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April 8, 2014

Concurrent Public and Private Offerings

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Background

Conducting concurrent private and public offerings has historically been very tricky and limited, mainly as a result of the SEC's position that the filing of an S-1 registration statement and unlimited ability to view such registration statement on the SEC EDGAR database in and of itself acted as a general solicitation and advertisement negating the availability of most private placement exemptions. In addition to the impediment of finding a private exemption to rely on, concurrent private and public offerings raised concerns of gun jumping by offering securities for sale prior to the filing of a registration statement, as prohibited by Section 5(c) of the Securities Act of 1933, as amended. However, with the enactment of the JOBS Act including its Rule 506(c) allowing general solicitation and advertising in an exempt offering, rules allowing the confidential submittal of registration statements for emerging growth companies (EGC) and rules permitting testing the waters communications prior to and after the filing of a registration statement, the ability to conduct concurrent private and public offerings has been dramatically changed.

The two principals that generally limit concurrent private and public offerings are 1) gun jumping and 2) the unavailability of an exemption where there is general solicitation or advertising. Gun jumping generally prohibits the offer or sale of securities prior to a registration statement being declared effective. However, the JOBS Act now allows for both oral and written test-the-waters communications and accordingly, would seem to be less of a concern in today's market.

The SEC has historically held the view that an offering must either be public or private; it cannot be both. Over the years, the SEC has recognized instances when a private and public offering may be conducted concurrently and has promulgated rules and issued no-action letters and guidance on the subject. Issuers that do not desire to rely on Rule 506(c), can still rely on these existing exemptions.

Analysis for Completing Concurrent Private and Public Offerings

An issuer that desires to complete a concurrent private and public offering may proceed using any one or combination of the following:

1. **Integration Rules:** Several rules address the subject of integration. In general the concept of integration is whether two offerings integrate such that either offering fails to comply with the exemption or registration rules being relied upon.

Rule 502(a) of Regulation D provides a five-factor test to determine whether separate offerings should be integrated (and thus whether an exemption is available for the private offering and there have been no violations of Section 5 for the registered offering). The five factors are: (1) whether the offerings are part of a single plan of financing; (2) whether the offerings involve issuance of the same class of security; (3) whether the offerings are made at or about the same time; (4) whether the same type of consideration is to be received; and (5) whether the offerings are for the same general purpose. The five-factor test is subjective and the SEC staff has not provided definitive guidance as to what weight to give to the various factors or indeed how many of them have to be met.

Rule 502(a) also provides for a six-month safe harbor wherein multiple private offerings that are conducted at least six (6) months apart will not be integrated. A private offering that is conducted at least six (6) months before or after a registered or exempt public offering will not be integrated with the public offering.

Rule 152 is a safe harbor for issuers undertaking a registered public offering after conducting a private offering. As interpreted by the SEC, a completed private offering will not be integrated with a subsequently commenced registered public offering. Note that Rule 152 provides protection for private offerings under Section 4(a)(2) and Rule 506 but not for the Section 3(b) exemptions under Rules 504 or 505.

In addition, Rule 155 sets forth a safe harbor for abandoned private and public offerings. Generally, the rule creates safe harbors to allow: (i) a public offering immediately following an abandoned private offering and (ii) a private offering thirty (30) days after an abandoned public offering, without integrating the public and private offerings in either situation. These safe harbors provide issuers with more flexibility to react to volatile capital market conditions.

Rule 155 does not replace, but rather supplements, the five-factor test that will be used whenever the safe harbor is inapplicable. For example, the five-factor test, rather than Rule 155, would apply when evaluating whether two or more private offerings should be integrated with each other. Moreover, Rule 155 like Rule 152 recognizes only Sections 4(a)(2) and Rule 506 offerings as exempt offerings. Rule 155 is not available for shelf registration statements.

2. Integration No-action Letters and Interpretations

The integration rules are supplemented by the SEC staff in its no-action letters to Black Box Inc. and Squadron, Ellenoff, Pleasant & Lehrer. In these letters, the staff indicated that it would not integrate a registered offering and a concurrent unregistered offering made only to Qualified Institutional Buyers (as defined by Rule 144A under the 1933 Act) and no more than two or three large accredited institutional investors.

