash equivalent), raise additional issues under Rule 144A, particularly relating to the nonfungibility requirement. [106] The SEC has retained authority to designate other securities as not fungible with listed or quoted securities, [107] but to date has not exercised its authority. Because not many debt or preferred stock issues are listed on a U.S. securities exchange, the question of fungibility arises less often than for common stock.

Whether a new issue of equity securities will be considered to be part of the "same class" as outstanding securities listed or quoted for purposes of Rule 144A depends on whether they are of substantially similar character and whether the holders have substantially similar rights and privileges. Although used for many years and for a variety of purposes in the U.S. federal securities laws, [108] this standard has not been elaborated in SEC no-action letters. A difference in designation alone will not be sufficient to create distinct classes. [109] In general, if equity securities differ as to preference or voting rights, they will not be considered to be of the same class. [110] On the other hand, if equity securities have identical terms with respect to dividend, liquidation and voting rights, but differ as to terms such as redemption or convertibility, they nevertheless may be deemed to constitute a single class. [111]

In the case of preferred stock and debt securities, the SEC stated in the release adopting Rule 144A that issues "commonly viewed as different series will generally be viewed as different, nonfungible classes of securities for purposes of Rule 144A." [112] The SEC stated, however, that preferred stock issues

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will be considered to be of the same class "if their terms relating to dividend rate, cumulation, participation, liquidation preference, voting rights, convertibility, call, redemption and other similar material matters are substantially identical." [113] Debt securities will be considered fungible if there is substantial identity in terms relating to coupon rate, maturity, subordination, security, convertibility, call, redemption and any other material terms. [114]

[c] Information Delivery

If the issuer of the securities is a reporting company under the Exchange Act, or if it is exempt from reporting under Rule 12g3-2(b) thereunder, [115] Rule 144A does not impose any requirement concerning available public information as a condition for resale under the Rule. There is also no information requirement if the issuer is a foreign government or government agency eligible to register securities under Schedule B to the Securities Act. [116]

Otherwise, however, Rule 144A provides that, as a condition to an exempt resale, the holder and the prospective purchaser must "have the right to obtain from the issuer" certain reasonably current information concerning the issuer. Documentation for Rule 144A offerings typically addresses this requirement by including an undertaking by the issuer to provide any information required by Rule 144A(d)(4) in connection with a future resale, unless it is reporting or exempt at that time. The existence of a reporting obligation in the issuer's home jurisdiction does not suffice. In the case of guaranteed securities, the SEC has stated that the information furnishing requirement does not apply if the guarantor is a reporting company under the Exchange Act or exempt pursuant to Rule 12g3-2(b) thereunder; alternatively, the information furnishing requirement may

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be satisfied in the case of guaranteed securities by looking to information furnished under Rule 144A(d)(4)(i) by the guarantor. [117] The Rule permits the seller or any of its agents, in addition to the issuer and its agents, to deliver the information to the prospective purchaser.

The information required by Rule 144A is a brief description of the issuer's business and the products and services it offers, its most recent balance sheet, profit and loss and retained earnings statements, and similar financial statements for that portion of the two preceding fiscal years during which the issuer has been in operation. [118] The financial statements should be audited "to the extent reasonably available," and the information must be "reasonably current" in relation to the date of resale pursuant to the Rule. The Rule specifies that information will be deemed to be "reasonably current," in the case of a foreign private issuer, if it meets the timing requirements of the issuer's home country or principal trading markets. [119]

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It has been suggested that the requirement to supply information could create additional liability for issuers under the U.S. securities laws, including in particular civil liability under § 10(b) of the Exchange Act and Rule 10b-5 thereunder. [120] This potential liability could also exist for any broker-dealer or other seller that provides the information to a prospective purchaser under Rule 144A. Rule 10b-5 imposes liability for material misstatements or omissions made in connection with the sale of a security. To sustain a claim under Rule 10b-5, a plaintiff must prove both that the defendant acted with *scienter* (*i.e.*, intentionally or recklessly) and that the plaintiff relied on the misstatement or omission in making its purchase. Issuers (and broker-dealers) providing information pursuant to Rule 144A(d)(4) may also be subject to liability for such information under state securities laws and the common law. [121] A particular issue with respect to liability is whether the information delivery requirement of Rule 144A(d)(4) includes a duty of the issuer to update the information with material developments affecting the issuer's financial condition and results of operations [122]—in effect, to maintain an "evergreen" disclosure document—to avoid liability to purchasers who request the information.

Although these risks may be remote, a nonreporting foreign issuer should consider whether to avoid the Rule 144A information requirement by complying with the conditions for the Rule 12g3-2(b) exemption from reporting, especially if a high volume of Rule 144A resales can be expected. [123] There is then no

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requirement to supply information as a condition to Rule 144A resales and no duty to keep information current or updated other than to continue complying with the conditions for the Rule 12g3-2(b) exemption. [124] Complying with the Rule 12g3-2(b) exemption would, however, also permit the establishment of a public ADR program for the issuer's securities without the issuer's consent, and this could be a disadvantage for an issuer that otherwise prefers to prevent the establishment of unsponsored ADR programs. [125]

[d] Notice

Rule 144A requires that a seller and any person acting on its behalf "take reasonable steps to ensure that the purchaser is aware that the seller may rely on [Rule 144A]." [126] This requirement will not in most cases present any difficulties. If the sale is by an investment bank in connection with a purchase from an issuer in a private placement, the offering document will indicate that the bank and other members of the syndicate may rely upon the Rule. If no offering document is prepared, such as where a block trade is being conducted on an "undocumented" basis, [127] notice may be provided in confirmations of sale. [128]

[4] Publicity and Marketing Consistent with Restrictions on General Solicitation and General Advertising

Although the SEC has eliminated the prohibitions on general solicitation and general advertising applicable to Rule 506(c) offerings and Rule 144A offerings, the prohibition on general solicitation and general advertising continues to apply to offerings made under Rule 506(b) and the statutory exemption under § 4(a)(2). [129] A press announcement in or directed into the United States regarding a private offering, which is made prior to completion of the offering, may constitute a general solicitation or general advertisement of the offer and could

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jeopardize the availability of these private placement exemptions. [130] There are, however, two rules that provide "safe harbor" protection by specifying that communications meeting specified conditions are not deemed to be offers.

Rule 135c under the Securities Act provides a safe harbor for certain public announcements of unregistered offerings by the issuer. It is similar to Rule 135, a safe harbor for announcements of registered public offerings made prior to the filing of a registration statement, but unlike Rule 135 it is available only to the issuer and not to a selling securityholder. To rely on the Rule 135c safe harbor, the issuer must be either subject to the reporting requirements of § 13 or § 15(d) of the Exchange Act or exempt from Exchange Act reporting requirements pursuant to Rule 12g3-2(b) thereunder. [131] Rule 135c(b) provides that an issuer may announce an offering in the form of a news release, written communication to securityholders or employees, or other published statements. The announcement may include (i) the name of the issuer, (ii) the title, amount and basic terms of the securities offered, (iii) the amount sold by any selling securityholders, (iv) the time of the offering and (v) a brief statement of the manner and purpose of the offering without naming the participating financial institutions. [132] The announcement must also include a legend to the effect that the securities have not been registered under the Securities Act and may not be offered or sold in the United States absent registration or an applicable exemption. Rule 135c specifies that it is not available if the announcement is made to condition the market for the offered securities. A foreign private issuer subject to Exchange Act reporting requirements must furnish a copy of any Rule 135c announcement to the SEC on Form 6-K. An issuer subject to the domestic reporting forms would instead file the announcement on Form 8-K. [133]

Rule 135e under the Securities Act provides a safe harbor for certain press-related activities outside the United States. It was adopted in 1997 to encourage issuers to grant the U.S. press equal access to offshore press activities in connection with offshore offerings. [134] Under Rule 135e, a foreign private issuer, foreign government issuer, or selling securityholder may give U.S. journalists access to offshore press activities relating to an offering of securities without being deemed to have made an offer for the sale of a security within the meaning

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of § 5 of the Securities Act, engaged in "general solicitation" within the meaning of Regulation D or engaged in "directed selling efforts" within the meaning of Regulation s —provided that it respects certain conditions. These conditions are (i) at least part of the offering is conducted outside the United States, (ii) access is provided to both U.S. and foreign journalists and (iii) any written materials released to journalists bear a specified legend and meet certain other conditions. Issuers conducting side-by-side offshore offerings and U.S. private offerings may rely on Rule 135e in conducting offshore press activities, so long as there is "an intent to make a *bona fide* offering offshore." [135]

The elimination of the prohibitions on general solicitation and offers to non-QIBs in Rule 506(c) and Rule 144A offerings, respectively, permits issuers and their agents to communicate with prospective investors in Rule 144A and Rule 506(c) offerings with no limit on the method of communication or the number or type of investors reached. Issuers may use, among other methods, cold calls, blast e-mails, advertisements, articles and other communications published in newspapers, magazines, on the Internet or in television or radio broadcasts. The liberalization also allows communications about these kinds of offerings at conferences, promotional seminars or other meetings. Regardless of the prospective investors reached by these communications, the ultimate sales must be made to investors reasonably believed to be QIBs (in Rule 144A offerings) or accredited investors (in Rule 506(c) offerings).

Issuers and their agents should be aware that any communications made to prospective investors are, of course, still subject to the antifraud provisions of the securities laws and, in particular, § 10(b) of the Exchange Act and Rule 10b-5 thereunder. In addition to liability concerns related to the purchasers in the offering itself, use of general solicitation may also expand the scope of potential liability for information contained in these communications to secondary market participants, either with respect to the security being sold or other securities of the issuer. Furthermore, many foreign jurisdictions have their own rules and restrictions regarding publicity in connection with offerings [136] that will require careful analysis and consultation with local counsel. As a result, issuers and their agents should carefully consider the content, form and distribution of general solicitation communications. To date, offering participants do not appear to be

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making any dramatic changes to offering practices to take advantage of the added flexibility.

Nevertheless, some changes in practice with respect to press releases and other publicity about or at the time of an offering pursuant to Rule 144A or Rule 506(c) seem likely over time. These press releases and other communications no longer need to comply with the strict requirements of Rule 135c under the Securities Act or other similar safe harbors. For example, participating financial institutions may now wish to include their names on press releases. In light of liability concerns, however, it would still be prudent to limit the content and ensure it is consistent with the offering circular. The timing of offering press releases is unlikely to change—they are unlikely to be published prior to launch both to avoid liability concerns associated with making statements prior to finalizing the content of the offering circular and also to preserve flexibility for the offering participants about whether and when to launch the offering. [137]

In light of these liability concerns, issuers and participating financial institutions may also want to limit discussion of Rule 144A and Rule 506(c) offerings at conferences or other public speaking engagements to completed transactions [138] and, after an offering has launched, to information consistent with the offering circular. [139]

Finally, the ability to use general solicitation permits issuers and their agents to expand the pool of potential investors and contact investors with which they had no pre-existing relationship. Over time, paid referral agencies and other similar services may develop to facilitate this process. [140]

The publication of a research report on an issuer by a financial institution participating in a distribution of securities of that issuer may be viewed as general solicitation, which would be inconsistent with the exemptions under Rule

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506(b) or § 4(a)(2). Accordingly, a financial institution that is participating in a U.S. private placement will ordinarily cease publishing research on the issuer in the United States unless the research qualifies for a safe harbor under Rule 138 or Rule 139 under the Securities Act. These safe harbors were originally developed to permit continuation of research coverage during a registered offering, but the SEC and the private bar understood them to be available also to permit publication of research during a Rule 144A offering, and the rules were amended in 2005 to codify that view. [141] In light of the adoption of Rule 506(c) and the change to Rule 144A, financial institutions are no longer restricted from publishing research reports on an issuer conducting a Rule 506(c) or a Rule 144A offering. However, given the liability concerns under Rule 10b-5, financial institutions participating in these offerings are not likely to take advantage of this flexibility to publish research other than in the ordinary course or that refers to a pending offering.

Rule 138 permits the publication of a research report about a qualifying issuer if the report relates to securities other than the type of securities being offered. Rule 139 permits issuer-specific research to continue if it meets certain conditions and the issuer is eligible. Eligible issuers include seasoned Exchange Act-reporting companies and nonreporting foreign private issuers that meet certain quantitative criteria for public float and trading markets. Rule 139 also permits the inclusion of an issuer in an industry report under specified circumstances. [142] The safe harbors typically are not available where the offering is a debut offering in the issuer's home market.

If a foreign private issuer is offering securities outside the United States, the participating financial institutions may propose to publish research reports in advance of the offering—often referred to as "pre-deal" research—based on customary practices in the home jurisdiction or other markets where the securities will be offered; this is particularly common in debut offerings. [143] For pre-deal research distribution in the United States, the participating financial institutions

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may rely on Rule 144A, which includes no prohibition on general solicitation and general advertising. They must also, however, consider limitations on the distribution of research in the United States that arise from the Global Research Settlement and FINRA rules limiting interaction between investment banking and research personnel. [144] Among other things, the settlement strictly limits communications between investment bankers and research analysts at the investment banking firms that are party to it, while the FINRA rules prohibit investment bankers at member firms from directing [145] a research analyst to engage in sales or marketing efforts related to an offering or to engage in any communication with an investor about an offering. Compliance with these restrictions, as well as concern over 10b-5 liability, led investment banking firms to refrain from distributing pre-deal research in the United States even to eligible investors in Rule 144A offerings and traditional private placements.

The practice of holding meetings between research analysts and prospective investors to discuss an issuer and its securities prior to the commencement of marketing—often referred to as "investor education"—also presents issues

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under the Global Research Settlement and FINRA rules. It is common in some markets outside the United States for meetings of this kind to occur in connection with a debut offering after the first public filing or other public disclosure. When the offering will include a Rule 144A component, research analysts at the banks involved may wish to conduct investor education with investors in the United States. Considering the potential liability for communications with investors during these meetings, analysts have generally only met with a limited number of QIBs despite the greater flexibility to engage with investors afforded by amendments to Rule 144A introduced by the JOBS Act. Investment banking personnel and representatives of the issuer may not participate in the meetings, and they must be organized and scheduled in compliance with the prohibition under the FINRA rules on investment banking personnel directing research analysts to engage in sales and marketing efforts or to communicate with investors concerning an offering. The information concerning the issuer that is used in investor education should be consistent as to factual matters with what will be included in the preliminary offering circular, though it often includes the analyst's (but not the issuer's) projections. Written presentations used in the meetings generally are not delivered in a manner that allows investors to retain them.

There is also a wide range of pre-launch investor contacts that do not include research personnel, and a range of terminology to describe them. One common form is sometimes called "pilot fishing," "pre-sounding" or "testing the waters"—contacts between the issuer and potential investors arranged by the investment bankers with a view to, for example, gauging investor interest, deciding whether to proceed with an offering, identifying issuers considered comparable, or developing an approach to valuation and the price range for launch. In private offerings by foreign private issuers, pilot fishing may occur in a variety of circumstances, such as a Rule 144A offering that is part of a home-country IPO, or a proposed debt offering in difficult market circumstances. Similarly, in some Rule 144A offerings, the launch of marketing is preceded by investor meetings at which the issuer and the investment bankers make a road show style presentation but do not typically market a specific offering (sometimes referred to as a "nondeal road show"); whether the launch then occurs depends on investor receptivity and market conditions.

In these pre-launch marketing activities, as with investor education, the issuer information is consistent with what will be included in the offering circular, investors do not retain written presentations, and the meetings are limited to QIBs. Some bank policies impose limits on the number of investors that may be contacted in some forms of pre-launch marketing, and the laws of the home country or other markets may require further limitations. Sometimes difficult negotiations arise concerning whether the issuer's indemnification, under the purchase agreement for the offering, should cover materials used in pilot fishing,

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pre-launch investor meetings or even investor education. Marketing to prospective "cornerstone" or "anchor" investors can raise some of the same issues. [146]

[5] Use of the Internet for Private Placements

As is the case with public offerings, the Internet provides an additional forum for private placements of securities, whether in the United States in reliance on § 4(a)(2) of the Securities Act or Regulation D thereunder or pursuant to Rule 144A or outside the United States in reliance on Regulation s. Because of the widespread public access to the Internet, conducting a private offering through the Internet in a manner that complies with the requirements for a valid private offering—in particular limiting, in the case of § 4(a)(2), the number and type of offerees and (with respect to Rule 506(b) offerings under Regulation D as well) the prohibition on the use of general solicitation or general advertising [147]—poses particular challenges.

[a] Material Available on Unrestricted Websites

Despite the existence of appropriate, restricted access procedures for offering-related information on a website, issuers in private placements made pursuant to § 4(a)(2) or Rule 506(b), in which general solicitation is not allowed, are advised to refrain from including on their unrestricted websites information that can reasonably be expected to encourage directly or indirectly interest in the offering or that could be deemed to have been released primarily for the purpose of directly or indirectly encouraging interest in the offering. This includes all information about any aspect of the offering (other than what is permitted by Rule 135c). [148] It can also encompass information about the operations, financial position or prospects of the company, statements with respect to the level of dividend payout, any predictions, projections, forecasts or opinions regarding the

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value of the company, any "corporate image" or other advertising not in the ordinary course of the company's business or inconsistent with its past practice and any information released through arranged press coverage about the company. Information that relates solely to the company's products or services and the publication of which is consistent with the company's past practice generally may be kept on an unrestricted website. As a rule, issuers in private offerings pursuant to § 4(a)(2) or Rule 506(b) should not establish or expand unrestricted websites until after completion of the offering. [149]

[b] Electronic Road Shows

One component of private offerings for which issuers have made frequent use of the Internet is the road show. As in the case of public offerings, [150] the SEC has approved the use of the Internet to conduct road shows for private offerings in the United States. [151] In order to comply with § 4(a)(2) of the Securities Act, no-action guidance has sought to ensure that the electronic road show is transmitted on behalf of a seller solely to persons reasonably believed to be QIBs (or accredited investors in Regulation D or traditional private placements). [152] Other protective measures arising from no-action relief or traditionally advocated by counsel include measures similar to those in the context of road shows for public offerings. These include presenting the entire unedited live road show, [153] except for corrections of misstatements and deletions of dead air, making the offering circular available on the website, accessible only through a password-protected "button" on the site; restrictions on downloading, videotaping or other copying and distribution of the road show's content, and consistency between the road show and the offering circular. The limited no-action relief granted in the context of private offerings so far suggests that unlimited viewings of a road show may be permitted until the offering is concluded.

[c] Non-U.S. Offerings

Special concerns arise when an issuer conducts through the Internet a private placement in the United States concurrently with an offshore offering to

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non-U.S. persons under Regulation s. In such cases, the SEC staff has suggested some measures that could be taken in order to comply with § 4(a)(2) and Rule 506(b) of Regulation D, as the case may be, but has expressly indicated that other types of measures may be sufficient to prevent offshore Internet offerings from being used to solicit investors in a private placement in the United States. [154] Consistent with the staff's suggestions, persons responding to the non-U.S. Internet offering should be prohibited from participating in the concurrent private placement in the United States, even if they would otherwise be qualified to do so. In addition, access to the offering materials posted on the Internet for the Regulation s offering should generally be limited to those viewers who first provide residence information (and who do not provide other information that would otherwise indicate that they are U.S. persons). [155] Finally, unless password protections are put in place, the posted offering information should generally be limited to information about the non-U.S. offering, except for information about the U.S. offering required by applicable non-U.S. law to be provided to investors participating in the non-U.S. offering.

[d] Electronic Document Distribution

Just as the SEC has expressly permitted the Internet to be used for the dissemination of mandatory disclosure documents in a U.S.-registered offering, [156] the Internet may also be used to distribute disclosure documents in a Regulation D private placement, a Rule 144A transaction or a traditional private placement, provided that the relevant requirements applicable to these types of offerings are satisfied. [157] The same considerations applying to hyperlinks in the context of

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public offerings apply in private offerings as well. [158] In addition, many market participants now distribute disclosure documents in Rule 144A transactions or other private offerings by e-mail; prior to the changes, to Rule 144A permitting general solicitation, such e-mails typically included a legend as to the possible reliance upon an exemption from the registration requirements under the Securities Act and the restrictions on redistribution of such disclosure documents. Although broad-reaching redistribution is no longer restricted by Rule 144A, the inclusion of legends on such e-mails is unlikely to change given the 10b-5 liability concerns discussed above. [159]

[6] Integration Concerns and Mixed Private/Public Offerings

All sales that are part of "the same Regulation D offering" must meet all the requirements for the exemption. This "integration" doctrine was developed to prevent a public offering from being divided into multiple "private" offerings to avoid registration. Regulation D provides a safe harbor from this "integration" doctrine with respect to offers and sales made more than six months before or after the transaction under consideration. [160]

The ability to use general solicitation in Rule 506(c) offerings raised integration questions in the context of proximate private offerings. If a Rule 506(c) offering that uses general solicitation is integrated with a Rule 506(b) offering, the general solicitation will result in the loss of the Rule 506(b) exemption and any sales to nonaccredited investors will be a violation of § 5. [161]

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If an issuer conducts a private offering of securities in close temporal proximity to a registered public offering, it could be argued that the two offerings should be integrated and viewed as a single distribution of securities. [162] If the private offerings are conducted under Rule 506(b) or § 4(a)(2), the resulting integrated offering would be illegal because the private offering exemption would be unavailable due to the general solicitation involved in the public offering. The offers and sales in the prior private offering (including private offerings under Rule 506(c) or Rule 144A) might also constitute an illegal public offer in connection with the registered public offering (so-called "gun jumping") in violation of § 5 of the Securities Act. The SEC has, however, provided some relief in this area through Rules 152 and 155 under the Securities Act, as well as no-action positions and interpretive guidance.

Rule 152 provides generally that a transaction that qualifies for the § 4(a)(2) exemption will continue to be exempt even if the issuer subsequently decides to make a public offering of the securities or files a registration statement. The SEC staff has clarified this Rule by taking the position that the filing of a registration statement following an offering otherwise exempt under § 4(a)(2) for the same securities does not vitiate the exemption, so long as the private offering is completed prior to the filing of the registration statement. [163] In *Black Box Inc.*, the staff indicated that the execution of binding purchase agreements for a private offering that were not subject to conditions within the control of the purchasers could constitute "completion" for these purposes even though the closing of the private offering had not occurred prior to the filing of the registration statement. [164] In *Privatization of the United States Enrichment Corp.*, the SEC staff indicated that abandonment of a private offering could also constitute completion for purposes of Rule 152. [165]

In *Squadron, Ellenoff, Pleasant & Lehrer*, the SEC staff confirmed that it intended Black Box to represent a policy position not to integrate a private placement to QIBs under Rule 144A (along with a private placement to up to three large institutional accredited investors that were not QIBs) with a concurrently registered public offering of the same class of securities. [166] The staff noted in *Squadron*, however, that the mere filing of a registration statement will generally be considered as a general solicitation, even where the issuer does not circulate a "red herring" prospectus or make any press announcement concerning the proposed offering. [167]

In its 2007 proposal to revise Regulation D, the SEC provided further guidance regarding the integration of concurrent public and private offerings, reiterating and elaborating on its position set out in *Black Box* and *Squadron*. The SEC clarified that, while there are many situations in which the filing of a registration statement could serve as general solicitation or general advertising for a concurrent private offering, the filing of a registration statement does not *per se* eliminate a company's ability to conduct a concurrent private offering. The determination as to whether the filing of the registration statement should be considered to be general solicitation or general advertising that would affect the

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availability of the § 4(a)(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 instead through some other means that would otherwise not foreclose the availability of the § 4(a)(2) exemption, such as through a substantive, pre-existing relationship with the company or direct contact by the company or its agents unrelated to the registration statement or the public offering effort. [168]

Rule 155 under the Securities Act provides a safe harbor for a registered offering following an abandoned private offering and for a private offering following an abandoned registered offering. Rule 155 facilitates a switch from a private offering to a registered public offering and *vice versa* in response to changing securities markets; it does not, however, modify or rescind the five-factor test for assessing integration in Regulation D, Rule 152 or the SEC guidance described above. [169]

Under Rule 155(b), an issuer that begins a private offering may subsequently commence a registered offering [170] without the risk that both offerings will be integrated if the following conditions are met:

- no securities were sold in the private offering;
- the issuer and any person acting on its behalf terminate all offering activity in the private offering before the issuer files the registration statement for the registered offering;
- any prospectus filed as part of the registration statement discloses information about the abandoned private offering, including the size and nature of the private offering, the date on which the issuer terminated all offering activity in the private offering, that any offers to buy or indications of interest in the private offering were rejected or otherwise not accepted and that the prospectus delivered in the registered offering supersedes any selling material used in the private offering; and

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- the issuer does not file the registration statement until at least 30 calendar days after termination of all offering activity in the private offering, except that the 30-day delay does not apply if the issuer and any person acting on its behalf offered securities in the private offering only to persons who were (or who the issuer reasonably believes were) accredited investors or who satisfy the knowledge and experience standard of Rule 506(b)(2)(ii) under the Securities Act.