Moreover, an issuer may rely on Section 4(a)(2) of the Securities Act provided that the issuer could establish that the investors did not learn of the offering through the registration statement and thus through general solicitation. An S-1 registration statement is deemed a general solicitation. In this case if the investors in the private offering become interested in the private offering through some means other than the registration statement – for example, there is a substantive, pre-existing relationship between the investors and the company – then the registration statement would not have served as a general solicitation for the private offering and Section 4(a)(2) would be available, assuming the offering is otherwise consistent with the exemption (i.e., the investors are accredited and sophisticated and the offering is not widely participated in such as to create a public offering).

3. Section 5(d); Rule 506(c); Confidential Submission of Registration Statement

The prior concerns that in a registered offering, communications that may be deemed offers, prior to the effectiveness of a registration statement, would violate Section 5 of the Securities Act have been greatly alleviated by new Section 5(d). In addition, new Rule 506(c) has provided an exemption that issuers can rely on that allows for general solicitation and advertising in conducting a private offering. Both of these rules provide the basis for issuers to proceed with concurrent private and public offerings without gun-jumping or violating Section 5 of the Securities Act.

Testing the Waters

Section 105(c) of the JOBS Act added renumbered paragraph (d) to Section 5 of the Securities Act, which permits emerging growth companies ("EGC"), and any person acting on their behalf to test the waters by engaging in pre-filing communications with qualified institutional buyers or institutions that are accredited investors regarding their interest in the offering subject to the requirement that no security may be sold unless accompanied or preceded by a Section 10(a) prospectus. As an EGC would not have filed any documents or requests with the SEC at this stage, it will be up to the EGC to determine whether it qualifies as an EGC prior to commencing test-the-waters communications. Under current rules, "well-known seasoned issuers," or WKSIs, can engage in similar test-the-waters communications, but smaller, less mature public companies and pre-IPO companies cannot. These new test-the-waters communications can be oral or written, and can be made either before filing a registration statement or after. They can be made in connection with an IPO or any other registered offering. These communications will still be subject to anti-fraud rules.

In addition, an EGC may engage in test-the-waters communications with QIBs and institutional accredited investors in connection with exchange offers and mergers. However, the JOBS Act does not amend the exchange offer or merger requirements under the Exchange Act. Accordingly, an EGC would still be required to make filings under Sections 13 and 14 of the Exchange Act for pre-commencement tender offer communications and proxy soliciting materials in connection with a business combination transaction.

Rule 506(c)

Historically, a fundamental basis for the private offering exemption, in the view of the SEC, is the absence of general solicitation of investors. That has changed. On September 23, 2013, the SEC adopted new Rule 506(c) which permits the use of general solicitation and advertising to offer and sell securities under Rule 506 provided that the following conditions are met:

1. the issuer takes reasonable steps to verify that the purchasers are accredited;
2. all purchasers of securities must be accredited investors, either because they come within one of the categories in the definition of accredited investor, or the issuer reasonably believes that they do, at the time of the sale; and
3. all terms and conditions of Rule 501 and Rules 502(a) and (d) must be satisfied.

Rule 501 sets out definitions, including the definition of accredited investors. Rule 502(a) is the integration rule providing a six-month safe harbor from integration for successive Regulation D offerings and setting out a five-factor fact test analysis which can be used if the six-month rule is not available. Rule 502(d) provides that securities sold in Regulation D offerings (with certain Rule 504 exceptions) are restricted under Rule 144.

Prior to September 23, 2013, it was very difficult for a company to overcome the prohibition against general solicitation and advertising in a private offering, if it attempted to conduct concurrent private and public offerings. To the extent this remains a concern, emerging growth companies have the ability under the JOBS Act to submit their registrations statements to the SEC for review confidentially, which may negate the general solicitation.