Under Rule 155(c), an issuer that begins a registered offering may subsequently commence a private offering without the risk that both offerings will be integrated if the following conditions are met:

- no securities were sold in the registered offering;
- the issuer withdraws the registration statement for the registered offering; [171]
- the issuer and any person acting on its behalf do not commence the private offering earlier than 30 calendar days after the effective date of withdrawal of the registration statement;
- the issuer notifies each offeree in the private offering that the offering is not registered under the Securities Act, the securities offered will be "restricted securities" as defined in Rule 144 under the Securities Act and cannot be resold without registration unless an exemption is available, purchasers do not have the protection of § 11 of the Securities Act and a registration statement for the abandoned offering was filed and withdrawn, specifying the effective date of the withdrawal; and
- any disclosure document used in the private offering discloses any changes in the issuer's business or financial condition that occurred after the issuer filed the registration statement that are material to the investment decision in the private offering.

Each of the specific conditions must be satisfied in order to take advantage of the Rule 155 safe harbor; however, it is not available for transactions that are

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part of a plan or scheme to avoid registration even if the issuer technically complies with the requirements of the Rule. [172]

Footnotes

16 Section 4(a)(3) of the Securities Act is not available (i) for sales of securities by a dealer taking place prior to the expiration of 40 days after the first date on which any of such securities were "*bona fide* offered to the public by the issuer or by or through an underwriter" or (ii) at any time with respect to an underwriter's unsold allotment securities. In a private placement that is part of a larger, non-U.S. public offering of securities, the 40-day § 4(a)(3) restriction on dealer sales is applicable commencing on the initial offering date of the non-U.S. offering, which is generally the date on which the offering price of the securities is determined.

17 § 2(a)(11) of the Securities Act.

18 *See, e.g.*, *Gilligan, Will & Co. v. SEC*, 267 F.2d 461, 466 (2d Cir.), *cert. denied*, 361 U.S. 896 (1959). In proposing amendments to Rule 144 in 1997, the SEC stated that:

> [i]ndividual investors who are not professionals in the securities business may be "underwriters" [and taking "with a view to … distribution"] within the meaning of that term as used in the [Securities] Act if they act as links in a chain of transactions through which securities move from an issuer to the public.

SEC Release No. 33-7391 (Feb. 20, 1997), 62 Fed. Reg. 9246, 9256 (Feb. 28, 1997).

19 Op. Gen. Counsel, SEC Release No. 33-285 (Jan. 24, 1935).

20 *SEC v. Ralston Purina Co.*, 346 U.S. 119 (1953).

21 *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953). *Ralston Purina* actually refers to § 4(1), because what is now § 4(2) of the Securities Act was included in a second clause of § 4(1) until 1964.

22 *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953). Footnote 11 to the quoted text cites *Nash v. Lynde*, [1929] A.C. 158, 169 (H.L.) (U.K.): "[t]he 'public'… is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve; perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole." *SEC v. Ralston Purina Co.,* 346 U.S. 119, 125 n.11 (1953).

23 *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953).

24 *See*, *e.g.*, SEC v. Continental Tobacco Company of South Carolina, Inc., 463 F.2d 137, 158 (5th Cir. 1972); *Henderson v. Hayden, Stone Inc.*, 461 F.2d 1069, 1071–72 (5th Cir. 1972); *Hill York Corp. v. American International Franchises, Inc.*, 448 F.2d 680, 687–89 (5th Cir. 1971); *SEC v. Murphy*, 626 F.2d 633, 645–47 (9th Cir. 1980).

25 *See, e.g.*, *Doran v. Petroleum Management Corp.*, 545 F.2d 893, 902–03 (5th Cir. 1977), *aff'd*, 576 F.2d 91 (5th Cir. 1978), and cases cited therein; *Hill York Corp. v. American International Franchises, Inc.*, 448 F.2d 680, 690–91 (5th Cir. 1971).

26 *See*, *e.g.*, SEC v. Continental Tobacco Company of South Carolina, Inc., 463 F.2d 137, 159 (5th Cir. 1972); *Western Federal Corp. v. Erickson*, 739 F.2d 1439, 1443 (9th Cir. 1984).

27 *SEC v. Ralston Purina Co.*, 346 U.S. 119, 126 (1953); *see also Mark v. FSC Securities Corp.*, 870 F.2d 331, 333 (6th Cir. 1989).

28 *See* § 11.02[2][b] for a discussion of liability for the offer or sale of unregistered securities under § 12(a)(1) of the Securities Act. Some courts have even indicated that if the person claiming a private placement exemption cannot show that each offeree was sufficiently sophisticated to participate in a private offering, all buyers could rescind even if the nonqualifying offerees did not actually purchase any securities. *Lively v. Hirschfeld*, 440 F.2d 631 (10th Cir. 1971); *see also SEC v. Murphy*, 626 F.2d 633 (9th Cir. 1980); *Eriksson v. Galvin*, 484 F. Supp. 1108 (S.D.N.Y. 1980).

29 SEC Release No. 33-5487 (Apr. 23, 1974). This safe harbor, Rule 146 under the Securities Act, was rescinded on adoption of Regulation D.

30 SEC Release No. 33-6389 (Mar. 8, 1982).

31 Regulation D under the Securities Act includes four safe harbors from registration. Two of the four, set forth in Rule 506 of the Regulation, arise under § 4(a)(2) of the Securities Act. The other two safe harbors, set out in Rules 504 and 505, are promulgated under the exemption for small offerings in § 3(b) of the Securities Act. Only the Rule 506 safe harbors are discussed here.

32 Preliminary Note 4 to Regulation D under the Securities Act. Regulation D may be relied upon for a sale by an issuer to one or more investors that involves an intermediary acting as *agent* for the issuer. However, Regulation D may not be relied upon for a sale to one or more investors by a dealer that purchases from an issuer as *principal*. In the second case, the sale by the issuer to the dealer may qualify for the Regulation D safe harbor and the sale by the dealer to the investors may qualify for the Rule 144A safe harbor. Thus, in private offerings structured on the model of public underwritten offerings (*i.e.*, an issuer sale to a dealer, acting as principal, followed by the dealer's separate sales to investors), the Regulation D safe harbor could cover the issuer's sale to the dealer, but not the dealer's resales.

33 Rules 502(d) and 144(a)(3) under the Securities Act.

34 Rule 502(c) under the Securities Act.

35 Rules 506(b)(2)(i) and 501(e)(1)(iv) under the Securities Act. Regulation D defines "accredited investor" to include most institutions, as well as directors and specified management officials of the issuer and certain

wealthy individuals. Rule 501(a) under the Securities Act. The SEC solicited comments on the definition of "accredited investor" for natural persons (SEC Release No. 33-9416 (July 10, 2013)) and published a report summarizing its review of the definition in December 2015 (SEC, REPORT ON THE REVIEW OF THE DEFINITION OF "Accredited Investor" (Dec. 18, 2015)). In the report, the staff recommended that the SEC consider several revisions to the definition, including (i) revising the financial thresholds above which a natural person may qualify as an accredited investor and (ii) permitting natural persons to qualify as accredited investors based on indicators other than financial thresholds, including a minimum investment amount or certain professional credentials. To date, the SEC has not adopted any changes to the definition of accredited investor.

36 Rule 506(b)(2)(ii) under the Securities Act. Like its predecessor (Rule 146), Rule 506 permits a prospective investor to be represented by one or more other persons having the appropriate degree of knowledge and sophistication. Rule 501(h) under the Securities Act.

37 Rule 502(b)(2)(i)(C) under the Securities Act. In 2010, the SEC proposed broad changes in disclosure requirements for asset-backed securities, including private placements. SEC Release No. 33-9117 (Apr. 7, 2010). Under these proposals, it would have been a condition to the exemptions under Rule 506 and Rule 144A for asset-backed securities that there be an undertaking to provide specified information to investors on a continuous basis throughout the life of the securities. This would have been a substantial departure from existing law, since there are currently no specific information requirements for sales to accredited investors under Rule 506 and only a limited requirement to provide continuous information for resales under Rule 144A. After requesting additional comments (SEC Release No. 33-9244 (July 26, 2011)), the SEC ultimately declined to adopt the proposed changes to the rules governing private placements. SEC Release No. 33-9638 (Sept. 4, 2014).

38 Rule 502(d) under the Securities Act.

39 Rule 503 under the Securities Act. Form D requires, among other things, information on the issuer (including its directors and officers, industry group, revenues and assets), the offering (including the number of accredited and nonaccredited investors, minimum investment size and the jurisdictions in which solicitation occurred) and the broker-dealers involved (including names and compensation).

40 Compliance with Rule 503 is not a condition to the availability of the exemption under Rule 506. SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 257.07 (Jan. 26, 2009). Rule 507 under the Securities Act expressly provides that the Regulation D exemptions are unavailable to an issuer that has previously been enjoined for failure to comply with Rule 503, but apparently no such injunction has ever been issued. *See* SEC Release No. 33-8891 (Feb. 6, 2008); SEC Office of Inspector General, Regulation D Exemption Practice 10 (Mar. 31, 2009). A 2009 report of the SEC's Office of Inspector General noted that noncompliance with Rule 503 is common and that there is no effective enforcement of the Rule. The report recommended that the SEC develop an enforcement program and consider making filing a Form D a required element of the Regulation D exemptions. SEC Office of Inspector General, Regulation D Exemption Practice (Mar. 31, 2009). In July 2013, the SEC stated that some issuers do not make Form D filings in Regulation D offerings because the filing of the form is not a condition to reliance on the Regulation D rules. SEC Release No. 33-9416 (July 10, 2013).

41 *See* Rule 506(c) under the Securities Act.

42 Rule 506(c)(2)(i) under the Securities Act.

43 Rule 503 under the Securities Act. The SEC has proposed to revise Form D to require certain additional disclosure items, some of which would apply to all Regulation D offerings and some of which would apply only to Rule 506(c) offerings. The most notable of the proposed changes would require issuers relying on Rule 506(c) to disclose (a) the methods of general solicitation used, (b) the methods used to verify accredited investor status of the purchasers and (c) the persons directly or indirectly controlling the issuer. SEC Release No. 33-9416 (July 10, 2013). To date, these proposed changes to Form D have not been adopted.

44 SEC Release No. 33-9415 (July 10, 2013).

45 SEC Release No. 33-9415 (July 10, 2013).

46 Rule 506(b) under the Securities Act.

47 *See* Rule 506(c) under the Securities Act.

48 Rule 506(c)(2)(ii) under the Securities Act.

49 SEC Release No. 33-9415 (July 10, 2013), 78 Fed. Reg. 44,771, 44,778 (July 24, 2013).

50 SEC Release No. 33-9415 (July 10, 2013).

51 Rule 506(c)(2)(ii) under the Securities Act.

52 Rule 506(c)(2)(ii)(A) under the Securities Act. The verification requirement is met if the issuer reviews specified IRS forms showing the requisite income level for the two most recent years and obtains a written representation from the potential investor that he or she has a reasonable expectation of reaching the requisite income level during the current year.

53 Rule 506(c)(2)(ii)(B) under the Securities Act. The verification requirement is met if the issuer reviews specified types of documentation of the potential investor's net worth and obtains a written representation from the potential investor that all liabilities necessary to make a determination of net worth have been disclosed.

54 Rule 506(c)(2)(ii)(C) under the Securities Act. The third party may be a broker-dealer, an investment adviser, an attorney or a certified public accountant. On June 23, 2014, SIFMA issued guidance to registered broker-dealers and investment advisers on some verification methods they could use to comply with the requirements of the safe harbor method designated for them with respect to purchasers who are natural persons as well as on some verification methods they could use to determine whether certain legal entities qualify as accredited investors. *See* SIFMA, SIFMA Guidance on Rule 506(c) Verification (June 23, 2014).

55 Rule 506(c)(2)(ii)(D) under the Securities Act. The investor must have invested in the issuer's Rule 506(b) offering prior to September 23, 2013 and continue to hold such securities.

56 Rule 506(c)(2)(ii) under the Securities Act.

57 SEC Release No. 33-9414 (July 10, 2013).

58 Rule 506(d) does not define what it means for an officer to be "participating in the offering." According to the adopting release, however, participation in an offering would be more than transitory or incidental involvement, and could include activities such as participation or involvement in due diligence activities, involvement in the preparation of disclosure documents and communication with the issuer, prospective investors or other offering participants. The SEC also considered, but determined not to make any changes to, the definition or coverage of promoters, noting that promoters represent a broad category of persons that captures all individuals and entities that have relevant relationships with the issuer or to the offering, and that those relationships must be analyzed on a look-through basis. SEC Release No. 33-9414 (July 10, 2013).

59 SEC Release No. 33-9414 (July 10, 2013).

60 The Rule delegates waiver authority to the Director of the Division of Corporation Finance and permits any court or regulatory authority that enters an order, judgment or decree that would cause an actor to be disqualified under the Rule to advise the SEC that, in its view, disqualification under Rule 506 should not arise as a consequence of such order, judgment or decree, and in such circumstances disqualification will not arise. The notice provided by the court or regulatory agency can either be in the relevant order, judgment or decree or in a separate writing to the SEC or its staff. That waiver will be effective even without a separate waiver from the SEC, if it was made before the relevant Rule 506 sale.

61 The adopting release states that issuers "should consider the totality of the offering taking into account the circumstances of the offering, the covered persons involved in the offering and the Rule's requirements, which include specific disqualifying events and covered persons subject to those disqualifying events." This will enable issuers to "determine their own methodology for a factual inquiry," which helps to promote efficiency because it enables the issuer "to tailor its own inquiry without adherence to uniform standards that

may not be applicable or appropriate in the context of a particular issuer or particular offering." SEC Release No. 33-9414 (July 10, 2013), 78 Fed. Reg. 44,730, 44,765 (July 24, 2013).

62 SEC Release No. 33-9414 (July 10, 2013), 78 Fed. Reg. 44,730, 44,747 (July 24, 2013).

63 SEC Release No. 33-9414 (July 10, 2013).

64 As an attempt to make the Regulation D safe harbors more "user friendly," the SEC adopted Rule 508, which permits issuers to deviate in part from Regulation D without losing the benefits of the safe harbor. SEC Release No. 33-6825 (Mar. 14, 1989).

65 *See supra* Note 39.

66 For example, the Rule 506 exemption turns on the nature and number of purchasers, not offerees, which is a departure from the generally accepted, and still prevailing, judicial interpretation of the § 4(a)(2) exemption. Moreover, it does not limit the number of accredited investors that can participate in any offering. The view that an exempt private placement can be made to an unlimited number of large institutional investors is also supported by the SEC's adoption of Rule 144A, as discussed at § 7.02[3].

67 SEC Release No. 33-9415 (July 10, 2013). The 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)." 78 Fed. Reg. 47,771, 44,774 (July 24, 2013).

68 Such activities include any advertisement, article, notice or other communication published in any newspaper, magazine or similar media or broadcast over television or radio and any seminar or meeting whose attendees have been invited by any general solicitation or general advertising. Rules 135c and 135e under the Securities Act provide exemptions for certain publicity activities. *See* §§ 7.02[4] and 3.02[4]. In 2007, the SEC proposed a new exemption within Regulation D, which would have permitted certain kinds of advertising in connection with an exempt offering to "large accredited investors." SEC Release No. 33-8828 (Aug. 3, 2007). This proposal was never adopted.

69 *See* SEC Release No. 33-8828 (Aug. 3, 2007), Part II.C (interest in a private placement through a "substantial, pre-existing relationship" could mean that a prior registration statement did not constitute general solicitation); *Robert T. Willis, Jr., P.C.* (avail. Jan. 18, 1988); *Mineral Lands Research & Marketing Corp.* (avail. Dec. 4, 1985); *E. F. Hutton & Co.* (avail. Dec. 3, 1985); *Woodtrails-Seattle, Ltd.* (avail. Aug. 9, 1982). *But see Agristar Global Networks, Ltd.* (avail. Feb. 9, 2004) ("Agristar") (refusing to confirm that no general solicitation would occur although a pre-existing relationship existed between the proposed offeror and the proposed offeree when the offeror proposed to send generic investor qualification questionnaires to certain principals in the offeror's database who appeared likely to be accredited investors).

70 This is to establish that, based on the *Ralston Purina* interpretation of § 4(a)(2) described above, the investor does not require the protection of the registration provisions of the Securities Act. Courts interpreting the § 4(a)(2) exemption have emphasized the importance of prospective purchasers having access to information, but have not imposed an affirmative duty on sellers to provide information to prospective purchasers. *See Law of Private Placements (Non-Public Offerings) Not Entitled to Benefits of Safe Harbors—A Report*, 66 B US. LAW, 85, 100 n.82 (2010) (a Report by the Committee on Federal Regulation of Securities, ABA Section of Business Law); *see also Investors Mortgage Group, Inc.* (avail. Feb. 9, 1976).

71 *See, e.g.*, the discussion of the exemption from registration under Rule 144 at § 7.04[2].

72 These arrangements may include, among others, establishing a restricted depositary facility for the securities or requiring an underwriter of the securities or a designated custodian to be the sole custodian through which all such securities may be held. Such measures would facilitate policing of the transfer restrictions.

73 *See* § 7.04[1].

74 Although we are not aware of any SEC gloss on what constitutes a *bona fide* market, we believe 20% of trading volume—the minimum threshold for a substantial U.S. market interest—certainly would suffice.

75 The belief may be held by a bank acting as an underwriter or a placement agent, even if as a contractual matter it does not purchase and resell the securities.

76 Nasdaq was the only such system but became a national securities exchange in 2006. *See* § 3.01, Note 4. The term "automated inter-dealer quotation system" does not include, for example, bid and ask quotations appearing in the "pink sheets" of Pink Sheets LLC (formerly the National Quotation Bureau, Inc.) or the OTC Bulletin Board. *See* SEC Release No. 34-27975 (May 1, 1990).

77 SEC Release No. 33-6806 (Oct. 25, 1988) (proposed rule); SEC Release No. 33-6862 (Apr. 23, 1990) (final rule).

78 For purposes of § 4(a)(3), the resold securities are also not part of an unsold allotment and are deemed not to have been *bona fide* offered to the public.

79 Preliminary Note 7 to Rule 144A under the Securities Act.

80 *See* § 7.04[1] for a more detailed discussion of certain documentation issues.

81 SEC Release No. 33-6862 (Oct. 25, 1988).

82 Indeed, § 201(a) of the JOBS Act required the SEC to amend Rule 144A to permit offers to persons other than QIBs, including by means of general solicitation or general advertising. In response, the SEC amended Rule 144A to eliminate the references to "offers" and "offerees" in the conditions set forth in paragraph (d)(1) of the Rule. Consequently, a seller may rely on Rule 144A even if the securities were offered to non-QIBs and even if there has been general solicitation or general advertising. Sales, however, must still be made only to QIBs. SEC Release No. 33-9415 (July 10, 2013).

83 "Qualified institutional buyer" is defined in Rule 144A(a)(1) under the Securities Act.

84 Rule 144A(a)(1)(i)(H) under the Securities Act. Certain other forms of corporate organization may also be treated as qualified institutional buyers—for example, the SEC staff has advised that limited liability companies meeting the $100 million threshold may be deemed to have QIB status. The SEC staff has also informally expressed the view that municipalities organized as corporations (such as New York City) may be treated as QIBs, while unincorporated states (such as New York State), or municipalities as such, may not. *See also Alaska Permanent Fund* (avail. July 14, 2011) (large sovereign wealth investment fund with unique form of organization may be treated as a QIB).

84.1 A limited partnership will be deemed a QIB if all of its limited partners are QIBs. The general partner need not be a QIB for the limited partnership to be deemed a QIB, unless the general partner is also a limited partner. SEC Division of Corporation Finance Compliance and Disclosure Interpretations Question 138.10 (Dec. 8, 2016).

85 A not-for-profit organization must be registered under § 501(c)(3) of the Internal Revenue Code to be eligible for purposes of Rule 144A(a)(1)(i)(H).

86 Although the SEC has not defined the term "similar business trust" for purposes of Rule 144A or the Securities Act, we consider it reasonable, based on the distinction drawn between institutional investors and individual investors in Rule 144A (both as adopted and amended) and on other factors, to conclude for purposes of Rule 144A that the term "similar business trust" refers to any trust created primarily to aggregate funds of a number of investors to engage in profit-making activity, including investing in securities or other assets, rather than one created primarily to protect and preserve the assets of an individual or one or more related individuals. If a trust is not established as a Massachusetts or similar business trust, in order for the trust to qualify as a QIB, each of its beneficiaries must be a QIB as provided in paragraph (v) below.

87 Rule 144A(a)(1)(i)(A) under the Securities Act.

88 Rule 144A(a)(1)(i)(D), (E) and (F) under the Securities Act. A trust fund may not have individual accounts as participants.

89 Rule 144A(a)(1)(i)(B), (C), (G) and (I) under the Securities Act. It is also reasonable to conclude that an unregistered investment adviser (assuming it is organized as a partnership or corporation and is not a natural person) that is acting for an unregistered investment company that is a qualified institutional buyer may purchase under Rule 144A.

90 Rule 144A(a)(1)(ii) and (iii) under the Securities Act.

90.1 An investment company that is not registered under the Investment Company Act cannot aggregate investments by other funds that are part of its family of funds when determining its status as a QIB. SEC Division of Corporation Finance Compliance and Disclosure Interpretations Question 138.09 (Dec. 8, 2016).

91 Rule 144A(a)(1)(iv) under the Securities Act.

92 Rule 144A(a)(1)(vi) under the Securities Act.

93 SEC Release No. 33-6862 (Apr. 23, 1990), 55 Fed. Reg. 17,933, 17,936 (Apr. 30, 1990).

94 According to the release adopting Rule 144A, "foreign bank" is defined in Rule 6c-9(b)(2) and (3) under the Investment Company Act. As a result of the SEC's rescission of Rule 6c-9 in 1991, the release should be read to refer instead to Rule 3a-6 under the Investment Company Act, which replaced Rule 6c-9. *See* § 15.05[2]. In keeping with the less stringent financial reporting standards applicable to foreign private issuers (Item 8 of Form 20-F), net worth is to be determined as of a date not more than 18 months (as opposed to 16 months) prior to the sale date. A bank's net worth currently includes the bank's perpetual preferred stock, common stock, surplus, undivided profits and capital reserves (less net unrealized loss on marketable equity securities) and cumulative foreign currency translation adjustments. For a U.S. thrift, net worth equals its adjusted core capital stated in its audited balance sheet. In adopting Rule 144A, the SEC requested comment on the appropriateness of the net worth test, including the $25 million threshold, and whether this test is rightly applied to foreign banks. SEC Release No. 33-6862 (Apr. 23, 1990). The test received mixed reviews. On the one hand, the Board of Governors of the Federal Reserve System preliminarily concluded that the test does not appreciably affect the number of insured banks that would qualify to purchase securities under Rule 144A, *see* Letter from Robert S. Plotkin, Division of Banking, Board of Governors of the Federal Reserve System, to Linda C. Quinn, Director, SEC Division of Corporation Finance (Aug. 1, 1990), and the United States League of Savings Institutions expressed support for the test, *see* Letter from Renie Yoshida Grohl, United States League of Savings Institutions, to Jonathan G. Katz, Secretary, SEC (June 12, 1990). On the other hand, private banking associations objected to the test as unfairly discriminating against banks, *see* Letter from Anthony T. Cluff, Association of Reserve City Bankers, to Jonathan G. Katz, Secretary, SEC (June 14, 1990). No commenters addressed the application of the test to foreign banks.

95 Rule 144A(a)(1)(v) under the Securities Act.

96 SEC Release No. 33-6963 (Oct. 22, 1992).

97 SEC Release No. 33-6963 (Oct. 22, 1992).

97.1 SEC Division of Corporation Finance Compliance and Disclosure Interpretations Questions 138.05 and 138.06 (Dec. 8, 2016).

98 The SEC staff has declined to take the position that the only type of arrangement to be excluded as a loan participation is that in which a participating bank is not in privity with the borrower but instead relies on an original lender to underwrite, administer and enforce the loan, although it has confirmed that generally, if an instrument would be subject to registration under the Securities Act, absent an exemption, it may be counted in determining the status of a buyer under the Rule. *Unum Life Insurance Company* (avail. Nov. 21, 1990). The SEC staff has often said that "pass-through" securities will not be deemed to be loan participations.

98.1 SEC Division of Corporation Finance Compliance and Disclosure Interpretations Questions 138.07 and 138.08 (Dec. 8, 2016).

98.2 Rule 144(a)(2) under the Securities Act.

98.3 Rule 144(a)(1)(ii) under the Securities Act.

99 Rule 144A(d)(1) under the Securities Act. Acceptable means are (i) a certificate of the chief financial or other executive officer of the prospective purchaser that specifies the amount of securities that it owned and invested on a discretionary basis on a specific date on or since the close of the prospective purchaser's

most recent fiscal year, (ii) the most recent publicly available financial statements of the prospective purchaser, (iii) the most recent publicly available information appearing in documents filed by the prospective purchaser with the SEC or another U.S. or foreign governmental agency or self-regulatory organization and (iv) the most recent publicly available information appearing in a recognized securities manual, in each case if the information is provided as of a date (16 months or, in the case of a foreign purchaser, 18 months prior to sale under the Rule) otherwise required by the Rule. However, a representation or certificate of a prospective purchaser claiming that it is a qualified institutional buyer, without more, is not sufficient in the view of the SEC staff.

100 *See CommScan, LLC* (avail. Feb. 3, 1999) (sellers may rely on the QIB List maintained by CommScan (now Dealogic)); *Communicator Inc.* (avail. Sept. 20, 2002) (broker-dealers may rely on the QIB List maintained by Communicator in a joint venture with eight leading broker-dealers).

101 SEC Release No. 33-6839 (July 11, 1989) (reproposing Rule 144A for public comment).

102 Rule 144A(d)(3)(ii) under the Securities Act. *See* § 15.06 for a discussion of issues raised in connection with U.S. private placements of securities by companies that are investment companies, including closed-end investment companies, whose securities are technically eligible for Rule144A. Private offerings of investment company securities are subject to restrictions that go beyond those applicable under the Securities Act.

103 Rule 144A(d)(3) under the Securities Act. The staff of the SEC has also confirmed that securities are eligible for resale under Rule 144A if they are received, without any payment by holders, upon conversion of convertible securities that are themselves eligible for resale under the Rule. *Debevoise & Plimpton* (avail. July 23, 1990). Based on a similar analysis, securities of an issuer obtainable upon the cashless exercise of warrants issued by the same issuer should be eligible for resale under Rule 144A, provided that the warrants themselves are eligible for resale under Rule 144A *. Cf.* Rule 144(d)(3)(x); SEC Release No. 33-8869 (Dec. 6, 2007); SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 132.11 (Jan. 26, 2009) (where equity securities of an issuer are acquired upon "cashless" exercise of warrants or options, the holding period for the equity securities may be "tacked" to the holding period of the warrants or options, except in the case of cashless exercise of employee stock options).

104 Rule 144A(d)(3)(i) under the Securities Act.

105 SEC Release No. 33-6839 (July 19, 1989); SEC Release No. 33-6862 (Apr. 23, 1990).

106 *See* § 10.06 for a general discussion of mandatorily exchangeable securities.

107 SEC Release No. 33-6862 (Apr. 23, 1990).

108 *See, e.g.*, §§ 12(g)(5), 15(d) and 16 of the Exchange Act. In the release adopting Rule 144A, the SEC expressed its intention to interpret Rule 144A's "fungibility" requirement in the case of equity securities in a manner consistent with its practice under § 12(g)(5) of the Exchange Act.

109 Louis Loss, FUNDAMENTALS OF SECURITIES REGULATION 642–43 (6th ed. 2011).

110 *See, e.g.*, *Jevic Transportation, Inc.* (avail. Apr. 20, 1999); *Bear, Stearns & Co.* (avail. Aug. 2, 1982); *Cal-West Real Estate Fund* (avail. Oct. 15, 1979); *Cal-American Income Property Fund II* (avail. Sept. 1, 1975); *Motorola, Inc.* (avail. Jan. 31, 1972); *see also Turner Broadcasting System, Inc.* (avail. Feb. 6, 1990) (two classes of common stock that varied as to voting and dividend rights were separate classes for purposes of § 16(a) of the Exchange Act); *Petro-Search, Inc.* (avail. July 28, 1975) (interests in separate partnerships constituted separate classes of securities for purposes of § 15(d) of the Exchange Act).

111 *Amana Society* (avail. Sept. 23, 1974); *Ellerin v. Massachusetts Mutual Life Insurance Co.*, 270 F.2d 259 (2d Cir. 1959).

112 SEC Release No. 33-6862 (Apr. 23, 1990), 55 Fed. Reg. 17,933, 17,935 (Apr. 30, 1990). In this respect, the SEC deviated from the position it has taken from time to time with respect to the broad reach of Exchange Act reporting requirements. *See, e.g.*, *Ellerin v. Massachusetts Mutual Life Insurance Co.*, 270 F.2d 259 (2d Cir. 1959) (where the SEC urged treatment of two series of preferred stock as a single class

of securities for purposes of § 16 of the Exchange Act).

113 SEC Release No. 33-6862 (Apr. 23, 1990), 55 Fed. Reg. 17,933, 17,935 (Apr. 30, 1990).

114 SEC Release No. 33-6862 (Apr. 23, 1990). In view of the aim of the nonfungibility requirement, for purposes of Rule 144A, securities are not of the same class and series if they are expected to trade as different series in the secondary market. In the case of "strips," where the interest and principal payments, or the dividend and capital appreciation components, of a listed security are separated into two securities, a question is raised as to the fungibility of the new instruments with the underlying security. In light of the purpose of the Rule 144A fungibility requirement, the "strips" should not be considered fungible since they can be expected to have substantially different trading patterns from the listed security.

115 The exemption under Rule 12g3-2(b) is discussed in § 4.02[3][a][iv].

116 Schedule B to the Securities Act is available for the registration of securities of a foreign government, as defined in Rule 405 under the Securities Act. The definition includes the government of a foreign country or a political subdivision of a foreign country, and Schedule B is also used to register securities of an agency or instrumentality of a foreign government that are fully and unconditionally guaranteed by that government. *See* § 3.05[1].

117 *See Homestake Mining Company* (avail. Aug. 28, 1998); *British Aerospace Public Limited Company* (avail. May 9, 1990). The SEC has also taken this position where an entity guarantees all of the obligations of its wholly owned subsidiary under warrants issued by the subsidiary and exercisable for securities of the guarantor. *Schering-Plough Corp.* (avail. Nov. 21, 1991). According to informal SEC advice, an agreement between an issuer and, for example, its parent whereby the parent agrees to provide funds or net worth necessary for the issuer to make payment (a so-called "keepwell" or "support" agreement) will not be treated as the functional equivalent of a guarantee for these purposes and, accordingly, a subsidiary benefiting from such an agreement must comply with Rule 144A(d)(4) in connection with its issuance of Rule 144A securities.

118 The SEC did not specify in adopting Rule 144A whether the required information must be provided in English. It ought to be the case, however, that no special translations or English language versions of the information need be provided if not otherwise available. First, the premise of Rule 144A is that qualified institutional buyers have sufficient sophistication and economic clout to fend for themselves—including, presumably, by reviewing disclosure in a foreign language or requiring the issuer to provide English summaries of any information not already in English. Second, in the context of Rule 12g3-2(b) under the Exchange Act (discussed at § 4.02[3][a][iv]), the SEC has expressly addressed the translation issue by specifying cases in which translations or English language summaries or versions are required. The SEC could have, but did not, include a similar requirement in Rule 144A. Thus, it would appear that the Rule's information delivery requirement may be met using foreign language documents. Certainly no more than an English language summary of the documents should be required. The staff of the SEC has in any event stated that it will not respond to inquiries concerning the adequacy of information proposed to be supplied pursuant to Rule 144A(d)(4). SEC Release No. 33-6862 (Apr. 23, 1990). Nevertheless, the SEC staff has stated, in the case of securities issued by a company and its principal subsidiary and guaranteed by two other groups of subsidiaries, that compliance with the Rule 144A(d)(4) requirements regarding financial statement presentation may be satisfied by aggregate presentation of financial results for each of the two groups. *CEMEX, S.A.* (avail. May 7, 1992).

119 Rule 144A(d)(4)(ii)(C) under the Securities Act. For U.S. issuers, by contrast, the balance sheet must be as of a date less than 16 months before the date of resale, and the statements of profit and loss and retained earnings must relate to the 12-month period preceding the date of the balance sheet. If the balance sheet is not as of a date less than six months before the date of resale, it must be accompanied by additional statements of profit and loss and retained earnings for the period from the date of the balance sheet to a date less than six months prior to the resale date. Rule 144A(d)(4)(ii)(A) under the Securities Act. Finally, the description of the issuer's business must be as of a date within 12 months prior to the resale date. Rule 144A(d)(4)(ii)(B) under the Securities Act.

120 *See* Separate Statement of Commissioner Fleischman, SEC Release No. 33-6862 (Apr. 23, 1990); *see also* Preliminary Note 1 to Rule 144A under the Securities Act ("This section relates solely to the application of Section 5 of the [Securities] Act and not to the antifraud or other provisions of the federal securities laws."). When Rule 144A was adopted, it was widely assumed that purchasers in a private placement also had a remedy under § 12(a)(2) of the Securities Act, although *Gustafson v. Alloyd Co.*, 513 U.S. 561 (1995), later held otherwise. *See* § 11.04[1].

121 *See* § 11.04.

122 Similar questions arise with respect to information presented in a "Management's Discussion and Analysis" section in a registration statement or report, *see* § 4.06, and with respect to communications with financial analysts, *see* § 4.10[4].

123 Under § 12(g) of the Exchange Act, a foreign private issuer that has 2,000 or more holders of record (or 500 or more holders of record who are not accredited investors) of a class of equity securities and more than $10 million in total assets, and 300 or more U.S. resident holders at the end of its most recently completed fiscal year, must register that class under the Exchange Act unless an exemption is available. Exchange Act registration requires a company to comply with SEC reporting requirements and with the Sarbanes-Oxley Act. However, an automatic exemption is available under Rule 12g3-2(b) under the Exchange Act, which exempts a non-U.S. company that has not listed or publicly offered securities in the United States from Exchange Act registration provided such company complies with the criteria under Rule 12g3-2(b). SEC Release No. 33-10075 (May 3, 2016). The criteria for the exemption under Rule 12g3-2(b) are discussed in § 7.02[3].

124 The information made public to meet the conditions for the Rule 12g3-2(b) exemption may still be subject to the antifraud provisions of § 10(b) of the Exchange Act and Rule 10b-5 thereunder.

125 *See* Form F-6, General Instruction I.A; § 3.04[1][b].

126 Rule 144A(d)(2) under the Securities Act. In 2010, the SEC proposed broad changes to the disclosure requirements for asset-backed securities, including private placements. SEC Release No. 33-9117 (Apr. 7, 2010). Under these proposals, an issuer would have been required to file with the SEC a notice of a Rule 144A offering of asset-backed securities providing specified information to investors. Rule 144A has not otherwise required any public notice. After requesting additional comments (SEC Release No. 33-9244 (July 26, 2011)), the SEC ultimately declined to adopt the proposed changes to the rules governing private placements. SEC Release No. 33-9638 (Sept. 4, 2014).

127 For a discussion of undocumented offerings, *see* § 13.06.

128 A sample legend might read "Sale Relying on Rule 144A—Restricted Security."

129 *See supra* Notes 67 and 68. *See also* text accompanying Notes 147–155 for a discussion of general solicitation and general advertising in the context of private offerings through the Internet.

130 A tombstone advertisement issued upon completion of a traditional private placement may also constitute a solicitation if, for example, the offering was part of an ongoing program. *Alma Securities Corp.* (avail. Aug. 2, 1982).

131 Rule 135c(a) under the Securities Act.

132 In the case of rights or exchange offerings, or offerings to the employees of the issuer or its affiliates, certain additional information may be provided. Rule 135c(a)(3) under the Securities Act.

133 Rule 135c(d) also requires an issuer that is exempt under Rule 12g3-2(b) to furnish any Rule 135c notice to the SEC "in accordance with the provisions of that exemptive section," but Rule 12g3-2(b) was amended in 2008 to eliminate the submission of documentation to the SEC. SEC Release No. 34-58465 (Sept. 5, 2008).

134 SEC Release No. 33-7470 (Oct. 10, 1997).

135 Note to paragraph (a)(1) of Rule 135e under the Securities Act. *See* § 4.05[4] for further discussion of Rule 135e.

136 As discussed below in § 7.09, for non-SEC-reporting issuers in Rule 144A offerings, U.S. state "blue sky"

laws also may inhibit the full use of the flexibility provided under the revised rules.

137 The SEC's proposal to require a Form D filing in advance of the first use of general solicitation, if adopted, could affect the timing of these press releases in Rule 506(c) offerings.

138 Issuers subject to Regulation FD will also have to consider the implications of any communications or disclosures of material nonpublic information they make as part of general solicitation materials. *See* § 3.02[3][c] for a discussion of Regulation FD. Form 8-K and Form 6-K filings designed to ensure public dissemination of material nonpublic information included in an offering circular for a Rule 144A or Rule 506(c) offering can now include the offering circular as an exhibit rather than including a summary of the specific material information without referencing the offering, as had been the practice to comply with Regulation FD before the elimination of restrictions on general solicitation and general advertising in connection with these types of offerings. However, liability concerns about expanding the scope of potential liability to secondary market participants for the entire contents of the offering circular may still favor the previous practice.

139 [Reserved.]

140 These kinds of services will need to consider a variety of issues, including whether they will be required to register as a broker-dealer under the Exchange Act.

141 Rules 138(b) and 139(c) under the Securities Act; *see* SEC Release No. 33-8591 (July 19, 2005). The safe harbors are not available for an offering under Regulation D (but are no longer necessary in connection with a Rule 506(c) offering) or § 4(a)(2).

142 *See* § 3.02[2][c] for a full discussion of Rules 138 and 139. *See* § 14.07[5] for a discussion of FINRA rules applicable to broker-dealer research practices.

143 *See* §§ 3.02[2] and 3.02[2][d] for a discussion of research in the context of a registered offering. As discussed in § 3.02[2][d], underwriters' practices concerning pre-deal research are influenced not only by regulatory issues, but also by the prospect that the content of research reports could be a potential source of liability. (Liability for a research report is not covered by indemnification from the issuer in a standard purchase agreement.) Based mainly on this concern, market participants have historically imposed a blackout period on pre-deal research for a limited period prior to the launch of marketing for the offering in order to be in a position to argue that the research reports should be viewed separately from the prospects, and underwriters also often agree to other restrictions such as limiting the scope of projections.

144 *See* § 14.07[5][b] for a discussion of the Global Research Settlement. *See also* FINRA Rules 2241 (for equity research) and 2242 (for debt research), FINRA MANUAL. Some banks avoided the distribution of pre-deal research in the United States for liability reasons even before the settlement. The research practices of international investment banks concerning pre-deal research still vary, based on differing views of the concerns discussed in the text above and in Note 143 *supra*, but in a given offering the underwriters often agree on a set of procedures to avoid divergent approaches. The SEC clarified that the provisions of the JOBS Act liberalizing the publication of research about "emerging growth companies" do not amend or modify the Global Research Settlement. *See* SEC, Division of Trading and Markets, Jumpstart Our Business Startup Act—Frequently Asked Questions [("FAQs")] About Research Analysts and Underwriters (Aug. 22, 2012), SEC Trading and Markets FAQs, FAQ2. Any investment bank currently subject to the Global Research Settlement therefore cannot take advantage of any relevant JOBS Act provision without first seeking amendment or modification of the Global Research Settlement from the court overseeing its application, and the SEC could support or oppose a requested modification. Although the SEC has indicated that the Global Research Settlement may also be modified through an SEC, FINRA or NYSE rule that specifically states an intent to supersede it, there is no evidence that such future rulemaking is likely.

145 The SEC has addressed the difference between investment banking personnel "arranging" for communication between research analysts and investors—conduct permitted by the JOBS Act in connection with an emerging growth company IPO—and "directing" research analysts to communicate with prospective clients or engage in other sales efforts—conduct prohibited by existing FINRA/NASD and NYSE rules. Permissible "arranging" includes an investment banker sending an analyst a list of clients to

contact, provided the analyst retains the discretion to decide whether to do so, and an investment banker arranging a call between an analyst and a client, provided the investment banker does not participate in such call. SEC Trading and Markets FAQs, FAQ 3 (Aug. 22, 2012).

146 In a registered offering, this kind of activity is limited by a number of considerations: the prohibition under § 5(c) of the Securities Act on making offers before a registration statement is filed; the conditions on reliance on the safe harbors from § 5(c) provided by Rule 163 (for a well-known seasoned issuer) and Rule 163A under the Securities Act; and the requirement (in an IPO) under the Instructions to Item 501(b)(3) of Regulation s -K to provide a price range in any preliminary prospectus that is "circulated." *See* §§ 3.02[2][a] and [b].

147 *See* § 7.02[1] and [2] for a discussion of the requirements for valid private offerings conducted in reliance on § 4(a)(2) of the Securities Act or Regulation D thereunder and § 7.02[3] for a discussion of the requirements for valid private offerings conducted pursuant to Rule 144A. As discussed above, the prohibition on general solicitation and general advertising no longer applies in offerings under Rule 506(c) of Regulation D and Rule 144A.

148 *See* § 7.02[4].

149 *Cf.* § 3.02[2][v][A] for a discussion of publicity with respect to the Internet in the context of a public offering.

150 *See* § 3.02[2][v][A]. This approval is relevant only for issuers who are not conducting a Rule 144A or Rule 506(c) offering, for which general solicitation (*via* the Internet or any other medium) is not prohibited.

151 *See Net Roadshow, Inc.* (avail. Jan. 30, 1998); *Net Roadshow, Inc.* (avail. Sept. 8, 1997).

152 *Net Roadshow, Inc.* (avail. Jan. 30, 1998).

153 *See* § 3.02[2][c][iii], therein and the accompanying text for a discussion of standard market practice regarding the taping of live road shows.

154 SEC Release No. 33-7516 (Mar. 23, 1998). The SEC subsequently emphasized the importance of restricting access from the United States or by U.S. persons, as appropriate, to web-posted offshore offering materials for offshore offerings conducted in conjunction with a U.S. private placement.

155 *See* Chapter 3, Note 237 therein for a discussion of the variety of electronic "gateposts" that can be used to restrict access to an Internet website. Where the offering materials posted on the website appear in English, it would be prudent to employ the more restrictive of these gateposts. Even where the posted offering materials are not in English, it may be prudent to employ more restrictive mechanisms, where, for instance, there is reason to believe a large expatriate community resident in the United States may seek to invest in securities issued by a company in their home jurisdiction.

156 *See* § 3.02[3][ix]. Some companies have conducted their own offerings on the Internet. These have tended to be issuers with small capitalizations that have used the Internet to raise fairly small sums, typically without the assistance of established underwriters. However, most issuers and established underwriters do not show signs of moving substantially away from traditional offering practices relying on paper-based disclosure, and most are using the Internet only supplementally.

157 Consideration must also be given to compliance with the broker-dealer registration requirements of the Exchange Act in connection with the use of the Internet to disseminate disclosure documents. *See* § 14.03.

158 *See* § 3.02[3][c][i].

159 *See* § 7.02[4].

160 Rule 502(a) under the Securities Act. In 2007, the SEC proposed to reduce the time frame for the Rule 502(a) integration safe harbor to 90 days, but it has never acted on the proposal. SEC Release No. 33-8828 (Aug. 3, 2007). The Note to Rule 502(a) also describes five factors to be considered in determining whether offers and sales should be integrated: (i) whether the sales are part of a single plan of financing, (ii) whether the sales involve issuance of the same class of securities, (iii) whether the sales have been made at or about the same time, (iv) whether the same type of consideration is being received and (v) whether the sales are made for the same general purpose.

161 Recent guidance from the SEC confirmed that a Rule 506(c) offering can follow a Rule 506(b) offering,

within six months of the Rule 506(b) offering (six months being the Rule 502(a) time-based threshold otherwise applicable to determine that two Regulation D offerings should not be integrated), and notwithstanding the five factors set forth in Rule 502(a) as being indicative of whether two offerings within six months of each other should be integrated. SEC Division of Corporation Finance Compliance and Disclosure Interpretations Question 256.34 (Nov. 17, 2016).In practice, this means an issuer can, for example, raise capital today from a number of investors with whom it has a previously existing relationship, under Rule 506(b) and without the need to take reasonable steps to verify the accredited investor status of those investors (so long as it "reasonably believes" they are accredited investors, as Rule 506(b) requires). Once all sales under that Rule 506(b) offering are completed, the issuer can then immediately do a separate offering under Rule 506(c) to raise additional capital by using general solicitation to find additional investors. The issuer would then have to take reasonable steps to verify accredited investor status of the investors only in the second (Rule 506(c)) offering. Earlier integration guidance from the SEC in 2015 addressed the combinations of Rule 506 offerings with each of Regulation A (SEC Release No. 33-9741 (Mar. 25, 2015)), proposed amendments to Rule 147 under the Securities Act (SEC Release No. 33-9973 (Oct. 30, 2015) (final rule)) and Regulation Crowdfunding (SEC Release No. 33-9974 (Oct. 30, 2015) (final rule)) but did not address the combination of consecutive offerings under Rules 506(b) and 506(c) (or vice versa).

162 The SEC's integration doctrine concerns "the determination as to whether separate sales of securities are part of the same offering (*i.e.*, are considered ‘integrated’)." SEC Release No. 33-6863 (Apr. 24, 1990), 55 Fed. Reg. 18,306, 18,322 (May 2, 1990). The question of integration originally arose with respect to whether two or more otherwise exempt offerings should be treated as a single offering to determine whether an exemption is available. The SEC has addressed integration of exempt offerings in, *inter alia*: Rule 502(a) under the Securities Act (safe harbor from integration for Regulation D offerings) and Preliminary Note 7 to Regulation s (no integration of private domestic offerings with offshore sales under Regulation s); *see also* § 7.02[2].

163 *Black Box Inc.* (avail. June 26, 1990); *Quad City Holdings, Inc.* (avail. Apr. 8, 1993).

164 *Black Box Inc.* (avail. June 26, 1990) (noting, however, that, if the issuer were to renegotiate the purchase agreements following the filing of the registration statement, the renegotiated placement might constitute a new offering and thus render this "completion" interpretation of the rule inapplicable). Thus, transactions in which investors agree to purchase securities in private offerings but condition closing on the availability of an effective resale registration statement (so-called "PIPE" transactions) are permitted under this *Black Box Inc.* interpretation of Rule 152, so long as the investors' commitments are subject only to conditions beyond their control and there is no renegotiation of the terms of the purchase after the filing of the registration statement. However, if there are any commitments made by investors after such filing to purchase privately the securities to which the registration statement relates, Rule 152 would be unavailable, the private offering could be integrated with the public offering deemed to have commenced with the filing of the registration statement, and the solicitation of the pre-filing commitments could be deemed to constitute an illegal public offer.