Confidential submittal and review of registration statements:

The JOBS Act allows the confidential submittal, review and treatment of initial public offering (IPO) registration statements with the SEC until just 21 days prior to commencing a road show. An EGC may initiate the "initial public offering" ("IPO") process by submitting its IPO registration statements confidentially to the SEC for nonpublic review by the SEC staff. A confidentially submitted registration statement is not deemed filed under the Securities Act and accordingly is not required to be signed

by an officer or director of the issuer or include auditor consent. Signatures and auditor consent are required at the time the registration is filed, no later than 21 days prior to commencing a "road show." If the EGC does not conduct a traditional road show, then the registration statements and confidential submissions must be publicly filed no later than 21 days prior to the anticipated effectiveness date of the registration statement.

This confidential process will allow an EGC to defer the public disclosure of sensitive or competitive information and avoid the public disclosure altogether if it ultimately decides not to proceed with the offering. In addition, the confidential process would allow an EGC to proceed with a private offering without violating general solicitation prohibitions.

Prior to the JOBS Act and its changes discussed herein, the SEC Compliance and Disclosure Interpretations published the below question and answer. Although the SEC has not issued specific guidance on the issue since enactment of 506(c) and the ability to confidentially submit registration statements, these changes clearly eliminate the issue of general solicitation and advertising.

Question: Does the five-factor integration analysis in Securities Act Rule 502(a) apply to the situation in which an issuer is conducting concurrent private and public offerings?

Answer: No. The Commission's integration guidance in Securities Act Release No. 8828 (Aug. 3, 2007) sets forth a framework for analyzing potential integration issues in the specific situation of concurrent private and public offerings. The guidance clarifies that, under appropriate circumstances, there can be a side-by-side private offering under Securities Act Section 4(2) or the Securities Act Rule 506 safe harbor with a registered public offering without having to limit the private offering to qualified institutional buyers and two or three additional large institutional accredited investors, as under the Black Box (June 26, 1990) and Squadron, Ellenoff (Feb. 28, 1992) no-action letters issued by the Division, or to a company's key officers and directors, as under our so-called "Macy's" position. The filing of the registration statement does not eliminate the company's ability to conduct a concurrent private offering, whether it is commenced before or after the filing of the registration statement. This guidance does not negate the five-factor integration analysis outlined in Securities Act Release No. 4552 (Nov. 6, 1962) and in Rule 502(a), which should be used to test whether two or more otherwise exempt offerings should be treated as a single offering to determine whether an exemption is available.

Specifically, the Commission's guidance focuses on how the investors in the private offering are solicited – whether by the registration statement or through some other means that would not otherwise foreclose the availability of the Section 4(2) exemption. If the investors in the private offering become interested in the private offering by means of the registration statement, then the registration statement will have served as a general solicitation for the securities being offered privately and Section 4(2) would not be available. On the other hand, if the investors in the private offering become interested in the private offering through some means other than the registration statement – for example, there is a substantive, pre-existing relationship between the investors and the company – then the registration statement would not have served as a general solicitation for the private offering and Section 4(2) would be available, assuming the offering is otherwise consistent with the exemption. Hence, there would be no integration of the private offering with the public offering.

In short, in the specific situation of concurrent public and private offerings, only the guidance set forth in the Securities Act Release No. 8828 applies. [Nov. 26, 2008]

Conclusion

An Issuer may conduct concurrent private and public offerings if:

1. The issuer satisfies itself that the two offerings will not integrate using traditional integration analysis
2. The issuer limits the private offering to qualified institutional buyers and two or three additional large institutional accredited investors, as under the Black Box (June 26, 1990) and Squadron, Ellenoff (Feb. 28, 1992) no-action letters issued by the Division;
3. The issuer limits the offering such that it would qualify under Section 4(a)(2) of the Securities Act provided that the issuer could establish that the investors did not learn of the offering through the registration statement and thus through general solicitation; or
4. The private offering qualifies under new Rule 506(c), which allows for general solicitation and advertising as long as all investors are accredited and the company takes steps to verify accredited status. Self-verification will not suffice.

5. The issuer's registration statement is confidential and the issuer relies on an exemption that does not allow for general solicitation or advertising. In this case, a standard integration analysis would also be prudent.

In all cases, the private and public offerings are and remain two separate offerings. An issuer should proceed cautiously, being cognizant that it does not violate either the rules related to its private offering or its public offering.

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Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, The Securities Law Network.

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