165 *Privatization of the United States Enrichment Corp*. (avail. May 13, 1998) (expressing the staff's view that unregistered offers to sell securities in connection with a possible merger or acquisition transaction, if made pursuant to a valid private placement exemption, need not be integrated with a subsequent initial public offering commenced by the filing of a registration statement after such possible merger or acquisition transaction has been abandoned).

166 *Squadron, Ellenoff, Pleasant & Lehrer* (avail. Feb. 28, 1992). Although the SEC staff is understood to have intended the restrictions in the Squadron letter to apply to both offerees and purchasers, we believe applying the restrictions to offerees is unduly restrictive and inconsistent with Regulation D 's focus on purchasers alone.

167 In taking this position, the SEC nevertheless distinguishes between a registration statement filed with respect to a specific issue of securities and a shelf registration statement. In the latter case, because the registration statement covers securities the final terms of which will not be determined until a "takedown" is

effected, no general solicitation occurs upon the mere filing of the registration statement. *See* SEC Release No. 33-7606 (Nov. 3, 1998), *as amended*, SEC Release No. 33-7606A (Nov. 13, 1998). This concern does not apply in the case of a Rule 144A or Rule 506(c) offering, for which general solicitation is not prohibited.

168 SEC Release No. 33-8828 (Aug. 3, 2007); *see also* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Sections, Question No. 139.25 (Nov. 26, 2008). Although the proposal to revise Regulation D was not adopted, the guidance in the release on this topic remains salient. Again, this concern does not apply in the case of a Rule 144A or Rule 506(c) offering, for which general solicitation is not prohibited.

169 SEC Release No. 33-7943 (Jan. 26, 2001); *see also infra* Note 234. Reliance on Rule 155 is unnecessary where an abandoned public offering is followed by a Rule 144A or Rule 506(c) offering, for which general solicitation is not prohibited.

170 The SEC staff has said informally that it will not permit reliance on Rule 155(b) if an issuer with an effective shelf registration statement wishes to distribute, on a private basis and without filing, written material about a proposed new securities offering and, if it is well received, convert that private placement into a shelf takedown.

171 In connection with the adoption of Rule 155, Rule 477 under the Securities Act was amended to provide that an issuer's application to withdraw an entire pre-effective registration statement will become effective automatically upon filing with the SEC unless it objects within 15 days. The SEC also indicated that it would consider promptly applications to withdraw effective registration statements. In addition, Rules 429 and 457 under the Securities Act were amended to permit issuers to offset the filing fees paid in respect of withdrawn registration statements against future filing fees within the five years following their original filing. *See* SEC Release No. 33-7943 (Jan. 26, 2001).

172 *See* SEC Release No. 33-7943 (Jan. 26, 2001). The SEC staff has indicated in an informal meeting with practitioners that the Rule 155(c) safe harbor will not be available if marketing efforts prior to abandoning the registered public offering constitute general solicitation with respect to the subsequent private offering, even if those marketing efforts were part of a good faith effort to complete the public offering and not part of a plan or scheme to avoid registration of the subsequent private offering. Neither the language of the Rule itself nor the discussion of it in the adopting release suggests this additional condition. If indeed the SEC continues to take this view, it could effectively limit the availability of the safe harbor, where there has been more than a quiet filing of the registration statement, to private offerings only to those with whom the issuer or its underwriters have a pre-existing relationship or done in reliance on Rule 506(c) or Rule 144A.

U.S. Regulation of the International Securities and Derivatives Markets, § 7.03, DISCLOSURE AND DUE DILIGENCE PRACTICES IN RULE 144A OFFERINGS

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.03 (11th and 12th Editions 2014-2017)
11th and 12th Editions

Most offerings by foreign private issuers to U.S. investors are structured as private placements, generally as offerings through financial intermediaries relying on Rule 144A. The principal technical U.S. legal issues in such an offering involve meeting U.S. regulatory requirements: ensuring that the offering is exempt from registration under the Securities Act; determining that the issuer is not an investment company or, if it is, ensuring that the offering is structured to comply with the Investment Company Act; [173] determining that the offering does not have derivative features that present issues under the Commodity Exchange Act; [174] and in the case of debt securities, ensuring that there is no violation of the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") rules. [175] In addition to these technical issues, however, Rule 144A offerings are shaped by disclosure and due diligence practices. These practices reflect U.S. liability concerns, and they have evolved to address them, in addition to complying with legal requirements and market practices in the issuer's home jurisdiction or in the primary trading market for its shares. [176]

The disclosure process in a typical Rule 144A offering is similar in its broad outlines to the process in a U.S. public offering. The issuer, assisted by counsel, prepares a formal offering document, [177] which is distributed to investors in preliminary form for use in marketing the offering and then in final form

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after the offering has been priced. [178] The financial institutions conducting the offering, assisted by counsel, conduct a due diligence investigation prior to the commencement of marketing and update it (or "bring it down") before pricing and again at closing. Those institutions, acting as initial purchasers, [179] enter into a purchase agreement with the issuer, in which (among other things) the issuer provides representations relating to the offering circular and to its legal status, business and other matters, the issuer agrees to indemnify the initial purchasers against liabilities arising from the disclosure, and the obligations of the initial purchasers are conditioned on delivery of documentation (*e.g.*, legal opinions and auditors' comfort letters) that supports the due diligence. If there are selling securityholders in an equity offering, they are also parties to the purchase agreement, and the contractual allocation of risk between selling securityholders and the issuer, through representations and indemnities, is negotiable; but the issuer is still responsible for the offering circular. There is typically a road show presentation, distinct from the offering circular but in principle consistent with it. [180]

[1] The Rule 144A Offering Circular—Form

There are many possible formats for an offering circular in a Rule 144A offering, depending on the structure of the offering. For example, many debt

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offerings are placed with U.S. institutional investors under Rule 144A and with non-U.S. investors under local exemptions from registration for institutional placements, so that no regulatory approval is required in any jurisdiction. In such an offering, it is typical to prepare a single, integrated, stand-alone offering circular in English. [181] Many equity offerings, on the other hand, are placed with U.S. institutional investors under Rule 144A and in a concurrent public offering registered under local securities laws in the home jurisdiction, which is the principal or only trading market. [182] In an equity offering of this kind, there would be (i) an offering circular for use in the Rule 144A placement (and for use in the offering elsewhere outside the home market) and (ii) a parallel prospectus for use in the home jurisdiction. The preparation of the parallel offering documents is particularly complex if the home jurisdiction prospectus is not in English. Practices vary widely as to whether the English-language offering circular or the home-language prospectus is prepared first.

If the issuer is a reporting company in the United States, information may be incorporated by reference into a Rule 144A offering circular from material filed with the SEC. This practice was at one time debated, because of the absence of any specific basis for it in the SEC's rules, but it has ceased to be controversial. Rule 144A offering circulars do not typically incorporate by reference material filed with a non-U.S. securities regulator or exchange, although they could presumably do so if the material is readily available, at least if it is in English.

Where the Rule 144A offering is part of a global offering that is primarily conducted outside the United States, the global offering document may include certain disclosure material that relates specifically to the U.S. placement. This disclosure might, for example, cover the aspects of the plan of distribution that are relevant to the U.S. market, restrictions on resale of the privately placed securities, any related ADR program, and tax consequences to U.S. purchasers. Alternative approaches, used less often today than in the past, include (i) a supplement (sometimes known as a "*wrap-around*") attached to the non-U.S. offering documentation and containing only the U.S. market material and (ii) a separate "U.S. version" of the offering circular for use in the United States, differing from the "non-U.S. version" only in including the U.S. market material.

[2] The Rule 144A Offering Circular—Content

The content of a Rule 144A offering circular is determined by a number of different factors. One of the most important is marketing, because the offering

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circular serves to present the securities and the issuer in a manner that is favorable to the success of the offering and that also responds to the expectations of institutional investors. Another is precedent, because investors and initial purchasers tend to compare disclosure in a new offering with disclosure in similar offerings or of similar issuers.

A third factor is existing disclosure. If the issuer is subject to periodic reporting in its home country or principal trading market, it will have existing disclosure that responds to local regulatory requirements and that is already being relied on by existing investors. If, on the other hand, it is conducting an initial public offering in its home jurisdiction concurrently with a Rule 144A offering in the United States, it will prepare disclosure for its home regulator in accordance with that regulator's requirements. In such cases, where the issuer will provide disclosure for home-country purposes at the same time as it provides an offering circular to Rule 144A investors, there is usually consensus that the two disclosure documents should be consistent—because if they diverge, the differences could be used in retrospect to characterize one of them as deficient, and also because regulators in the home jurisdiction may expect that information provided to investors in the international offering will also be provided to investors in the home offering. Divergences do, however, arise. The home country disclosure may include material that is unnecessary or confusing in the context of a Rule 144A offering, or that cannot be verified in the due diligence process, and that is consequently omitted from the Rule 144A offering circular. [183] Conversely, the Rule 144A offering circular may include material that is considered unnecessary under home country practice.

In addition to these factors, practitioners have developed a broad consensus that certain items of disclosure are standard in Rule 144A offerings. This consensus is reflected in the criteria of international financial institutions for their participation in a Rule 144A transaction, and in the criteria of international law firms and auditing firms for their participation and for their delivery of the "negative assurance" letters on disclosure that are customary conditions precedent to closing. Ultimately all these are driven by a combination of liability concerns, reputational concerns, investor expectations and institutionalized best practices. For all these purposes, the touchstone is materiality to investors—the offering

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circular must be free of both material misstatements and omissions of material facts necessary to make the statements made therein not misleading. Practices in SEC-registered offerings often serve as a reference point: if a particular element of disclosure would be sufficient in a U.S.-registered offering, it is presumed to be sufficient in a Rule 144A offering. But other sources, including implementing regulations and practices under the European Prospectus Directive, are important as well, and generally the fact that information would be disclosed in a registered public offering does not in itself require the conclusion that it must also be disclosed in a Rule 144A offering.

Views about the sufficiency of disclosure evolve as market practices change. Following is a list of core elements of disclosure in a Rule 144A offering, without which an offering circular would present challenges for an investment bank, an auditor or a law firm. The list includes only the principal disclosure elements that arise in common situations.

Audited financial statements—Financial statements of the issuer, with full notes and audited by an independent auditor are included. Financial statements in Rule 144A offerings may be presented under various systems of accounting principles—U.S. generally accepted accounting principles ("GAAP"), International Financial Reporting Standards ("IFRS") or another national system. [184] The audited financial statements are generally consolidated. They typically cover three years, based on what would be required under SEC rules and under the European Prospectus Directive and implementing regulations. [185] They are accompanied by explanatory notes, whose scope and content are governed by the applicable accounting and auditing principles. Unless the issuer is an SEC-reporting company, the standards governing the conduct of the audit are usually not the Public Company Accounting Oversight Board ("PCAOB") standards that would apply in an SEC-registered offering, [186] and auditor independence is not

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usually evaluated under Regulation s -X, as it would be in an SEC-registered offering. [187] The audited financial statements are sometimes more than 12 months old by the time the securities are sold—in other words, the offering may be conducted in the early months of a fiscal year without audited financial statements from the most recently completed fiscal year.

If the issuer has not otherwise published interim financial statements, difficult questions occasionally arise as to whether they should be included, depending on the age of the audited financial statements at the time of the offering. [188] When interim financial statements are presented, they are ordinarily not audited, and a limited review report of the auditor is generally not included in the offering circular. [189] An interim income statement is ordinarily accompanied by the income statement for the corresponding period of the previous year.

Potentially challenging issues regarding financial statements arise when the issuer has recently made a material acquisition, or has agreed to make one. In such a situation, financial statements of the target could obviously be valuable for investors to understand the acquisition, but they may not be readily available or reliable. In an SEC-registered offering, detailed rules provide for the inclusion in the registration statement of separate financial statements of the acquired (or target) company and *pro forma* financial information showing the effects of the acquisition, depending on how "significant" the acquisition is under a highly specific measurement rule. [190] In Rule 144A offerings, these rules are of course inapplicable, and many other jurisdictions have either no applicable regulation, or principles of uncertain application, or regulator discretion. Practitioners accordingly often refer to the rules that apply in an SEC-registered offering as a first

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step in determining what financial information should be provided. [191] In some cases, the inability to provide target financial statements or *pro forma* financial information makes it impossible to proceed with an offering.

MD&A or OFR—A discussion of the issuer's financial performance and its financial condition is included, and is similar to the "management's discussion and analysis" ("MD&A") or "operating and financial review" ("OFR") required in offerings and periodic reports under SEC rules, the European Prospectus Directive and many other national disclosure regimes. [192] The guiding principle is to present management's view of the issuer's financial performance and financial condition, supplementing the information provided in the financial statements and notes. The typical elements include: (i) an overview identifying key issues about the financial statements and recent performance, (ii) a discussion of critical accounting policies, generally meaning policies that require significant estimates and judgments, (iii) a detailed discussion comparing results of operations for recent annual and interim periods, with particular attention to trends and uncertainties that will affect future performance and to factors that may affect comparability among periods, and (iv) a discussion of liquidity and capital resources, with particular attention to liquidity, funding requirements, sources of funding, terms of outstanding debt and related matters. Of these four elements, the last two are more nearly universal. Many of the specific elements of the discussion are based on SEC requirements, although some of the specific disclosures required in SEC filings, particularly those introduced after the Sarbanes-Oxley Act of 2002, are not as common in Rule 144A offerings. [193]

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Risk factors—A discussion of the principal risks applicable to the issuer, its business and the particular securities is included. In its breadth, this discussion usually corresponds to practices in the U.S. public markets. The expression "risk factors," borrowed from SEC requirements [194] but now adopted in many other jurisdictions, is perhaps too narrow, as this discussion usually provides an extensive list of challenges facing the issuer and potential disadvantages of investing in its securities. While there may be an argument that a particular issuer or offering does not present significant risks, it is extremely rare for a Rule 144A offering circular to omit risk factors altogether.

Use of proceeds—In a primary offering (where the net proceeds will go to the issuer, as opposed to a selling securityholder), disclosure about how the issuer plans to use the net proceeds of the offering is included.

Description of business—A description of the issuer's business, including strategy, operations, facilities, competitive and regulatory environment and other elements is provided. [195] The extent of this description varies widely, depending on many factors including home-country regulatory requirements, economic sector of the issuer, familiarity with the issuer on the part of the market and investors, and marketing considerations. [196] Some key elements of the business description, such as capital expenditure requirements, major contracts or material legal proceedings, may be described under other or separate headings.

SEC rules provide specific, detailed disclosure regimes for registered offerings by issuers in certain sectors, including banking, mining, oil and gas and insurance. [197] In Rule 144A offerings by foreign private issuers in those sectors, questions often arise as to the degree to which the offering circular should follow the SEC's specific disclosure requirements. If there is a well-developed alternative disclosure regime under home country law that addresses the same issues—as there may be, for example, for disclosure of mineral reserves or oil

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and gas reserves—that can be sufficient. [198] Otherwise, practitioners usually agree on a package of disclosures that addresses the same issues as the SEC's requirements but may do so in a different way or at a lower level of detail.

Management and board of directors—There is a discussion of how the issuer is managed and governed, including the identity of the members of the board of directors (or similar body) and the principal executives. A particularly sensitive issue is arrangements for compensation of directors and especially management. Although regulatory requirements have become far more demanding in domestic markets around the world, and especially in the United States, it remains common in Rule 144A offerings to provide aggregate disclosure at a

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comparatively low level of detail. [199] Additional detail is provided if it is publicly available or it is particularly material, either because of the amounts involved or the potential incentives or contingencies they create, for example, with respect to a potential change of control.

Major shareholders—Any shareholders with a controlling or otherwise significant interest are identified, and there is disclosure of contractual arrangements among them relating to their investment in the issuer. Practices differ concerning the threshold for disclosure of a shareholding interest. [200] In some cases, the identification of direct shareholders of the issuer is simple enough, but if effective control lies with other parties that own their interest through the direct shareholders, more detailed disclosure relating to such other parties would be appropriate. It is sometimes difficult to determine the parties that have effective control, and the issuer or such parties may be reluctant to disclose their identities, but most practitioners believe controlling interests must be disclosed where the information is known or reasonably available to the issuer or selling securityholders. [201]

Related-party transactions—A description of transactions or circumstances that present the possibility of conflict of interest between the issuer and its executives, directors or major shareholders is provided. This topic is fundamentally important, because of the potential that parties in a position to influence the issuer will do so to the detriment of investors in the offering, because of the inherent importance of conflicting interests, and because in rare cases the consequences can be serious for investors and for the initial purchasers. It can be difficult to identify and evaluate related-party transactions, but in close cases the touchstone should be the potential for material effects on investors and it is common to err on the side of caution. [202]

Description of securities—There is a description of the terms of the securities and their governing instruments. For debt securities, this description is ordinarily very complete and may consist of the actual terms of the securities. For equity securities, it customarily consists of a description of those aspects of the issuer's constitutive documents that bear on the rights of equity holders.

Tax disclosure—A summary of the tax implications of investing in the securities is provided. In Rule 144A offerings, this disclosure typically covers the laws of the United States and the issuer's home jurisdiction.

Plan of distribution—There is disclosure about the contractual arrangements between the initial purchasers and the issuer or selling securityholders, including the terms of initial purchase, the expected terms of sale to investors and other matters. [203]

Transfer restrictions—A summary of the restrictions applicable to any offer, sale or transfer of the securities by a holder after closing, including deemed representations by purchasers in the offering that they acknowledge the securities have not been registered under the Securities Act and may only be offered, resold or transferred in compliance with the Securities Act, is provided.

[3] Due Diligence Practices

The initial purchasers in a Rule 144A offering conduct due diligence for the same reasons as underwriters in a registered public offering—because it assists them in defending against liability and because it reduces the risk of defective disclosure. [204] Defective disclosure is harmful to the initial purchasers even when it does not lead to litigation and liability, because if investors suffer losses they may hold the initial purchasers commercially responsible, which hurts their reputation and may also entail direct costs to compensate investors.

The standard due diligence process includes discussions with the issuer's senior management, often based on a written questionnaire, and often referred to as management or business due diligence. Sometimes these discussions extend to major shareholders or outside parties like important creditors or suppliers. There are also discussions with the issuer's auditors. All these conversations are

updated ("brought down") by additional conversations shortly prior to pricing and again shortly prior to closing.

The standard due diligence process also includes review of issuer documentation, again often in response to a written list of requests typically prepared by counsel to the initial purchasers. For example, the review may include corporate documentation, major contracts and records of the board of directors and its major committees. In some cases, sensitivities about the confidentiality of documents lead issuers to restrict access to certain documents or impose other conditions on the due diligence process, but counsel need to conclude that any proposed restrictions will not unreasonably interfere with the access they require to provide their negative assurance letters. The review is usually conducted mainly by counsel, often in a team including lawyers from the home jurisdiction who are qualified to review documentation and lawyers with experience in U.S. disclosure practices. [205]

As a supplement to the due diligence process, there is a contractual requirement that the issuer deliver various documents as a condition to the obligations of the initial purchasers to close. These documents typically include, in addition to various certificates, negative assurance letters of counsel (often from more than one law firm) [206] and a comfort letter from the auditor. Under the applicable auditing standards, delivery of a comfort letter in a transaction that is not subject to § 11 of the Securities Act is not permitted unless the recipient of the letter has provided the auditors with a representation letter to the effect that it has conducted a review process, or due diligence inquiry, substantially consistent with that it would conduct in a registered offering. [207] Alternatively, if the recipient chooses not to provide such a letter, the auditors may report on the results of applying certain agreed-upon procedures to specific financial statement line

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items; [208] under these circumstances, the auditors may not, however, provide negative assurance with respect to such items. [209]

Footnotes

173 *See* Chapter 14, Part A.

174 *See* U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES, TWELFTH EDITION, DERIVATIVES MARKETS, § 2.03[4].

175 *See* § 8.03[2].

176 The liability regime under U.S. law applicable to Rule 144A and other private placements is discussed in Chapter 11.

177 The Rule 144A offering document is not ordinarily referred to as a "prospectus"—that term being reserved for the analogous document filed with the SEC in an offering registered under the Securities Act and, in many cases, for a disclosure document filed for regulatory purposes in a non-U.S. jurisdiction. The names most often used are offering circular (which is used in this Chapter 7) and offering memorandum.

178 In a Rule 144A offering, the use of preliminary and final versions of the offering document is not required for any regulatory reason (in contrast to the practice in SEC-registered offerings and in many non-U.S. jurisdictions). In a successful Rule 144A offering, the offering is fully sold before the final offering circular is prepared, so the final offering circular is not actually used in the marketing process or as a basis for investment decisions.

179 The financial institutions conducting a Rule 144A offering on behalf of the issuer are not typically referred to as "underwriters," even when they make a firm commitment to purchase the securities just as underwriters do in a registered offering, because pursuant to Rule 144A they are not underwriters for purposes of the statutory definition of the term in § 2(a)(11) of the Securities Act. They are often referred to as "initial purchasers." For the same reason, the agreement is not typically called an "underwriting" agreement. In some markets, the financial institutions conducting the offering do not purchase and resell the securities but rather undertake to procure purchasers, and they agree that if they fail to do so they will purchase the securities themselves. In other markets, the financial institutions conducting the Rule 144A placement do so as agents for the home-country underwriters. Practices of this kind may be to avoid additional stamp duty under applicable local law, or to accommodate local regulatory concerns.

180 Road show presentations may be made in person or accessed *via* the Internet, but in either case the presentation is not usually made available in a format that allows investors to retain it. Transaction participants typically seek to ensure that road show materials are consistent with the offering circular and do not contain material information that is not in the offering circular. Initial purchasers increasingly request that road show materials be covered by company representation and indemnities in the purchase agreement, especially when there is an electronic road show.

181 The offering circular, or a slightly modified version of it, may also serve as a listing prospectus for a listing on an exchange-regulated market like the Euro MTF in Luxembourg or the Global Exchange Market in Ireland.

182 In both the debt and equity examples, the non-U.S. offering is, for U.S. purposes, exempt from registration under Regulation s.

183 Forward-looking information, such as projections or forecasts of future financial performance, presents difficult issues in this respect. In some jurisdictions outside the United States, it is required or customary, particularly for a company or operation that is new or still under development, to include projections that would be unusual in U.S. practice because of the perception that liability risk is high and conducting due diligence is difficult. Unless the information is clearly positive or inconsequential (which will rarely be the case), excluding it from the Rule 144A offering circular might appear to be a material omission, so including it with appropriate cautionary language and due diligence procedures may be preferable. *See* Chapter 11 for a discussion of 10b-5 liability considerations applicable to forward-looking information.

184 In the early years of Rule 144A offerings it was common, where the financial statements were presented under a system other than U.S. GAAP, for the offering circular to include a discussion of significant differences between that system and U.S. GAAP. Such a discussion is no longer considered necessary, at least if the system of accounting principles is reasonably well established. If it is not, the offering participants would want to consider additional due diligence concerning the system of accounting principles as well as disclosure about how it differs from U.S. GAAP or IFRS. Similar considerations might arise in the case of a financial presentation under a variant of IFRS that does not conform fully to IFRS as adopted by the International Accounting Standards Board ("IASB").

185 A balance sheet as of the end of the earliest of the three years is not required under SEC rules, however, if that balance sheet is not required by the registrant's home jurisdiction (or any other jurisdiction whose rules are applicable to the registrant outside the United States). If the issuer were an "emerging growth company," consideration could be given to including only two years of audited financial statements. *See* § 3.02[1][c].

186 *See* Chapter 5 for a discussion of the standards of the U.S. PCAOB. Many non-U.S. jurisdictions require an audit to be performed in accordance with the International Standards on Auditing ("ISAs") promulgated by the International Auditing and Assurance Standards Board ("IAASB"), while others rely on auditing standards adopted by a national auditor oversight body. An auditor's use of unfamiliar auditing standards would be a point for additional due diligence and possibly for cautionary disclosures.

187 *See* Rule 2.01 of Regulation s -X (auditor independence requirements for an SEC registration statement or annual report). There is, however, a general expectation that the auditors qualify as independent under some applicable standard, and they are ordinarily expected to confirm it in their comfort letter to the initial purchasers. If the independence standards are unfamiliar, they would be a topic for due diligence inquiry by the initial purchasers.

188 For an SEC registration statement of a foreign private issuer, interim financial statements are required if the audited financial statements are more than nine months old, and if the issuer has published more recent financial information, that information must be reflected in the registration statement. *See* Form 20-F, Item 8.A.5; § 4.04[4].

189 Depending on how much time has passed since the last audit, limited review may be necessary to support the ability of the auditor to provide, in its comfort letter to the initial purchasers, negative assurance as to changes subsequent to the date of the last financial statements included in the offering circular. *See* AS §

6101.46. Even then, however, the limited review report is not typically included in the offering circular unless it is included in home-country disclosure.

190 *See* § 4.04[10].

191 SEC rules for a registered offering also require the inclusion in the registration statement of financial statements of a major unconsolidated subsidiary or equity-method investee. *See* § 4.05[5][b]. These financial statements are not always considered necessary in a Rule 144A offering.

192 *See* Form 20-F, Item 5 (for an SEC registration statement or annual report of a foreign private issuer); Item 303 of Regulation s -K (for an SEC registration statement or annual report of a domestic issuer); Items 9 and 10 of Annex I to Commission Regulation (EC) 809/2004, as amended (the "Prospectus Regulation") (disclosures on operating and financial review and capital resources applicable to equity offerings). The term "MD&A" derives from the title of the disclosure under SEC rules applicable to domestic issuers; it has not been used since 2000 in the SEC rules governing disclosure by foreign private issuers (Form 20-F requires instead, in Item 5, a discussion of "Operating and Financial Review and Prospects"). Lawyers and auditors often refer to SEC guidance on the content of MD&A, even though for a nonreporting issuer it has no direct bearing on a Rule 144A offering and might be unknown to the issuer's financial reporting personnel. *See* § 4.05.

193 For example, disclosure requirements on off-balance sheet arrangements and on contractual obligations were added to Item 5 of Form 20-F pursuant to the Sarbanes-Oxley Act but are not required by the International Organization of Securities Commissions ("IOSCO") standards on which Form 20-F is otherwise based. These disclosures are often not included in Rule 144A offering circulars, particularly in equity offerings where home country requirements frequently guide the scope of disclosure.

194 *See* Form 20-F, Item 3.D; Item 503 of Regulation s -K; *see also*, *e.g.*, Item 4 of Annex I and Item 2 of Annex III to the Prospectus Regulation (risk factor disclosure requirements for equity offerings).

195 Early Rule 144A offering circulars often also included disclosure about general economic and political conditions in the issuer's country, primarily because information about the country was considered helpful for marketing to U.S. investors that might not be familiar with it. This practice has become rare, as investors have become familiar with a wide range of jurisdictions and have developed other information sources. Initial purchasers may find it challenging to conduct adequate due diligence on country disclosures, unless they are attributable to official sources. In this regard, the liability provisions applicable to a registered offering establish a lower threshold for an initial purchaser's due diligence defense where statements in a registration statement are copied or extracted from a public official document. § 11(b)(3)(D) of the Securities Act.

196 The SEC requirements applicable in registered offerings are in Item 4 of Form 20-F (for a foreign private issuer) and Item 101 (as to business), Item 102 (as to property) and Item 103 (as to legal proceedings) of Regulation s -K (for a domestic issuer). *See also*, *e.g.*, Item 6 of Annex I to the Prospectus Regulation (business disclosure requirements for equity offerings).

197 *See* § 4.08 ; *see also* § 4.02[1][a].

198 Some private placements involve more expansive disclosures than would be required in an SEC-registered offering. For example, some Russian oil companies making Rule 144A offerings have provided more complete disclosure than their U.S.-registered counterparts in the oil and gas context. The offering circular prepared in connection with a Rule 144A private placement by Rosneft in July 2006 contained a variety of reserves and resources data that would not otherwise have been permitted under SEC rules in place at the time. *See* Rosneft, Offering Circular (July 14, 2006). Generally, the SEC had permitted oil and gas companies, in their filings with the SEC, to disclose only proved reserves, *i.e.*, the estimated quantities of crude oil, natural gas and natural gas liquids that geological and engineering data demonstrate with "reasonable certainty" to be recoverable in future years from known reservoirs under existing economic and operating conditions. The SEC now permits additional categories of reserves to be disclosed, but still does not allow the disclosure of resources that are not reserves. *See* § 4.08[1] for a discussion of amendments to the SEC's rules governing disclosures about oil and gas activities that took effect for Securities Act

registration statements filed on or after January 1, 2010. In addition, SEC guidance has indicated that disclosed reserves should generally include only those reserves that can be produced through the license expiration date, unless there is a long and clear track record of license renewal as a matter of course. The Rosneft offering circular contained not only SEC-standard proved reserves data through expiration of licenses, but also SEC-standard proved reserves data through the economic lives of the fields, as well as proved, probable and possible reserves data under the standards set forth by the Society of Petroleum Engineers (the "SPE"), estimates of reserves determined under the Russian reserves methodology and crude oil and gas resources data based on standards set forth by the SPE covering both prospective and contingent resources. *See* Rosneft, Offering Circular (July 14, 2006). The SEC-standard proved reserves data through the economic lives of the fields were included in the offering circular based on the fact that, under relevant Russian law, Rosneft had a right to renew its licenses to the end of the economic lives of the fields so long as it did not violate the conditions of the license, and Rosneft's established history of success in extending various licenses. The other additional reserves and resources data were included in the Rosneft offering circular following consideration, in part, of the customary scope of disclosure in the international market and the issuer's home market. It is our experience that disclosure of proved, probable and possible reserves data under the SPE standards has become quite standard in the international market in connection with a Rule 144A offering. Inclusion of any other resources data in an offering document prepared in connection with a private placement will require a case-by-case analysis of the facts and circumstances concerning the issuer and any particular characteristics of its home market. In June 2016, the SEC proposed new rules intended to align disclosure requirements for mining properties with industry and global regulatory practices and standards. The proposed rules include more expansive disclosure requirements relating to mining operations and mineral reserves, exploration and resources. SEC Release No. 33-10098 (June 16, 2016). *See* § 4.07.

199 Aggregate disclosure is permitted in an SEC registration statement or annual report of a foreign private issuer, provided that individual information is not required in the home jurisdiction or otherwise publicly disclosed. Form 20-F, Item 6.B. This would support the position that the absence of individual disclosures is not *per se* a material omission.

200 The 5% level applicable in an SEC registration statement or annual report may serve as a threshold below which an interest can generally be presumed not to be material. *See* Form 20-F, Item 7.A; Item 403(a) of Regulation s -K.

201 Similarly, in some cases there are arrangements between shareholders that have an important effect on control of the issuer but to which the issuer is not a party, and these should be disclosed if the information is known or reasonably available to the issuer or selling securityholders. *See* Form 20-F, Item 7.A; Item 403(c) of Regulation s -K. In some countries, concern for personal security may be a factor in the discussion whether to identify an individual with a significant interest or to provide individual compensation information. The key issue is whether the information is material to investors, and the materiality concern is strongest where control of the issuer is concerned and may be less strong where compensation is concerned.

202 *See* Form 20-F, Item 7.B; Item 404(a) of Regulation s -K.

203 *See* Form 20-F, Item 9.B; Item 508 of Regulation s -K. Many Rule 144A offering circulars include disclosures derived from those included for regulatory reasons in registered offerings—for example, relating to stabilization transactions. However, they often do not include information about initial purchaser compensation and the allocation of offering expenses that would be required in an SEC-registered offering when that disclosure is determined not to be material to investors.

204 *See* § 11.04 for a discussion of the liability standards applicable to a Rule 144A offering under the securities laws. *See* § 3.02[6] for a discussion of due diligence practices in public offerings.

205 Practices vary widely with respect to the preparation of written reports on due diligence, depending on how initial purchasers and their counsel balance the potential advantages of documenting a rigorous process against the risk that a written report will be damaging evidence in future litigation. In some cases, local

underwriter or listing sponsor requirements will dictate whether due diligence or verification documentation will be preserved.

206 *See Negative Assurance in Securities Offerings* (*2008 Revision*), 64 BUS. LAW. 395 (2009) (report of an American Bar Association ("ABA") committee on law firm negative assurance letters). While there are other approaches, negative assurance is commonly provided by two U.S. firms, one representing the issuer and the other representing the initial purchasers. It is also often provided by law firms in the issuer's home jurisdiction and by in-house counsel for the issuer.

207 U.S. auditor comfort letters are governed by AS § 6101, which codifies Statement of Auditing Standards No. 72 and subsequent amending statements. *See* AS § 6101.04 (providing for a representation letter from the recipient in unregistered offerings). For a general discussion of comfort letters, *see* § 3.02[6], Note 325.

208 Reports of the results of applying agreed-upon procedures are governed by AT § 201 ("Agreed-Upon Procedures Engagements"). AT § 201 is based on Statement on Standards for Attestation Engagements ("SSAE") No. 10 (Attestation Standards: Revision and Recodification), which also withdrew SAS 75 (Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement).

209 *See* § 3.02[6], Note 348, as to the meaning of the term "negative assurance." Although the negative assurance provided through a comfort letter is based essentially on the same procedures reported on in an agreed-procedures letter, the extent to which a court may accord greater weight to a comfort letter in establishing that the initial purchasers did not have the requisite *scienter* for Rule 10b-5 liability remains untested.

U.S. Regulation of the International Securities and Derivatives Markets, § 7.04, RESALES OF PRIVATELY PLACED SECURITIES

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.04 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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While § 4(a)(2) of the Securities Act and Regulation D thereunder provide the basis for an issuer's exemption from the registration requirements of the Securities Act, they do not provide an exemption from registration for investors to resell, publicly or privately, securities purchased in a private offering. Securities acquired from an issuer in a private placement are considered "restricted" securities, and purchasers must have their own exemption for resale of those securities. The SEC's concept of "restricted securities" was without direct foundation in the Securities Act and was based on its view that a purchaser in a private offering that subsequently resold the securities in the public market could be viewed as "taking from an issuer with a view to distribution" and thus be an underwriter, in which case it had no statutory exemption from Securities Act registration requirements under § 4(a)(1), or in the case of dealers, § 4(a)(3). Further, as noted above, one of the requirements of Regulation D is that the issuer exercise "reasonable care" to ensure that purchasers are not underwriters of the securities in question, and the procedures used to ensure compliance with either Regulation D or § 4(a)(2) include restrictions on resales of privately sold securities. Regulation D and § 4(a)(2) do not, however, indicate what resales are permissible. One answer, as discussed above, is embodied in the safe harbor for resales to QIBs under Rule 144A. This section also addresses resales under the Rule 144 safe harbor, the § 4(1 ½) doctrine, the § 4(a)(7) safe harbor and the Regulation s safe harbor.

[1] Resale Under Rule 144A

Securities sold in a private placement can be resold pursuant to Rule 144A under the Securities Act, as discussed above.

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Many foreign issuers also provide for the possibility of Rule 144A resales in connection with offerings of their securities under Regulation s under the Securities Act. [210] As discussed below, securities initially sold under Regulation s are effectively subject to a limitation on U.S. sales, generally 40 days from the date the offering commenced, as a result of the prohibition against dealer sales contained in § 4(a)(3)(A) of the Securities Act. [211] In addition, in certain cases resales are also subject to the applicable distribution compliance period (40 days, six months or one year), also referred to as a "seasoning" period, under the safe harbors of Regulation s. [212] After these periods, securities sold in a Regulation s offering are generally unrestricted with two important exceptions: (i) equity securities of U.S. issuers [213] and (ii) securities that are part of an unsold allotment, for which the limitations on U.S. sales of § 4(a)(3)(C) of the Securities Act apply. [214] However, Rule 144A provides a safe harbor for U.S. sales of eligible securities even during these periods. In cases where the underwriting or other selling documentation does not restrict sales of the securities under Rule 144A, and the securities are otherwise eligible for resale under Rule 144A (*i.e.*, the securities are not fungible with U.S. exchange-listed securities and the information requirement is satisfied or does not apply), U.S. broker-dealers may purchase securities sold abroad under Regulation s and resell them to QIBs under the Rule, even during any applicable Regulation s distribution compliance period and the 40-day period of § 4(a)(3)(A). Following Rule 144A sales, the securities in question will be "restricted" even after the expiration of any such seasoning period. [215]

The rationale underpinning the broker-dealer's ability to resell under Rule 144A securities initially sold abroad derives from the nature of the exemption

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provided by Rule 144A. Sales under Rule 144A do not constitute a distribution and are not subject to registration under the Securities Act, even during the distribution compliance period that follows a foreign offering. [216]

Under the philosophy of Rule 144A, issuer-imposed documentation and procedures to police resales by the purchaser should not be necessary. However, since Regulation D requires the issuer to take "reasonable care" to ensure that purchasers are not underwriters—or risk strict liability under § 12(a)(1) of the Securities Act—the question for issuers is to what extent they need to police resales to comply with the reasonable care requirement. Commenters on Rule 144A as originally proposed requested that the SEC amend Regulation D to provide expressly that "reasonable care" could include sales to dealers based solely on contractual restrictions requiring them to resell the securities only pursuant to Rule 144A. The imposition of other restrictions to monitor subsequent resales, such as transfer restrictions, "stop-transfer" procedures, letters from subsequent purchasers and other procedures, would then be unnecessary to establish the issuer's private offering exemption. The SEC did not, however, amend Regulation D, leaving open the question whether contractual restrictions limited to the requirement that the first round of resales be made under Rule 144A are sufficient to constitute "reasonable care."

The SEC adopted Rule 144A on the premise that QIBs can be relied on to know the law, and the law requires them to have an exemption for any resale of a restricted security. The seller under Rule 144A does not police and is not responsible for the resales by the buyer—it must only notify a buyer that the seller may be relying on the Rule. If a seller is not responsible for the acts of its buyer, it would be anomalous to think that the issuer has responsibility for resales after its initial § 4(a)(2) sale; it should therefore be enough that the issuer has by contract required that resales be made only to QIBs in compliance with Rule 144A. Under this analysis, a court should respect an issuer's § 4(a)(2) exemption in a case where a remote purchaser sells in violation of the Rule, and liability should be found under § 12(a)(1) only against the seller that sold without a Securities Act exemption. Moreover, if the SEC did not intend, by the very adoption of Rule 144A, to facilitate liquidity by reducing documentation, it is difficult to imagine a rationale for the SEC initiative in proposing the Rule at all. [217]

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Transaction practices suggest a consensus among issuers and the private securities bar that (i) an issuer has a valid exemption under § 4(a)(2) if it sells securities to investment banks that agree to resell only under Rule 144A and in accordance with its requirements and (ii) there is no need to restrict subsequent resales by investors or take other procedural steps. Under this approach, no investment letters from initial or subsequent investors are required, no transfer restrictions or "stop-transfer" provisions are imposed, and no legends on securities are necessary. Documentation for Rule 144A offerings does generally include disclosure—under the headings "Transfer Restrictions" and/or "Notice to Investors"—stating that investors are (i) deemed to represent and agree as to their sophistication and investigation in respect of the offering and (ii) notified that the offering is exempt from registration under the Securities Act, that they may only resell or otherwise transfer the restricted securities they will hold under a valid exemption from registration (such as resales under Rule 144A, Rule 144 and Regulation s and, in some cases, under § 4(1 ½)), and of other matters. [218] It is also common practice to include a legend on certificated and global securities that describes the limitations on resale. [219]

One area where there is a tendency to obtain letters from investors in Rule 144A offerings, notwithstanding the general practice of not obtaining such letters, involves cautionary letters in cases of issuers, especially in certain emerging markets, where special levels of sophistication and care by investors are required. Such letters have been used for offerings out of certain markets at certain times, such as Russia and parts of Eastern Europe during their transition to market-based economies, where accounting standards, disclosure standards and

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the relative unavailability of information raise special issues, but where there is demand for investment opportunities by sophisticated investors. In such letters, investors generally acknowledge their special sophistication in the market in question and the special accounting and disclosure issues and lack of information involved, state that they have not relied on the financial institution intermediary in making their investment decision, represent that they have performed and relied on their own investigation and make certain other representations and undertakings. These letters are sometimes referred to as "toxic waste" letters.

A consensus among issuers and the private bar has also developed with respect to "side-by-side" offerings in which the participating financial institutions are permitted to resell both to QIBs under Rule 144A and to other investors under § 4(1 ½). The non-QIB investors are usually limited to institutions that are accredited investors as defined in Regulation D. In the immediate wake of Rule 144A's adoption, there was concern that, whatever the SEC's view of the sophistication of QIBs, the introduction of the § 4(1 ½) element requires policing of all resales to ensure that the issuer has taken reasonable care to avoid a distribution. The imposition of such procedures on Rule 144A transactions, even if only using a short form of nondistribution letter, [220] can still lead to reduced market liquidity, and reduced attractiveness of private placements, especially for foreign issuers.

The consensus approach instead applies traditional § 4(1 ½) procedures only to the sales relying on that exemption, thus in effect separating the transaction into two parts and giving the Rule 144A part the full benefit of the Rule on the theory that it is independent of the part proceeding under full § 4(1 ½) procedures. Transfers are permitted not only by the § 4(1 ½) purchasers to QIBs under Rule 144A but also by QIBs to other QIBs or to accredited investors under § 4(1 ½) (with QIBs deciding for themselves what procedures to apply to document their own compliance with the Securities Act in the case of subsequent transfers). In the case of side-by-side placements in which accredited investors purchasing in the initial placement are required by the applicable documentation to resell only to QIBs, thereby subjecting the entire deal to Rule 144A after all accredited investors have completed their first resale, ongoing stop-transfer and other transfer restrictions on the securities are not necessary.

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Putting aside the legal debate as to sufficiency of procedures, the lack of uniform documentation in respect of resale restrictions may raise practical uncertainties for a secondary market purchaser. It can be expected that when an offering document is prepared, the applicable restrictions will be disclosed to the initial investors in detail. An offering document, however, is not generally made available to subsequent investors. Moreover, certificates representing securities held in "street" name or book-entry form (on which contractual transfer restrictions might be stated) are not generally available to investors. Similar factors limit the utility of a "Notice to Investors" in the original offering document outlining contractual resale restrictions that could prohibit exempt transfers outside Rule 144A or impose procedural requirements. As a result, investors considering a resale of restricted securities outside Rule 144A should ascertain the scope of any applicable resale restrictions.

[2] Resale Under Rule 144

Early doctrine suggested that private placement investors were required to purchase with an intent to invest and with no current intention to dispose of the security. [221] This doctrine gave rise to a theory that restricted securities could be sold only upon a "change of circumstances" affecting the investor. [222] There was no clear indication what "change" was sufficient or that passage of time alone was enough to free restricted securities of any applicable resale restrictions.

The SEC expressly rejected the "change of circumstances" doctrine in 1972 when it adopted Rule 144 under the Securities Act. Rule 144 provides a nonexclusive safe harbor from the § 2(a)(11) definition of "underwriter" for resales in the U.S. public market of securities acquired in a private offering, establishing specific criteria for determining that a holder of such securities is not engaged in a distribution. [223] The critical element under the Rule is the passage of time after acquisition of the securities from the issuer, or from an affiliate of the issuer. The other conditions for the Rule 144 safe harbor depend on whether the seller is an affiliate or a nonaffiliate of the issuer.

If the seller is not an affiliate of the issuer (and has not been for the three months preceding the sale), the Rule provides safe harbor protection for a resale

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beginning one year after acquisition of the securities, with no other conditions. [224] Where the issuer is an Exchange Act-reporting company that is current in its reporting obligations, the Rule provides safe harbor protection for resale by a nonaffiliate beginning six months after acquisition of the securities, with no other conditions. To be current for this purpose, the issuer must have been a reporting company for at least 90 days prior to the sale and must have filed all required reports (other than on Form 8-K or Form 6-K) during the 12 months (or such shorter period as it has been a reporting company) preceding the sale. [225]

If the seller is an affiliate of the issuer and acquired the securities in a private offering, [226] the same holding periods apply, and resales are subject to additional conditions relating to current public information, volume of sales, manner of sale and filing of a notice with the SEC. [227] These additional requirements are summarized below:

(i) If the issuer is an Exchange Act-reporting company, it must be current in its reporting obligations, as described above. If it is not an

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Exchange Act-reporting company, certain information concerning the issuer must be publicly available. [228]

(ii) The seller must comply with restrictions limiting the aggregate amount of securities of the issuer sold during the preceding three months pursuant to Rule 144 to:

(a) for equity securities, the greater of:

- 1% of the outstanding shares or other units of the class of securities as shown by the most recent report or statement published by the issuer; and
- the average weekly reported volume of trading in such securities on all national exchanges in the United States and/or reported through an automated quotation system in the United States or on the consolidated tape during the four calendar weeks preceding the date of execution of the sale order or the date of notice in paragraph (iv) below; and

(b) for debt securities, the greater of the two tests described above for equity securities and 10% of the principal amount of the tranche [229] (or class when the securities are nonparticipatory preferred stock) attributable to the securities sold. [230]

(iii) In the case of equity securities only, the securities must be sold in "brokers' transactions" exempt from registration pursuant to § 4(4) of the Securities Act, in transactions directly with a market-maker [231]

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(which is the manner of sale generally relied upon for Rule 144-complying block trades) [232] or in riskless principal transactions, [233] and no solicitations of orders may be made.

(iv) If sales during any three-month period exceed 5,000 shares or other units or $50,000 in sale price, a notice must be filed with the SEC.

Rule 144 includes specific "tacking" rules that address the calculation of the six-month and one-year holding periods in special cases, such as stock dividends and splits, convertible securities and pledges. Acquisition and resale of securities by the issuer or any of its affiliates restarts the holding periods.

Rule 144 also applies to the sale of securities that are not restricted securities when those securities are sold by an affiliate of the issuer (*i.e.*, "control securities"). For example, it provides a safe harbor for resale of securities acquired by the affiliate in the open market, in a registered offering or in an offering of securities (other than equity securities of domestic issuers) exempt from Securities Act registration under Regulation s. For such resales, no holding period is required, but resales must be conducted in accordance with the other requirements described above. The SEC, however, has taken the position that the Rule 144 safe harbor is not available for sales of securities by a wholly owned subsidiary of an issuer. [234] The SEC staff has also rejected the use of the Rule 144

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safe harbor in so-called "gypsy swap" transactions. In such transactions, an issuer would arrange for a nonaffiliated stockholder who either has unrestricted securities or has restricted securities eligible for resale under Rule 144, or an affiliated stockholder who has securities eligible for resale under Rule 144, to sell its securities to end investors. Through pre-arrangement, the issuer would, at or about the same time, sell an equivalent number of unregistered securities to the selling stockholder. The SEC has stated that the shares taken by the end purchasers would be restricted securities within the meaning of Rule 144(a)(3) notwithstanding the purported reliance on the Rule 144 safe harbor, and that the holding period for such securities would begin on the date of the acquisition from the seller. [235]

[a] Hedging Transactions

The SEC has repeatedly expressed concern regarding the effect of hedging activities designed to shift the economic risk of investment away from the holder of restricted securities. If a holder of restricted securities, soon after acquiring them, enters into a derivative transaction that transfers the economic risk of owning the securities to another party, "[i]t becomes more difficult to conclude that the security holder … has held the security for investment purposes and not with a view to distribution." [236]

This concern has led the SEC to question whether Rule 144 adequately deals with hedging activities. One specific proposal has been to provide that hedging suspends (or "tolls") the holding period under Rule 144. Under Rule 144 as it stood prior to 1990, the Rule 144 holding period for restricted securities would be tolled if the securityholder maintained a short position in, or held any put or other option to dispose of, securities equivalent to the restricted securities. This tolling provision was eliminated in 1990 when the Rule was amended to broaden the ability to tack the holding period of a prior holder to the holding period of the current holder. [237] The SEC proposed in 1997 and again in 2007 to reinstitute a version of the tolling provision, but it has not adopted either proposal, in part because of the complexity of applying it to investors with complex

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positions or where holding periods of successive holders are tacked. [238] A number of other proposals to address hedging activities were included in the 1997 proposal but not the 2007 proposal. [239]

On the other hand, industry participants have been concerned about uncertainty whether certain hedging activities could be viewed as distributions violating § 5 of the Securities Act. They have, for example, proposed that the SEC adopt a specific safe harbor for certain hedging activities that would be deemed permissible under Rule 144, and the SEC has declined to do so but has addressed some of these concerns in an interpretive letter. [240] Some hedging activities are widely thought to be permissible despite the absence of any confirmation from the SEC—for example, the widespread practice of a buyer of convertible notes in a Rule 144A private placement engaging in a short sale of equity securities corresponding to the shares into which the notes are convertible. However, where an investor purchases securities in a private placement and then engages in a short sale of a corresponding amount of the same securities, uncertainty remains as to whether the short sale should be considered a distribution. [241]

[3] Resale Under Section 4(1 ½)

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Rule 144 does not address the question whether and under what circumstances a purchaser in a private offering can sell in another private sale without waiting for the expiration of the applicable Rule 144 holding period. However, so long as the subsequent resale also is private, it would be consistent with concluding that the seller—as initial investor in the private placement—had not taken the privately placed, restricted securities from the issuer with a "view to distribution" and therefore was not an underwriter.

While the SEC did not provide any guidance in this area, the private bar and market participants developed mechanisms permitting limited resales from one purchaser in a private offering to another, without requiring any particular holding period, and dubbed the exemption "Section 4(1 ½)." [242] The exemption relies on the interplay of §§ 4(a)(1) (or for dealers, 4(a)(3)) and 4(a)(2), and it proceeds on the theory that if the seller is not an underwriter—that is, the seller did not purchase with a view to distribution and its sale is not being made for the issuer—one of these exemptions should be available. [243]

Thus, if an investor to whom the private sale could originally have been made purchases from another investor a security acquired in a private offering where the new investor will be subject to the same restrictions imposed on the original purchaser, the resale should not be a distribution and should therefore be exempt from registration. Such resales generally are permitted under the § 4(a)(1) exemption only if accompanied by (i) a legal opinion that the transaction in question is exempt or (ii) an investment or nondistribution letter from the purchaser containing essentially the same representations and agreements as those provided by the original purchaser, [244] or both. Restrictive legends on the securities and any stop-transfer instructions ordinarily remain in place. [245]

The continuation of these restrictions through the chain of opinions and letters required by the investment or nondistribution letter obtained from each purchaser by each seller in the chain is intended to keep the requirements of the original private offering in effect. The use by the private bar and market participants of this method of cascading sales restrictions is consistent with the SEC's policy of preventing public offerings or distributions of unregistered securities

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before the end of the periods set out in Rule 144 and, in that respect, does not take advantage of a more aggressive reading of the exemptions provided in the Securities Act. One may ask why an investor, at the end of a chain of resales that are exempt under so-called § 4(1 ½), is not entitled to the § 4(a)(1) exemption on resale, regardless of the manner of sale or the time elapsed since its initial sale. The only argument that § 4(a)(1) is not available is that the selling investor is a so-called "statutory underwriter." But even if the sale in question is a "distribution," the investor at the end of a chain of resales arguably does not meet the other prong of the definition of underwriter—it has not taken from an issuer or sold for an issuer or participated (even indirectly) in any such undertaking within any reasonable meaning of the words. Some insurance companies and other investors in private offerings have, on the basis of this argument, taken the position that when they sell a security, whether purchased in a public or private offering, they are entitled to rely on the § 4(a)(1) exemption. The SEC, however, has never accepted this position, and indeed its entire "restricted security" theory is based on its assertion that any seller, however remote from the issuer, may be an underwriter if the sale is into the public market before the end of the periods set out in Rule 144. While this theory has, as indicated above, no direct basis in the statute, the fact that § 4(1 ½) and the regulatory safe harbors (Rule 144, Rule 144A and Regulation s) have been almost the exclusive means of resale for securities purchased in private offerings attests to the dominance of the SEC's view.

[4] Resale Under § 4(a)(7)

A new nonexclusive safe harbor from registration for resales in the United States came into effect in December 2015 upon the signing into law of the Fixing America's Surface Transportation Act (the "FAST Act"). [246] New § 4(a)(7) of the Securities Act exempts from registration certain resales of securities to accredited investors. We believe § 4(a)(7) was generally intended to codify existing market use of § 4(1 ½). The new exemption, like Regulation D for private placements by issuers, provides sellers, and issuers required to police resales following their private placements, with certainty regarding these subjective elements for private resales, which is particularly important for sales to natural persons.

Section 4(a)(7) includes several significant limitations that will not allow sellers to rely on it as broadly as they have relied on § 4(1 ½) in the past. However, § 4(a)(7) by its terms is a nonexclusive safe harbor, and we believe market

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participants will continue to rely on § 4(1 ½) in many situations, which we discuss below.

The requirements of § 4(a)(7) [247] are as follows:

- All purchasers must be accredited investors. A seller seeking an exemption from registration under § 4(a)(7) should be able to rely on the "reasonable belief" standard with respect to the determination as to whether a purchaser is an accredited investor, but the SEC has not provided guidance as to whether the "reasonable belief" standard applies in the context of § 4(a)(7).
- No general solicitation or general advertising may be used by the seller or anyone acting on the seller's behalf. This prohibition is limited to actions taken by the seller or anyone acting on its behalf and does not capture concurrent actions by the issuer, which provides confirmation that an issuer's conduct should not affect a private resale by an unaffiliated seller not acting in concert with the issuer.
- For resales of securities of an issuer that is not an SEC reporting company or exempt from reporting pursuant to Rule 12g3-2(b) under the Exchange Act, the seller must deliver certain information to prospective purchasers. The required information includes, among other items, "reasonably current" financial information [248] prepared in accordance with U.S. GAAP or IFRS but which need not be audited or reviewed. [249]
- If the seller is an affiliate of the issuer, the seller must include a brief statement regarding the nature of the affiliation and a statement certified by the

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  seller that it has no reasonable grounds to believe the issuer is in violation of the securities laws or regulations. [250]
- The exemption may not be used if the seller or any agent being compensated for its participation in the transaction would be disqualified under the bad actor provisions of Rule 506(d)(1) of Regulation D.
- The exemption may not be used by an issuer or a direct or indirect subsidiary of the issuer.
- The issuer must be engaged in business. The exemption may not be used for resales of securities of an issuer that is in bankruptcy or reorganization, or in formation, or that is a blank check, blind pool or shell company.
- The exemption cannot be used for an unsold allotment held by a broker or dealer as an underwriter.
- The exemption may only be used for securities of a class that has been authorized and outstanding for at least 90 days.

Furthermore, § 4(a)(7) expressly establishes that (i) securities sold under the exemption are "covered securities" within the meaning of § 18 of the Securities Act, and therefore state "blue sky" laws [251] are preempted for resales made in compliance with the exemption, and (ii) the exemption provided by § 4(a)(7) "shall not be the exclusive means for establishing an exemption from the registration requirements of [S]ection 5."

The new exemption under § 4(a)(7) will be particularly useful for private resales to natural person accredited investors because, as discussed above, it avoids the need to assess investors' sophistication, familiarity with the issuer and ability to "fend for themselves" as required by *Ralston Purina*. [252] Equally important to facilitate such sales is the preemption of "blue sky" laws provided by the exemption, because those laws are more burdensome for offers and sales to natural persons, even accredited investors, than to institutional investors.

For sales of securities of private companies, the information delivery requirement in § 4(a)(7) appears at first glance to be the biggest obstacle to using the new exemption, but it generally should not be too burdensome for sellers.

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Even small companies should be able to provide the required financial information, which need not be audited or reviewed. The information requirement does make resales contingent on the issuer cooperating with the seller by making the required information available. It is common, however, for private companies to contractually regulate subsequent transfers anyway, by imposing pre-approval requirements at the time of an initial investment. In any event, we expect the market may require an issuer in a private offering to covenant to make the information required by § 4(a)(7) available to sellers on request, similar to the covenant to make information available to a prospective investor required by Rule 144A(d)(4).

Finally, § 4(a)(7) is available to affiliates of the issuer. The exemption will therefore provide affiliates with additional secondary market liquidity, which could be particularly valuable where there is no public market for the securities.

In situations other than secondary market trading in private company securities, the use of § 4(a)(7) may be limited. In light of the 90-day seasoning condition for the class of securities sought to be sold, § 4(a)(7) will not be available for the kind of side-by-side transaction that is sometimes used, for example, by an issuer and a selling securityholder in a private placement of a newly issued class of debt or preferred stock, to expand the investor pool beyond QIBs to include institutional accredited investors. Nevertheless, the use of § 4(1 ½) for those private placements has never been viewed as problematic, because those accredited investors are sophisticated and have adequate access to information about the issuer, and offers and sales to them therefore typically do not raise any burdensome *Ralston Purina* (or "blue sky") concerns. The market will likely continue to rely on § 4(1 ½) in these contexts.

Section 4(a)(7) will be available, but burdensome to comply with due to the information delivery requirement, for other resales to institutional investors that are traditionally made in reliance on § 4(1 ½), such as private, secondary block trades. In these cases, because § 4(a)(7) is a nonexclusive safe harbor, we believe sellers will generally treat the choice between § 4(1 ½) and § 4(a)(7) as issuers have historically treated the choice between § 4(a)(2) and Regulation D. Where private offerings by issuers are limited principally to institutional investors, they generally are made under § 4(a)(2) and not Regulation D. Similarly, we believe private resales principally to institutional investors will generally continue to rely on § 4(1 ½) notwithstanding the availability of § 4(a)(7).

In these contexts, we do not expect law firms to change their practices regarding no-registration opinions just because the transactions either cannot or do not comply with § 4(a)(7).

As noted above, it is clear that a broker-dealer cannot use § 4(a)(7) to resell unsold allotments of securities acquired in a public offering. A question remains whether a broker-dealer can effect a firmly underwritten resale, under § 4(a)(7), of securities acquired privately from the issuer (assuming the class of securities

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has been outstanding for 90 days). [253] There is no express prohibition on this type of resale, but in contrast to Rule 144A, § 4(a)(7) does not expressly permit an immediate resale by a broker-dealer following a purchase from an issuer. [254] Moreover, Congress may well have intended the prohibition on issuer use of the exemption to also prohibit sales made in a planned, two-step process effectively on behalf of an issuer.

Broker-dealers will need to consider this question when deciding whether to rely on § 4(a)(7) to expand the universe of potential purchasers in underwritten offerings of private company equity securities, particularly to natural person accredited investors. They also will need to consider the question in connection with reopenings of debt and preferred stock issues, which will often meet the requirement of § 4(a)(7) that the class of securities have been outstanding for 90 days. Of course, broker-dealers can continue to rely on § 4(1 ½) for these types of underwritten offerings so long as sales are made only to institutional accredited investors and to natural person accredited investors that clearly meet the requirements of *Ralston Purina* and raise no "blue sky" concerns.

[5] Resale Outside the United States Under Regulation s

Securities sold in reliance on Rule 144A are restricted securities under the Securities Act. Regulation s, however, provides—as discussed in Chapter 8 —a safe harbor for resales of securities outside the United States, including by investors that have acquired their securities in Rule 144A or other private placement transactions. [255] The only requirements for this safe harbor are that the seller not use directed selling efforts in the United States and that the sale be made in an offshore transaction. [256] For purposes of this safe harbor, the offshore transaction requirement is met if the offer is not made to a person in the United States and either the buyer is outside the United States when the order is given (or the seller and its agent reasonably believe the buyer is outside the United States) or the transaction takes place on one of the markets outside the United States designated by the SEC. [257] Once resold outside the United States pursuant to Rule 904

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under the Securities Act, securities issued by foreign companies generally are considered unrestricted, and may be freely sold anywhere, including into the United States. [258]

This ability to resell restricted securities outside the United States provides perhaps the major source of liquidity for foreign securities (particularly foreign equity securities) privately placed in the United States. For example, common equity shares of a foreign issuer with a foreign trading market that are sold in the United States pursuant to Rule 144A (directly or in ADR form) can be resold on that foreign market. [259] A security sold in a Rule 144A tranche of a foreign public offering can thus be resold into the same secondary market in which the securities originally sold outside the United States will trade. [260] U.S. private placement investors in foreign equity securities have essentially the same liquidity as foreign investors in those securities. [261]

Footnotes

210 For a discussion of the safe harbor provisions of Regulation s, *see* § 8.02.

211 *See supra* Note 16; § 8.03.

212 The one-year distribution compliance period was shortened to match the most shortened holding period for restricted securities of reporting companies in the amendments to Rule 144. *See* SEC Release No. 33-8869 (Dec. 6, 2007).

213 Rule 905 under the Securities Act; *see* § 8.02[2].

214 The SEC staff has indicated that an underwriter may resell, in compliance with Rule 144's volume and manner of sale restrictions, an unsold allotment of securities from a public offering, provided that six months have elapsed since the closing of the last sale under the relevant registration statement. SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 128.02 (Jan. 26, 2009). We believe the same analysis should apply to allotment securities from offshore transactions conducted pursuant to Regulation s.

215 *See supra* Notes 5–7 and accompanying text. Resales of restricted securities in the public market by nonaffiliates of the issuer may be made after six months for securities of an SEC-reporting issuer and one year for securities of other issuers.

216 Although the SEC has not addressed the issue, the same rationale should apply to permit § 4(1 ½) sales, which should not constitute a "distribution," during the distribution compliance period.

217 No reported case has addressed the liability of an issuer for remote sales in violation of Securities Act registration requirements. However, the U.S. Supreme Court has narrowed the view of who may be a "seller" from that adopted by some lower courts, holding that a person does not become a "seller" for purposes of § 12(a)(1) solely because his or her actions were a "substantial factor" in causing purchases of

unregistered securities. Rather, there must be evidence that the person sought or received financial benefit for himself or herself (or someone other than the purchaser) as a result of the purchaser's investment. *Pinter v. Dahl*, 486 U.S. 622 (1988). In *In re Deutsche Telekom AG Securities Litigation*, Fed. Sec. L. Rep. (CCH) ¶91,703 (S.D.N.Y. Feb. 20, 2002), the court expressed the Pinter holding as a two-prong test: to be found as a statutory seller, a person "must have either (1) passed title of the security to the plaintiff or (2) successfully solicited the purchase motivated at least in part by his own financial interest." Under this test, an issuer of Rule 144A securities would not seem to fall within either prong of the test with respect to any remote sale because title passes from the immediate seller, not the issuer, to the purchaser in such a sale, and the issuer does not seek or receive any financial benefit from such a sale. Therefore, an issuer should not be liable for sales in violation of the Securities Act by remote purchasers.

218 A qualified institutional buyer making a resale under § 4(1 ½) not prohibited by the documentation might consider various steps to ensure that the purchaser is in fact sophisticated and able to fend for itself and is aware of the restricted nature of the securities.

219 Until 2009, Rule 144A securities were required to be included in the PORTAL Market in order to clear in DTC. SEC Release No. 34-59384 (Feb. 11, 2009) (Order). Under pressure from the SEC, the rules of the PORTAL Market originally provided that, if a PORTAL security was issued in certificated form, each certificate must bear a legend to the effect that the security is restricted. SEC Release No. 34-33326 (Dec. 13, 1993). The legending requirement was eliminated in 2001. SEC Release No. 34-44042 (Mar. 6, 2001). The practice of including legends has, however, continued.

220 Certain issuers have attempted to simplify the policing of resales in side-by-side offerings by requiring only that a transferor relying on Rule 144A so indicate by checking a box on the reverse of the security. No additional documentation is required. Even this has encountered resistance from intermediaries, which are concerned about "back-office" procedures and compliance, and qualified institutional buyers, which, by taking a broad view of the premise of Rule 144A, have objected to any procedural steps whatsoever not otherwise required by the Rule.

221 *See* Preliminary Note to Rule 144 under the Securities Act ("[I]ndividual investors who are not professionals in the securities business also may be ‘underwriters' if they act as links in a chain of transactions through which securities move from an issuer to the public.").

222 *See, e.g.*, *Roto American Corp.* (avail. Feb. 19, 1971); *Gilligan, Will & Co. v. SEC*, 267 F.2d 461 (2d Cir.), *cert. denied*, 361 U.S. 869 (1959).

223 SEC Release No. 33-5223 (Jan. 11, 1972). The SEC has adopted major amendments to Rule 144 in 1990, 1997 and 2007. SEC Release No. 33-6862 (Apr. 23, 1990); SEC Release No. 33-7390 (Feb. 20, 1997); SEC Release No. 33-8869 (Dec. 6, 2007).

224 Prior to the 2007 amendments to Rule 144, a nonaffiliate selling restricted securities under Rule 144 was subject to a one-year holding period and to other conditions relating to current public information, volume of sales, manner of sale and filing of Form 144; the other conditions ceased to apply after a two-year holding period. For resales by nonaffiliates, the 2007 amendments reduced the holding period to six months with respect to securities of an Exchange Act-reporting issuer and eliminated all conditions other than the holding period and, with respect to securities of an Exchange Act-reporting issuer sold after six months and before one year, the current public information requirement described in the text. SEC Release No. 33-8869 (Dec. 6, 2007).

225 An issuer that submits reports to the SEC voluntarily is not considered a reporting issuer for purposes of Rule 144. SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Questions 131.07, 132.09 (Jan. 26, 2009).

226 For purposes of Rule 144, the term "affiliate" means "a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with" the issuer. The term "control" is defined broadly as "the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise." The SEC staff has declined to issue no-action letters on affiliate status because

of its facts-and-circumstances nature, but an executive officer or director or beneficial owner of more than 10% of the voting securities of the issuer are rebuttably presumed to be affiliates. Securities held by affiliates of the issuer (whether or not the securities were acquired in a private placement or are otherwise restricted securities) are often referred to as "control securities."

227 With respect to resales by affiliates, the 2007 amendments shortened the holding period from one year to six months with respect to securities of an Exchange Act-reporting issuer and modified the other conditions in several respects. SEC Release No. 33-8869 (Dec. 6, 2007).

228 The information that must be publicly available is defined (except for an insurance company) by reference to Rule 15c2-11 under the Exchange Act, which identifies information concerning an issuer that a U.S. broker-dealer is required to maintain if it publishes quotations for that issuer's securities.

229 While the SEC has not formally defined the term "tranche," it has been used by the SEC in other contexts to mean securities with identical terms. *See, e.g.*, Rule 902(f)(3) of Regulation s under the Securities Act ("[I]n a continuous offering of nonconvertible debt securities offered and sold in identifiable tranches, the distribution compliance period for securities in a tranche shall commence upon completion of the distribution of such tranche.").

230 Rule 144(e)(3)(vi) also provides that all sales of the same class of securities made by two or more affiliates of the issuer, or other persons who have agreed to act in concert for the purpose of selling securities of an issuer, shall be aggregated during any three-month period for purposes of determining the limitation on the amount of securities that can be sold pursuant to Rule 144.

231 A "market-maker" is "any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis." § 3(a)(38) of the Exchange Act.

232 *See* § 10.04 for a discussion of offerings on an "undocumented" basis.

233 For purposes of Rule 144, "riskless principal transactions" are defined as "principal transaction[s] where, after having received from a customer an order to buy, a broker or dealer purchases the security as principal in the market in order to satisfy the order to buy or, after having received from a customer an order to sell, sells the security as principal to the market to satisfy the order to sell." Note to Rule 144(f)(1) under the Securities Act. To be eligible for the Rule 144 safe harbor, the offsetting trades must be executed at the same price (excluding any explicitly disclosed markup or markdown, commission equivalent or other fee), must be permitted to be reported as riskless under the rules of a self-regulatory organization and must meet all the requirements of a brokers' transaction enumerated in Rule 144(g) (except for the requirement that the broker does no more than execute the order to sell the securities as agent). Rule 144(f)(1)(iii) under the Securities Act. The SEC amended Rule 144 in 2007 to permit the resale of equity securities by affiliates not only through brokers' transactions and transactions with a market-maker but also, based on input from commenters, through riskless principal transactions, which it believes will help to ensure the Rule 144 restrictions better reflect current trading practices and venues. The SEC also amended Rule 144(g) to except the posting of bid and ask quotations in alternative trading systems from the Rule's nonsolicitation provisions. In order to comply with Rule 144, a broker may not solicit or arrange for the solicitation of customers' orders to buy the securities in anticipation of, or in connection with, the transaction, subject to certain exceptions. The posting of bid and ask quotations by a broker in an alternative trading system will not be deemed a solicitation so long as the broker has published *bona fide* bid and ask quotations for the security in the alternative trading system on each of the last 12 business days. Rule 144(g)(3)(iv) under the Securities Act.

234 SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Interpretive Responses Regarding Particular Situations, Section 528.01 (Jan. 26, 2009).

235 SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Interpretive Responses Regarding Particular Situations, Section 528.08 (Jan. 26, 2009).

236 SEC Release No. 33-8813 (June 22, 2007), 72 Fed. Reg. 36,822, 36,826 (July 5, 2007) (solicitation of

public comments).

237 SEC Release No. 33-6862 (Apr. 23, 1990) (eliminating the tolling provision in Rule 144).

238 *See* Letter from SIFMA, International Swaps and Derivatives Association, Inc., and Managed Funds Association to the SEC (Sept. 21, 2007).

239 SEC Release No. 33-7187 (June 27, 1995) (requesting comment on whether Rule 144 should be amended to address derivatives); SEC Release No. 33-7391 (Feb. 20, 1997) (proposals—on which the SEC never acted—to make Rule 144 unavailable to a holder who hedges during the restricted period, to define a sale for purposes of § 5 to include specified hedging transactions, to adopt a shorter holding period during which hedging could not occur without losing the safe harbor, and to reinstitute tolling); SEC Release No. 33-8813 (June 22, 2007) (proposal to reinstitute tolling); SEC Release No. 33-8869 (Dec. 6, 2007) (determining not to reinstitute tolling).

240 *See* U.S. REGULATION OF THE INTERNATIONAL SECURITIES AND DERIVATIVES, TWELFTH EDITION, DERIVATIVES MARKETS, § 2.03[1], Note 42, and accompanying text for a discussion of SEC interpretive relief granted for certain equity derivative transactions.

241 Counsel often advise that there should be a delay between the purchase of the restricted securities and the short sale, and that, rather than cover the short position with the restricted securities, the investor should, after the Rule 144 holding period, sell the restricted securities in the open market and cover the short position with securities purchased in the open market (a practice referred to as "double-printing"). *See* SEC Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules, Question 528.03 (Jan. 26, 2009). A related question is presented by "PIPE" (or private investment, public equity) transactions, in which investors agree to purchase shares in a private placement but closing is conditioned on availability of an effective resale shelf registration statement. Several courts have considered whether a PIPE investor that sells short before the registration statement is effective and covers with registered shares after it is effective has violated § 5 of the Securities Act. *SEC v. Lyon*, 529 F. Supp. 2d 444 (S.D.N.Y. 2008); *SEC v. Berlacher*, Civil Action No. 07-3800-ER, 2008 U.S. Dist. LEXIS 109246 (E.D. Pa. Jan. 23, 2008); *SEC v. Mangan*, No. 3: 06-CV-531, 2008 WL 3925059 (W.D.N.C. Aug. 20, 2008). These courts found that there was no § 5 violation, but the question remains uncertain.

242 *See supra* Note 10.

243 *See The Section 4(1 ½) Phenomenon* (arguing that notwithstanding certain judicial precedent and staff no-action letters to the contrary, § 4(a)(1) provides the only viable statutory basis for private resales of unregistered securities, since § 4(a)(2) is expressly limited to sales by an issuer).

244 *See* text accompanying *supra* Note 70.

245 Offshore sales under Regulation s of securities of non-U.S. issuers generally would not require such procedures. *See* § 7.05[4].

246 Pub. L. No. 114-94, 129 Stat. 1312 (2015); *see* Nicolas Grabar, *FAST Act Amendments to the U.S. Securities Laws*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION, *available at* https://corpgov.law.harvard.edu/2016/01/16/fast-act-amendments-to-the-u-s-securities-laws (Jan. 16, 2016).

247 Conditions to reliance on the exemption under § 4(a)(7) are included in §§ 4(d) and 4(e) of the Securities Act.

248 This financial information must include the issuer's most recent balance sheet and profit and loss statement and "similar financial statements" for the two preceding fiscal years (for which the issuer has been in operation) and it must be "reasonably current," meaning it must include a balance sheet and corresponding profit and loss statement as of a date and for a fiscal year ended less than 16 months prior to the sale and, if those items are not as of a date and for a period ending less than six months prior to the sale, be accompanied by an interim balance sheet and profit and loss statement for a date and a period ending less than six months before the transaction date.

249 This information requirement is more burdensome than the information requirements imposed by Rule

144A and Regulation D. First and most importantly, while the information is similar to what an issuer is required to make available if requested by a purchaser under Rule 144A(d)(4), § 4(a)(7) requires a seller to deliver the information to a purchaser. Section 4(a)(7) also imposes the same requirement for all issuers, while Rule 144A has a special rule for foreign private issuers, allowing them to meet the "reasonably current" financial information requirement by complying with the requirements of their home country or principal trading market. The § 4(a)(7) information requirement is also more stringent than Regulation D, where information delivery is mandatory only for offerings that include nonaccredited investors.

250 It is not clear what duty this requirement imposes on a seller with respect to potential securities law violations by the issuer. By comparison, an affiliate can avoid control person liability under § 20 of the Exchange Act if the person "in good faith" was unaware of issuer violations of the Exchange Act. Further, as written, the representation would extend to any violations of the securities laws or regulations (which could include minor violations).

251 *See* § 7.09.

252 *See* § 7.02[1].

253 We believe it is clear that a broker-dealer may purchase restricted securities from a nonsubsidiary affiliate and resell them in reliance on § 4(a)(7), because the new exemption expressly permits use by such affiliates and there is no reason why such use could not be done indirectly *via* a broker-dealer.

254 In Rule 144A, it is explicit that these types of firmly underwritten back-to-back sales are permitted. *See* Note 7 to Rule 144A and Rule 144A(e).

255 Rule 904 under the Securities Act; SEC Release No. 33-6863 (Apr. 24, 1990) (adopting Regulation s); *see* § 8.02[2].

256 Additional requirements apply to resales by dealers, persons receiving selling concessions and certain affiliates. *See* Rule 904 under the Securities Act. Conditions applicable to the Regulation s safe harbor are discussed in § 8.02.

257 *See* Rule 902(h) under the Securities Act; § 8.02[1][a].

258 As discussed in § 8.02[2], in 1998 the SEC adopted amendments to Regulation s that classify domestic equity securities (but not the equity securities of foreign private issuers) as "restricted securities" within the meaning of Rule 144. SEC Release No. 33-7505 (Feb. 17, 1998). The amendments were adopted after the SEC staff expressed concern with alleged abuse of the safe harbor of Regulation s to sell offshore, free from the registration requirements of the Securities Act, securities that later return to the U.S. public markets. The concern applied in particular to sales of restricted securities under Rule 904 to "wash" the restrictions off, followed by resales (or matched sales) back into the United States—especially in the case of securities of U.S. companies trading publicly in the United States.

259 Many Rule 144A offerings of foreign equity securities have been made in ADR form or have given purchasers the option of purchasing ADRs or ordinary shares. In either case, a "restricted" ADR program is established that does not require filing a registration statement with the SEC. The original private placement securities sold in ADR form are deposited in that facility and the resulting ADRs are restricted securities, as are the underlying securities that the ADR represent. *See* § 10.05[3][b].

260 U.S. tax law limits the ability of issuers to offer or sell in the United States debt obligations in bearer form. Combined foreign offerings and U.S. private placements of debt securities sold to U.S. investors generally must be in registered form and not be later exchangeable for bearer form securities. In the common case where the securities sold in a foreign offering are in bearer form, the U.S. portion of the offering is not interchangeable with the offshore portion, and much of the liquidity advantage that the resale safe harbor of Regulation s would otherwise provide is lost. *See* § 8.03[2] for a discussion of U.S. tax law restrictions on the offer and sale of debt obligations in bearer form.

261 *See* § 8.02[2].

U.S. Regulation of the International Securities and Derivatives Markets, § 7.05, PRIVATE OFFERINGS WITH REGISTRATION RIGHTS

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.05 (11th and 12th Editions 2014-2017)
11th and 12th Editions

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The term "registration rights" refers to a practice that developed to improve the execution of a private placement by having the issuer promise investors a mechanism to resell the securities in the United States without the resale restrictions that apply to privately placed securities. One possible mechanism is a resale registration statement, which the issuer files after the private offering to register

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resales by the investors in the offering. The other possible mechanism is a registered exchange offer—referred to as an "A/B" exchange offer or an "Exxon Capital" exchange offer (after a leading no-action letter)—in which, following the private placement, the issuer offers securities that are materially identical to those initially issued but that, having been sold in a registered exchange offer, can be freely resold. [262] In either case, the issuer enters into a "registration rights agreement" with the financial institutions conducting the initial private offering, in which the issuer undertakes for the benefit of holders of the securities to take the necessary steps—either to establish an effective resale registration statement, or to conduct a registered exchange offer—and generally agrees to pay holders liquidated damages if it fails to meet specified deadlines. [263] Registration rights can improve the attractiveness of the securities by enlarging the population of potential investors, particularly where the principal secondary market is expected to be in the United States. Some key market indices also require that debt securities include registration rights for inclusion in those indices.

[1] Registration Rights Generally

Registration rights are employed in a variety of situations where the resale restrictions applicable to privately placed securities make the securities less attractive, and SEC registration is practicable eventually but not immediately. [264] Conducting a registered offering has become substantially easier for SEC-reporting companies with the refinement of the shelf rules and particularly the 2005 reform establishing automatic shelf registration for well-known seasoned issuers, but there are still several situations where a Rule 144A offering, coupled with registration rights, is used. One is where the registrant is not yet a reporting company, or the registrant or the transaction is ineligible for shelf registration. In such cases, a private placement with registration rights can be executed more quickly than a registered offering. Another case is where the registrant is unable to meet some specific requirement for an SEC-registered offering, such as (i) the presentation of the most recently available financial information of an acquired company or *pro forma* financial statements showing the effects of an acquisition

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or disposition, [265] or (ii) for a foreign private issuer, the presentation of the required most recently available interim financial statements. [266]

The 2008 amendments to Rule 144 led to the development of new procedures that have replaced traditional registration rights techniques in some transactions. Rule 144 now permits a nonaffiliate to resell privately placed securities without restrictions after a one-year holding period, [267] and thus promises a mechanism for unrestricted resales that is much less cumbersome and almost as fast as under many traditional registration rights agreements.

Under the procedures, the privately placed securities are initially issued with a restricted Committee on Uniform Security Identification Procedures ("CUSIP") or an International Securities Identification Number ("ISIN") identifier code, and the global security certificate deposited with the clearing system bears a legend setting forth transfer restrictions. When the required holding period has expired and the issuer certifies to the trustee that the securities have become freely resalable by nonaffiliates, an unrestricted code (reserved at the time of issuance), which may be the Regulation s CUSIP or ISIN, replaces the restricted code and the restrictive legend is removed from the global security. [268] To implement the removal of the legend, the issuer must also certify to the Depository Trust Company ("DTC") at least 15 days prior to the date of the change in CUSIP (in the case of a mandatory change), or ten days (if the terms of the security allow holders the option of retaining the restricted security). [269] To inform the market of the change, Bloomberg has indicated that upon notice from issuers or trustees, it will advise holders through its system of a corporate action

indicating the change in CUSIP or ISIN, and also make corresponding adjustments to its screen pages. [270] No action from holders is required under the procedures, and there is no need for a new global note to be executed. [271]

These procedures have been more readily adopted for some types of securities than for others. In the investment grade debt market, A/B exchange offers remain the normal practice. Certain key market indices such as the Barclays Capital U.S. Aggregate Bond Index still require securities to be "registered" and not merely "unrestricted" for inclusion, and investment funds may maintain similar requirements for the securities that can be included in some or all of their portfolios. On the other hand, in the convertible debt market, most transactions have done away with resale registration rights altogether in favor of the issuer being required to pay additional interest if it fails to permit delivery of unrestricted securities after a defined period. In the high-yield market, practice is varied, but there appears to be a trend toward using the new procedures, while providing investors with contingent registration rights. [272]

[2] A/B Exchange Offers

In an "A/B" or "Exxon Capital" exchange offer, [273] the issuer of securities that have been sold in a private placement offers to exchange those securities for securities that are identical in all material respects. The SEC has taken the position that, for certain types of securities, the securities issued pursuant to the SEC-registered exchange offer can be freely resold by a nonaffiliate of the issuer without registration. [274]

This SEC position permitting resale by nonaffiliates of the issuer without registration is available for debt securities and investment grade preferred stock that are not convertible into equity securities of a U.S. issuer (other than into preferred stock), as well as warrants or other rights to subscribe for such debt or preferred stock. [275] The SEC has also permitted foreign issuers that are not yet reporting companies under the Exchange Act wider latitude than U.S. issuers to

make use of A/B exchange offers in connection with equity offerings. Foreign issuers have received no-action relief from the SEC allowing them to conduct registered A/B exchange offers of equity securities and convertible debentures in connection with a subsequent listing or offering of equity securities. [276] This more lenient position reflects the SEC's policy of encouraging foreign listings on U.S. public equity markets by allowing foreign issuers to take a "stepping stone" approach, by first conducting a private placement to institutional investors (usually accompanied by an offshore placement under Regulation s) before pursuing a full public offering in the United States. [277] This exchange-offer structure does not appear to have been used recently, however, perhaps reflecting the general reticence of foreign companies to commit to U.S. equity listings and the accompanying regulatory burdens.

A nonaffiliate reselling securities received in an A/B exchange offer is not required to deliver a prospectus, unless it is a broker-dealer. A broker-dealer that

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receives for its own account registered securities in exchange for restricted securities must agree to deliver a prospectus meeting the requirements of the Securities Act in connection with any resales (and the prospectus and any related letter of transmittal used in the exchange offer must contain a notice to such effect). The prospectus it delivers may be the prospectus for the exchange offer so long as it contains disclosure regarding the plan of distribution with respect to resale transactions. The plan of distribution need not name the broker-dealer or the amount of exchange securities owned by the broker-dealer. According to the SEC staff, by agreeing to deliver or by delivering a prospectus, the broker-dealer will nevertheless not be deemed to have admitted that it is an "underwriter" within the meaning of the Securities Act. [278]

The structure sanctioned by these SEC staff no-action letters has been conditioned upon an agreement by the issuer to provide to the SEC a supplemental letter stating that the issuer is relying upon this no-action relief. The letter must also include representations that the issuer has not entered into any arrangement with any person to distribute the securities to be issued in the exchange and that, to the best knowledge of the issuer, persons participating in the exchange are acquiring the securities in the ordinary course and have not entered into any arrangement or understanding with anyone to participate in a distribution of the securities. [279]

The A/B exchange offer procedure offers advantages to both issuers and investors over the alternative of granting investors resale registration rights. First, issuers in these transactions avoid maintaining an "evergreen" resale registration statement, as is customary in the case of privately offered securities with resale registration rights. [280] Second, from the investor's perspective there is no potential liability in connection with a resale by an exchanging holder under § 12(a)(2) of the Securities Act (unless the seller is a broker-dealer), no prospectus delivery requirement (unless the seller is a broker-dealer) and no requirement to include the names of the holders of securities being exchanged in the registration statement.

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Standard agreements to conduct A/B exchange offers typically set deadlines for the filing and declaration of effectiveness of the exchange offer registration statement and the consummation of the related exchange offer. They also usually require the issuer to maintain the effectiveness of the registration statement for a specified period (often 90 to 180 days) to enable broker-dealers to comply with their prospectus delivery obligations. The issuer must consequently consider whether any development that occurs during this period requires the filing of a prospectus supplement or a post-effective amendment to the registration statement. [281] Any failure to comply with these deadlines typically triggers liquidated damages in the form of the obligation to pay additional interest on debt securities until the failure is cured. This consequence emphasizes the importance of assessing, in connection with the initial private placement, whether any difficult issues are likely to arise that could delay or prevent filing or the effectiveness of the exchange offer registration statement.

[3] “Rule 144A for Life” Offerings

If, generally in the case of debt securities or non-participating preferred stock, an issuer's investor base is willing to hold restricted securities, an issuer may not be required to offer registration rights, whether *via* resale registration or a registered exchange offer. This is particularly true where an issuer does not have reporting obligations under the Exchange Act and does not wish to become a reporting issuer. Such offerings that do not provide for registration rights are referred to as "Rule 144A for Life" offerings, and the offered securities remain unregistered and restricted for the entire period during which they remain outstanding.

Footnotes

262 A/B (or Exxon Capital) exchange offers are discussed at § 7.04[2]. A/B exchange offers are used primarily for nonconvertible debt securities and investment grade preferred stock. They are not permitted for other equity securities (including convertible debt), except in limited circumstances for equity securities of a

foreign private issuer. Resale registration statements are most frequently used for issuances of common stock.

263 If a registered exchange offer is contemplated, debt securities in a Rule 144A placement will need to be issued pursuant to a trust indenture that meets the requirements of the Trust Indenture Act. *See* § 3.05[4]. The same applies if a resale registration statement is used for debt securities, although this practice is less common.

264 Issuers may also offer registration rights to affiliates holding control securities if so requested. *See* §§ 7.05 and 9.05[8].

265 *See* § 4.04[10].

266 *See* § 4.04[4]. In addition, securities that are convertible into U.S.-listed equity are sometimes sold in a Rule 144A private placement even where SEC registration would be available. This practice exists because, in order to facilitate the offering, the issuer will sometimes purchase shares from the investors to mitigate the downward pressure on the shares resulting from the offering, thereby also permitting the investors to establish under their hedge. The issuer would not be permitted to purchase its shares under Regulation M of the Exchange Act if the offering were done on an SEC-registered basis.

267 Under Rule 144, a nonaffiliate can resell securities of an Exchange Act-reporting issuer freely after a six-month holding period, but only if the issuer is current in its periodic reporting. If the issuer ceases to be current ("goes dark"), nonaffiliates must wait one year to resell without restrictions.

268 The SEC has stated that it will not object if issuers remove restrictive legends from securities held by nonaffiliates after all of the applicable conditions in Rule 144 are satisfied, while observing that such removals are at the discretion of the issuer and that disputes over removals are likely to be governed by contract and by state law, rather than federal law. *See* SEC Release No. 33-8869 (Dec. 6, 2007).

269 *See* The Depository Trust Company, DTC Important Notice 4903-09, Optional Use of the Depository Trust Company's ("DTC") Mandatory Exchange Platform for Rule 144A and Reg. S Securities that have become unrestricted securities (Apr. 1, 2009). Similar actions would need to be taken if the securities are held in a different clearing system.

270 SIFMA, *SIFMA Guidance: Procedures, Covenants, and Remedies in Light of Revised Rule 144* (Oct. 2008).

271 In the case of optional resales where an issuer has not undergone procedures to provide for free transferability of the entire tranche of securities, a holder may need to submit a certificate of transfer.

272 *See* Adam E. Fleisher & Jung W. Ju, *Revised Rule 144 and Registration Rights, Market Practice Two Years On*, PRACTICAL LAW, THE JOURNAL (Feb. 2010).

273 *Exxon Capital Holdings Corp.* (avail. May 13, 1988).

274 *See Shearman & Sterling* (avail. July 2, 1993), *Morgan Stanley & Co. Inc.* (avail. June 5, 1991) ("Morgan Stanley") and letters cited therein.

275 The SEC has offered no rationale to explain why preferred stock should be rated investment grade to qualify for relief, whereas debt securities are not subject to any rating requirement. Some exceptions from the rating requirement have been granted, *see K-III Communications Corp.* (avail. May 14, 1993) (permitting the use of a registered exchange offer in connection with unrated preferred stock convertible into debt securities of the issuer), but the SEC staff has informally advised that *K-III Communications* should not be viewed as an extension of *Morgan Stanley* or its progeny since the preferred stock at issue was in the staff's view the functional equivalent of debt. (It remains to be seen whether the removal in July 2011 of references to credit ratings in Securities Act rules and forms pursuant to § 939A of the Dodd-Frank Act, *see* SEC Release No. 33-9245 (July 27, 2011), will affect the SEC's position on this issue.) The SEC also suggested in a subsequent no-action letter that the availability of the exchange offer procedure may depend upon characteristics of the privately placed security, including, among others, whether it is more attractive to qualified institutional buyers and institutional accredited investors and, accordingly, has been sold to them rather than to "retail" investors, whether the security is listed on a national securities exchange and whether it pays distributions semi-annually rather than monthly or quarterly. *See Brown & Wood LLP*

(avail. Feb. 7, 1997). Again, the staff offered no rationale for why those characteristics are significant.

276 *Grupo Financiero InverMexico, S.A.* (avail. Apr. 4, 1995) (granting no-action relief in connection with an exchange offer of convertible debentures in connection with a registered offering or listing of capital stock of the issuer); *Corimon C.A. S.A.C.A.* (avail. Mar. 22, 1993) (granting no-action relief in connection with an exchange offer of ADRs in connection with the listing of similar ADRs); *Transportación Maritima Mexicana, S.A. de C.V.* (avail. June 8, 1992) (granting no-action relief in connection with an exchange offer of ADRs to be conducted concurrently with a global offering outside Mexico, including a registered U.S. offering, of units consisting in part of similar ADRs); *Vitro, Sociedad Anónima* (avail. Nov. 19, 1991) (granting no-action relief in connection with an exchange offer of ADRs to be conducted concurrently with a global offering of common shares, including a registered U.S. offering of ADRs representing common shares). Certain Schedule B issuers have relied on the *Exxon Capital* no-action letters (see, e.g., Corporación Andina de Fomento (SEC File Nos. 333-90296 and 333-88404, filed June 6, 2002, and May 10, 2002, respectively) and Republic of Peru (SEC File No. 333-98403, filed Aug. 19, 2002).

277 It is not clear, however, that the SEC staff would permit a foreign issuer of equity securities to conduct an A/B exchange offer if its obligation to conduct the exchange offer were not also contingent on a subsequent public offering or listing in the United States. *See* Adam E. Fleisher, David E. Webb & Malini Mukhopadhyay, THE MECHANICS OF A/B EXCHANGE OFFERS (Practical Law Company, 2010).

278 *Shearman & Sterling* (avail. July 2, 1993). The SEC has also stated its view that the initial purchasers in the private placement would not normally be considered "underwriters" of the subsequent registered exchange offer or bear liability under § 11 or § 12(a)(2) of the Securities Act. *See* Brief of SEC as *Amicus Curiae* Supporting Defendants, *In re HealthSouth Securities Litigation*, No. CV-03-BE-1500-S (N.D. Ala. Nov. 28, 2006); *see also In re Livent*, 151 F. Supp. 2d 371 (S.D.N.Y. 2001).

279 *See Grupo Financiero InverMexico, S.A.* (avail. Apr. 4, 1995); *Corimon C.A. S.A.C.A.* (avail. Mar. 22, 1993); *Transportación Maritima Mexicana, S.A. de C.V.* (avail. June 8, 1992); *Vitro, Sociedad Anónima* (avail. Nov. 19, 1991).

280 Agreements to conduct an A/B exchange offer do, however, typically require the filing and maintenance of a resale registration statement in certain circumstances if the exchange offer is not available to all investors (including if the initial purchasers are holding allotment securities) or if the SEC repeals its position permitting exchange offers.

281 An issuer eligible to use Form S-3 or F-3 is permitted to incorporate by reference into its exchange offer registration statement any current Exchange Act report filed on Forms 8-K or 6-K (as applicable) after the effective date of the registration statement. An issuer filing on Form S-1 or F-1, however, may only incorporate by reference past, rather than future, Exchange Act reports—as a result, such an issuer may be required to file a post-effective amendment to its registration statement in order to reflect any material development arising after the initial effective date. The amendment to the registration statement is subject to SEC review (like the original registration statement itself), which can require suspending use of the registration statement.

U.S. Regulation of the International Securities and Derivatives Markets, § 7.06, PRIVATE PLACEMENT OF ADRs

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.06 (11th and 12th Editions 2014-2017)
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Rule 144A offerings of foreign equity securities are sometimes made in ADR form or give investors the option of purchasing American depositary shares ("ADSs") or ordinary shares. In either case, the issuer and the depositary establish a "restricted" ADR program, under which privately placed shares are delivered to the depositary, which issues ADSs that are restricted securities for

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purposes of Rule 144 under the Securities Act. The restricted ADSs are not eligible for registration on Form F-6 with the SEC. [282]

In some cases, the foreign issuer may also plan to set up an "unrestricted" ADR program subsequently. Under the unrestricted program, shares are delivered to the depositary, which issues unrestricted ADSs that are available for public trading, and the program is registered with the SEC on Form F-6. [283] Special issues can arise where a foreign issuer attempts to establish an unrestricted ADR facility within one year after a private placement, since the shares sold in the private placement are restricted securities and not yet eligible for resale under Rule 144, and accordingly may not be deposited in the unrestricted facility. The SEC staff has cautioned that it may be unwilling to declare the requisite F-6 registration statement effective unless the purchasers in the private placement (but not subsequent transferees) have acknowledged in writing the restrictions on transfer and deposit in an unrestricted ADR facility of the privately placed shares. Some banks have resisted issuer requests to require such acknowledgements, arguing that the resulting administrative burden could significantly limit the number of potential investors in the Rule 144A offering. An issuer that accedes to these marketing concerns may not be able to establish an unrestricted ADR facility within one year of the private placement. [284]

Special issues also may arise where a foreign issuer wishes to establish an unrestricted ADR facility immediately upon, or shortly after, completion of an offering outside the United States that is exempt from Securities Act registration under Regulation s. The SEC staff has taken the position that the registration statement on Form F-6 relating to the unrestricted ADSs may not be filed until the expiration of the applicable distribution compliance period (if any) under Regulation s or seasoning period under § 4(a)(3), whichever is longer. [285]

The SEC has also expressed concern regarding the possibility for leakage of restricted securities into the U.S. public market where an issuer proposes to sponsor concurrent restricted and unrestricted ADR programs. These programs can operate as a single combined facility, under which both restricted and unrestricted securities are issued under a single deposit agreement, or as separate facilities. In such cases, the SEC staff has taken the position, as a condition to

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effectiveness of a Form F-6, that it will require various procedures to be implemented in connection with the facility or facilities to prevent leakage, including assigning separate CUSIP numbers to the restricted and unrestricted ADSs and obtaining written certifications acknowledging applicable transfer restrictions on the restricted ADSs or that the ADSs were obtained in an offshore transaction complying with Rule 904 of Regulation s. [286] So-called "collapsible" facilities, which provide, upon effectiveness of the related Form F-6, for automatic fungibility of restricted ADSs with ADSs issued out of an unrestricted facility, have also attracted SEC attention. In such circumstances, the SEC staff has informally taken the position that effectiveness of the Form

F-6 will depend upon implementation of various procedures, including obtaining written certifications on deposit and withdrawal of securities with respect to the restricted ADR facility as to the status of the beneficial owner and compliance with resale restrictions.

Footnotes

282 The ADSs are not eligible for registration because the underlying shares, having been sold in a private placement, do not meet the requirements of General Instruction I.A(2) of Form F-6. Restricted ADSs may be resold under Rule 144 to the same extent the underlying restricted shares could have been. SEC, Division of Corporation Finance, Compliance and Disclosure Interpretations, Securities Act Rules 532.16 (Jan. 26, 2009).

283 ADR programs of foreign issuers generally are discussed in § 3.04.

284 If the unrestricted facility is to be exchange-listed, the issuer might consider conducting a registered exchange offer of unrestricted shares for restricted shares at the time it establishes the unrestricted ADR facility. *See* § 7.04[2].

285 *Depositary Receipts* (avail. Apr. 14, 1993).

286 *Depositary Receipts* (avail. Apr. 14, 1993).

U.S. Regulation of the International Securities and Derivatives Markets, § 7.07, CLEARANCE AND TRADING

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.07 (11th and 12th Editions 2014-2017)
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Under the rules of the principal U.S. clearing system, The Depository Trust Company, securities that are eligible for resale under Rule 144A are eligible for electronic clearing and settlement through DTC. [287] In a typical Rule 144A offering of debt securities or ADSs, DTC holds one or more certificates in global form evidencing the amount of securities issued. Restricted securities placed with QIBs pursuant to the § 4(a)(2) exemption may also be held in DTC if they meet the criteria for resale under Rule 144A. Securities sold to non-QIBs are not normally held in DTC, since resales of such securities are ordinarily subject to "policing" mechanisms to prevent a distribution, and DTC does not have procedures for this purpose. All Rule 144A securities deposited at DTC are required to bear a CUSIP or other identification number different from the number borne by any unrestricted securities of the same class, including, for example, securities that were sold in a concurrent offering under Regulation s and that have "seasoned" for purposes of U.S. securities law. [288] DTC participants (brokers and dealers) trade and settle transactions electronically through book-entry trades recorded on the participants' accounts.

Euroclear and Clearstream are able to participate in DTC indirectly through their depositaries that maintain an account as participants in DTC. This arrangement permits trades to be made between DTC participants and participants in Euroclear and Clearstream.

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Many offerings use a "dual tranche" system, in which two global securities are deposited with DTC, one for the Rule 144A tranche and one for the Regulation s tranche, but it is also possible for an entire issue of securities placed in a global offering to be represented by one global security deposited with DTC and for transactions in the securities to be effected worldwide using a single book-entry system; in such a case all securities are subject to Rule 144A restrictions.

Rule 144A securities trade primarily over the counter among dealers. Transactions in Rule 144A securities conducted by U.S. broker-dealers are generally subject to transaction reporting requirements. [289] Attempts to develop organized markets or trading systems for Rule 144A securities began concurrently with the adoption of Rule 144A, when the SEC approved the PORTAL Market, a system for primary and secondary trading of securities pursuant to Rule 144A with facilities for clearance and settlement of both domestic and foreign securities through DTC, in the case of transactions effected in the United States, and Clearstream Banking, in the case of transactions effected outside the United States. [290]

The PORTAL Market originally was a "closed" trading system, in that it required prequalification of PORTAL Market participants and imposed restrictions on a participant's ability to trade securities out of the system except in transactions that resulted in the delivery of an unrestricted security. The PORTAL rules were substantially amended in 1993 and again in 2007, each time in an effort to make PORTAL a more effective trading venue. [291] But these measures were unsuccessful, and the PORTAL Market ultimately ceased operating in 2008. [292]

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In addition to the PORTAL Market, there have been several other attempts to develop electronic trading platforms for Rule 144A securities. These trading platforms have not been widely used.

Footnotes

287 The Depository Trust Company, Operational Arrangements (Necessary for Securities to Become and Remain Eligible for DTC Services) (Jan. 2012).

288 SEC Release No. 34-33327 (Dec. 13, 1993).

289 FINRA Rules, Rules 6600–6630 and 7700–7730, FINRA MANUAL. FINRA operates TRACE for reporting and disseminating information on secondary market transactions in debt securities, which covers both SEC-registered and Rule 144A debt securities. SEC Release No. 34-43873 (Jan. 23, 2001). Trades in Rule 144A equity securities are reported to the OTC Reporting Facility. On June 30, 2014, FINRA began publicly disseminating Rule 144A corporate debt security transaction data. This data previously was not publicly disseminated due to the prohibition on offers to non-QIBs in Rule 144A transactions. FINRA Rules, Rule 6750. SEC Release No. 34-70345 (Sept. 6, 2013).

290 SEC Release No. 34-27956 (Apr. 27, 1990).

291 SEC Release No. 34-33326 (Dec. 13, 1993); SEC Release No. 34-56172 (July 31, 2007). Pursuant to the 2007 amendments, Nasdaq launched an updated version of the PORTAL Market that sought to reestablish it as a closed trading system permitting qualified participants to trade PORTAL-eligible securities with one another through a centralized electronic quotation and trading platform. The new market established qualification requirements for brokers and dealers and for QIBs that wished to access PORTAL, and implemented quotation, trade negotiation and trade reporting functions in the PORTAL Market for PORTAL-designated securities.

292 SEC Release No. 34-58638 (Sept. 24, 2008). Even though Nasdaq terminated PORTAL security designation processes as of October 26, 2009, existing regulatory obligations for securities previously designated as PORTAL securities were not eliminated until June 2010. SEC Release No. 34-61979 (Apr. 23, 2010) (Order).

U.S. Regulation of the International Securities and Derivatives Markets, § 7.08, SPECIAL CONCERNS OF BROKER-DEALERS

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.08 (11th and 12th Editions 2014-2017)
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Private placements raise certain specific compliance issues for broker-dealers, including those discussed below.

[1] Application of Regulation T to Rule 144A Transactions

Regulation T, promulgated by the Board of Governors of the Federal Reserve System (the "Board") under § 7 of the Exchange Act, regulates extensions of credit by broker-dealers. [293] Under Regulation T, purchases by broker-dealers of debt securities in a *bona fide* public offering are deemed not to be extensions of credit to the issuer, [294] while purchases of privately offered debt securities are deemed to be extensions of credit. [295] When purchasing privately offered debt securities, therefore, broker-dealers must take steps to comply with Regulation T. [296]

To facilitate the SEC's goal in adopting Rule 144A of achieving a more liquid and efficient institutional resale market for unregistered securities, however, the Board has interpreted Regulation T not to treat a broker-dealer's purchase of an unregistered debt security for resale under Rule 144A, including a purchase in the course of Rule 144A market-making activities, as an extension of credit by the broker-dealer for purposes of Regulation T. [297] The Board's interpretation is applicable to both primary and secondary market transactions.

The theory of the Board's interpretation is that, in purchasing debt securities with the intention to resell them pursuant to Rule 144A, a broker-dealer is "arranging" for an extension of credit by the purchaser of the debt securities in the resale transaction, rather than extending the credit itself. Regulation T permits a broker-dealer to arrange any credit provided that it does not willfully

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arrange credit that violates the Board's other margin regulations, Regulations U and X. [298] The narrow focus of the Board's interpretation leaves open the applicability of Regulation T in circumstances in which, notwithstanding a good faith intention when the security is purchased to resell it under Rule 144A, the broker-dealer is unable to resell it or resells it other than pursuant to Rule 144A.

In adopting its interpretation, the Board declined to accept a proposal made by the Securities Industry Association that it simply declare that a broker-dealer's purchase of a security for resale—whether or not pursuant to Rule 144A—constitutes a permitted arranging rather than an extension of credit. The effect of the Board's refusal is to leave Regulation T relevant for a broker-dealer's purchase, as principal, of privately offered debt securities other than for resale under Rule 144A. In the context of such transactions (including, *e.g.*, initial resales to both QIBs and to accredited investors in traditional private sales), the participating financial institution should consider whether it needs to obtain an appropriate representation from the issuer that the proceeds of the offering will not be used for purchasing, carrying or trading in securities. [299]

[2] Net Capital Consequences of Rule 144A Securities

Restricted securities held by a broker-dealer have traditionally resulted in a 100% charge to its regulatory capital because such securities do not have a "ready market" and "cannot be publicly offered or sold because of statutory, regulatory or contractual arrangements or other restrictions." [300] In the adopting

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release for Rule 144A, however, as well as in several subsequent no-action letters, the SEC and its staff have outlined criteria under which certain Rule 144A-eligible securities and other securities that the SEC may not otherwise deem to have a "ready market" may qualify for reduced capital charges. Application of such reduced capital charges depends on factors such as, among other things, the rating of the securities (or the issuer) by "nationally recognized statistical rating organizations," [301] the availability of public information regarding the issuer, the issuance size and the convertibility of the securities into publicly traded securities that have a ready market. [302]

[3] FINRA Rule 5123

Upon its effectiveness in 2012, FINRA Rule 5123 increased the disclosure and reporting obligations of certain broker-dealers that participate in private placements. Rule 5123 generally requires FINRA members and associated persons to provide disclosure to investors in private offerings describing the anticipated use of offering proceeds and the amount and type of offering expenses and offering compensation (either in the private placement memorandum or a separate term sheet). Rule 5123 requires FINRA members to file this disclosure with FINRA no later than 15 days after the document is provided to investors or indicate in the filing that no written documents were used. [303] Because of its numerous exemptions—which include most offerings to institutional investors (including offerings made pursuant to Rule 144A) and offerings pursuant to Regulation s under the Securities Act, as well as offerings of nonconvertible debt or preferred securities by issuers that meet the eligibility criteria for incorporation by reference in Forms S-3 and F-3)—from a practical perspective the Rule applies mainly to private placements of securities to natural persons in the United States.

Footnotes

293 *See* § 14.07[6][a].

294 *See* Fed. Res. Reg. Serv. ¶5-606.56 (staff opinion, Dec. 20, 1993) (Board staff does not regard the purchase of debt securities offered in a public offering as an extension of credit subject to the margin regulations, with the caveat that the public offering must not be structured "so that the sale in actual practice resembles a private placement.").

295 *See* Fed. Res. Reg. Serv. ¶5-606.4 (staff opinion, Dec. 11, 1984).

296 Where the proceeds of the debt securities will not be used for the purpose of purchasing, carrying or trading in securities, the broker-dealer may obtain a certification of the purpose of the credit on Board Form T-4 and extend and maintain the credit on a "good faith" basis. *See* 12 C.F.R. § 220.6(e); *see also* § 14.07[6][a][i]. Nonpurpose credit extended by a broker-dealer may be subject to applicable net capital charges. *See* FINRA Rules, Rule 4210(e)(7), FINRA MANUAL.

297 *See* Fed. Res. Reg. Serv. ¶5-470.1 (Board interp., July 16, 1990).

298 *See* 12 C.F.R. § 220.3(g). Purchases of privately offered debt securities by nonbroker-dealers, including in transactions under Rule 144A, are extensions of credit that may be subject to the Board's Regulation U (applicable to certain U.S. lenders other than broker-dealers) and Regulation X (applicable to certain U.S. and U.S.-controlled borrowers). For example, Regulation U limits extensions of credit to finance the purchase or carrying of "margin stock" (such credit referred to as "purpose credit") that are secured, directly or indirectly, by "margin stock." *See* 12 C.F.R. § 221.3. "Indirect" security may include, for example, restrictions on the sale, pledge or other disposition of assets where 25% or more of the assets subject to the arrangement consist of margin stock. *See* 12 C.F.R. § 221.2. "Margin stock" includes, among other securities, stock registered on a U.S. national securities exchange (including Nasdaq) and debt convertible into such stock. *See* 12 C.F.R. § 221.2. Accordingly, a U.S. person purchasing a privately offered note (including debt of a foreign issuer) any proceeds of which are used for "purpose credit" and the collateral for which includes "margin stock" may be subject to Regulation U, which among other requirements would limit the amount of credit that may be extended through the note. In addition, even where a privately placed note

is not "purpose credit" but is directly or indirectly secured by "margin stock," Regulation U may require the purchaser to register and make certain related filings with the Board, although the Board staff has by interpretation created an exception from this requirement for nonpurpose credit notes purchased under Rule 144A. *See* Fed. Res. Reg. Serv. ¶5-942.69 (staff opinion, Aug. 30, 1996).

299 *See supra* Note 296.

300 Rule 15c3-1(c)(2)(vii) under the Exchange Act; *see also* § 14.07[2][b][i].

301 [Reserved.]

302 *See* SEC Release No. 33-6862 (Apr. 23, 1990); *Securities Industry Association* (avail. July 27, 2000); *Securities Industry Association* (avail. Aug. 16, 1999); *Securities Industry Association* (avail. Mar. 30, 1996); *Securities Industry Association* (avail. June 12, 1992).

303 As of 2013 FINRA updated the form that firms must use to file offering documents and information pursuant to FINRA Rule 5123. The updated form includes six new questions that are designed to assist FINRA in prioritizing its review of private placement filings. The updated form is available on the FINRA website.

U.S. Regulation of the International Securities and Derivatives Markets, § 7.09, STATE SECURITIES LAW CONCERNS

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.09 (11th and 12th Editions 2014-2017)
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Institutional private placements of the kind discussed in this chapter are structured primarily to comply with federal securities laws, but they may also be

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subject to state securities laws, traditionally referred to as "blue sky" laws. [304] For transactions in "covered securities," as described below, federal law expressly preempts state securities laws, making them inapplicable. For other transactions, including most private placements by foreign private issuers, there is no federal preemption of state law, and such transactions are typically conducted under exemptions from state law registration requirements.

The National Securities Markets Improvement Act of 1996 (the "NSMIA") [305] amended § 18 of the Securities Act to provide for federal preemption of state laws requiring registration of securities that are "covered securities" or transactions in "covered securities," as defined in § 18. [306] Several categories of preemption are potentially relevant to private placements: (i) where the securities are listed (or will be listed upon completion of the transaction) on a national securities exchange or are senior to listed securities of the same issuer (for example, debt securities of an issuer that has listed common equity), (ii) where the transaction is exempt from registration pursuant to regulations promulgated by the SEC under § 4(a)(2) of the Securities Act [307] and (iii) where the securities are exempt from registration pursuant to § 4(a)(7) of the Securities Act.

The private placement of debt or equity securities of a foreign private issuer with U.S.-listed equity falls squarely within the scope of federal preemption. Other Rule 144A offerings require a two-part analysis. First, the issuer's sale of securities to the initial purchasers is typically conducted in reliance on

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§ 4(a)(2) and not on Regulation D, so it does not have the benefit of federal preemption. [308] However, all state securities laws provide for an exemption from state registration for offers and sales of securities to specified types of institutional investors. While the breadth of these exemptions varies from state to state, most states have adopted provisions similar to those contained in the various versions of the Uniform Securities Act, which exempt offers and sales specifically to broker-dealers or more generally to institutional investors, a term defined to include registered broker-dealers. [309]

Second, a participating financial institution's resale to investors will benefit from federal preemption if the securities are listed or are senior to listed securities. If federal preemption does not apply to the participating financial institution's resale, the placement can be conducted in most states under published interpretations or adopted statutory or regulatory provisions specifically to the effect that sales made in compliance with Rule 144A or to QIBs will be exempt under the applicable state securities laws. [310] Sales in states without specific Rule 144A or QIB exemptions may be made if the purchaser otherwise qualifies under the definition of statutorily specified types of institutions, which vary from state to state. [311]

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An additional concern under state "blue sky" laws arose as a result of the amendments to Rule 144A permitting general solicitation. Broad-reaching general solicitation could constitute offers to noninstitutional investors—and only three states effectively exempt offers by nonreporting issuers to those investors in a Rule 144A context. [312] Accordingly, use of broad-reaching general solicitation in Rule 144A offerings by nonreporting issuers [313] could require registration under most state "blue sky" laws. [314]

Footnotes

304 *See* § 3.02[7] for a further discussion of state "blue sky" laws.

305 National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (1996).

306 The scope of preemption under the NSMIA also extends to state laws that prohibit, limit or impose conditions on (i) the use of an offering document prepared by or on behalf of the issuer, (ii) proxy statements, reports and other disclosure documents filed with the SEC or (iii) offers or sales based on the merits of the offering or the issuer, in each case, in connection with transactions in "covered securities." *See* § 18(a) of the Securities Act.

307 State securities laws are also preempted with respect to the securities of an investment company registered under the Investment Company Act. Moreover, the NSMIA provides for preemption with respect to offers or sales of securities to "qualified purchasers," as defined by the SEC. The SEC has never acted to provide a widely applicable definition of "qualified purchasers" for this purpose but, in connection with amendments made to Regulation A in 2015, did apply this designation to "any person to whom securities are offered or sold pursuant to a [Regulation A] Tier 2 offering." *See* 17 CFR 230.256. On two prior occasions, first in 2001 and then in 2007, the SEC proposed but did not adopt a definition of "qualified purchasers" that would preempt state securities regulations in connection with offers and sales to "accredited investors" and "large accredited investors," respectively, each as defined in Regulation D under the Securities Act. SEC Release No. 33-8041 (Dec. 19, 2001); SEC Release No. 33-8828 (Aug. 3, 2007) (withdrawn Oct. 1, 2009).

308 *See* § 7.02[2]. An issuer selling directly to investors will often do so in reliance on Rule 506 of Regulation D, rather than on § 4(2), specifically in order to have the benefit of federal preemption, particularly where the availability of state law exemptions is uncertain because not all investors are qualified institutional buyers.

309 For example, § 402(b)(8) of the Uniform Securities Act of 1956 defines the relevant exemption as "any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit-sharing trust, or other financial institution or institutional buyer, or *to a broker-dealer*, whether the purchaser is acting for itself or in some fiduciary capacity" (emphasis added). Similarly, § 202(13) of the Uniform Securities Act of 2002 provides an exemption for "a sale or offer to sell to: (A) an institutional investor; (B) a federal covered investment advisor; or (C) any other person exempted by rule adopted or order issued under this [Act]."

310 California (CAL. CODE REGS. tit. 10, § 260.105.13.1 (2011)); Florida (FLA. STAT. ANN. § 517.061(7)); Louisiana (LA. REV. STAT. ANN. § 51:709(4)); Maryland (MD. CODE REGS. 02.02.04, § Rule.04); (MASS. CODE REGS. tit. 950, § 14.401 (2011)); Michigan (MICH. COMP. LAWS § 451.2102a); New Jersey (NEW JERSEY STAT. ANN. § 49:3-49 (West); New York (N.Y. GEN. BUS. LAW § 359-e(a)); Ohio (OHIO ADMIN. CODE § 1301:6-3-02(D) (2003)); Texas (7 TEX. ADMIN. CODE § 109.4); Wisconsin (WIS. STAT. § 551.102); Blue Sky L. Rep. (CCH) ¶¶9,136 & 9695L (Arizona); 15,520 (Delaware); 16,758 (District of Columbia); 21,644 (Idaho); 24,675 (Indiana); 27,579 (Kentucky); 35,587 (Missouri); 36,517 (Montana); 39,623 (New Hampshire); 44,527 (North Dakota); 47,667, 47,668 (Oregon); 49,602 (Puerto Rico); 50,505 (Rhode Island); 57,468 (Utah); 58,414 (Vermont); 61,810U (Washington); 63,641 (West Virginia); and 66,464 (Wyoming).

311 Occasionally, underwriters request that counsel prepare a "blue sky" survey describing the criteria for the state-law exceptions, so as to provide specific guidance to sales personnel. However, this practice, which was standard in public offerings prior to the enactment of the NSMIA, is virtually unheard of in private placements today, at least where they are conducted under Rule 144A or otherwise limited to QIBs.

312 California, Louisiana and Vermont exempt from their registration requirements offers and sales made in compliance with Rule 144A as in effect from time to time. *See supra* Note 310.

313 This could also include Rule 144A offerings by reporting issuers with nonreporting guarantors.

314 It remains to be seen whether any of those states would pursue an enforcement action in such a case. Practitioners may ask the SEC to use its authority under § 18 of the Securities Act to preempt "blue sky" laws for all offers and sales made pursuant to Rule 144A, which would align them with the existing preemption for all offers and sales made pursuant to Rule 506, but this request has been made before, and the SEC has yet to address it.

U.S. Regulation of the International Securities and Derivatives Markets, § 7.10, APPLICATION OF REGULATION M TO PRIVATE PLACEMENTS

U.S. Regulation of the International Securities and Derivatives Markets
1 Edward F. Greene, Alan L. Beller, Edward J. Rosen, Leslie N. Silverman, Daniel A. Braverman, Sebastian R. Sperber, Nicolas Grabar & Adam E. Fleisher, U.S. Regulation of the International Securities and Derivatives Markets § 7.10 (11th and 12th Editions 2014-2017)
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Regulation M under the Exchange Act [315] governs the market activities of issuers, selling securityholders, underwriters and other participants in securities offerings, and certain of their affiliates. [316] Regulation M consists of six rules, including a definitional rule (Rule 100). Rules 101 and 102 regulate bids for and purchases of securities in "distribution" in the United States (and certain related securities) by participants in the distribution and certain of their affiliates. Rule 101 regulates bids and purchases by underwriters, prospective underwriters and other distribution participants, and affiliates of such persons that fall within the definition of "affiliated purchaser." Rule 102 regulates bids and purchases by issuers, selling securityholders and their affiliated purchasers. Rule 103 governs passive market making by Nasdaq market-makers participating in a distribution. Rule 104 regulates stabilization to facilitate an offering. Rule 104 also adds disclosure and reporting requirements regarding certain post-distribution activities, including purchases to cover syndicate short positions and the imposition of "penalty bids." Finally, Rule 105 restricts short selling in connection with a registered offering.

The determination whether an offering constitutes a distribution in the United States for purposes of Regulation M is based on the "magnitude of the offering" and the "presence of special selling efforts and selling methods." [317]

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Offerings subject to Rule 101 include private offerings where the indicia of a distribution are present.

Regulation M, however, by its terms has only limited application to transactions under Rule 144A. In particular, Rule 101 and 102 contain exemptions for distributions of Rule 144A-eligible securities of any issuer, U.S. or non-U.S., if such securities are sold in the United States only to QIBs or persons reasonably believed to be QIBs in transactions exempt from registration under § 4(a)(2), Rule 144A or Regulation D under the Securities Act. [318] The exemption also applies if the distribution includes certain persons in the United States not deemed to be "U.S. persons" for the purposes of Regulation s under the Securities Act. [319] Rule 104, which governs stabilizing transactions, contains comparable exemptions. [320] The exemptions would not, however, be available for a distribution of securities that are not Rule 144A-eligible, for example because of the fungibility or information delivery requirement of the Rule, [321] or that are not sold only to QIBs, for example because sales were also made to institutional accredited investors. [322]

Footnotes

315 SEC Release No. 34-38067 (Dec. 20, 1996) (the "Regulation M Release").

316 For a discussion of Regulation M in the context of global offerings and enforcement, see §§ 3.02[8][a] and 11.05[3][c], respectively.

317 Rule 100 of Regulation M under the Exchange Act.

318 Rules 101(b)(10)(i) and 102(b)(7)(i) of Regulation M under the Exchange Act. As a result of the mandate of § 201(a)(2) of the JOBS Act, the SEC amended the exemptions under Rules 101, 102 and 104 of Regulation M to conform to the amendments to Rule 144A by eliminating references to "offered" and "offerees."

319 Rules 101(b)(10)(ii) and 102(b)(7)(ii) of Regulation M under the Exchange Act.

320 Rule 104(j)(2) of Regulation M under the Exchange Act. However, unlike the exemptions provided in Rules 101 and 102 for securities eligible for resale under Rule 144A, the exemption contained in Rule 104(j)(2) is currently limited to the subject security. The SEC has stated that, when Rule 104 was adopted, the scope of the private placement exemption under it was intended to be identical to that provided in Rules 101 and 102. SEC Release No. 33-8511 (Dec. 9, 2004). Accordingly, the SEC proposed to extend the Rule 144A-eligible securities exemption in Rule 104 to reference securities (that is, any security into which a subject security may be converted, exchanged or exercised (whether immediately or not), or which, under the terms of the subject security, may in whole or significant part determine the value of the subject security). *See* SEC Release No. 33-8511 (Dec. 9, 2004). As a consequence of this extension, in the context of an offering of Rule 144A-eligible convertible bonds, for example, Rule 104 would not apply to transactions in the underlying equity securities. This proposal was never adopted. For a discussion of Rule 104 generally, *see* § 3.02[9][b].

321 *See* § 7.02[3][c] and [d].

322 For a further discussion of Regulation M, *see* § 3.02[8][a].