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Regulation D Offerings and Private Placements

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**Private Placements in Mergers and Acquisitions**



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## **Private Placements in Mergers and Acquisitions: Avoiding General Solicitation**

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### I. Overview

#### A. Typical Issuances of Securities in Mergers or Acquisitions

1. Company A issues its securities in exchange for the assets, outstanding stock or cash of Company B
2. Since the adoption of Rule 145 of the Securities Act of 1933 (the “Securities Act”), these transactions are deemed to involve a “sale” of Company A’s securities.
3. Company A must either file a registration statement for these newly issued securities or find an exemption from the registration requirements.

#### B. Securities Act Exemptions Available in Mergers or Acquisitions

1. No explicit exemption from the registration requirements of the Securities Act exists for companies issuing stock to security holders of another company as consideration for a merger or acquisition.
  - a) Section 4(2): Exempts from Section 5 “transactions by an issuer not involving any public offering”; provides statutory basis for Rule 506 of Regulation D.
  - b) Section 3(a)(11): Exempts transactions involving residents of a single state and an issuer who (1) was incorporated in or resides in, and (2) does business in the same state.
  - c) Section 4(6): Exempts from Section 5 transactions solely involving accredited investors, provided that the offering size is limited by Section 3(b), no advertising or public solicitation is permitted, and the issuer files such notice with the SEC as the SEC prescribes.
  - d) Section 3(b): Provides statutory basis for Rules 504 and 505 of Regulation D, Regulation A, and Rules 701 and 1001.
  - e) Regulation S: May apply to acquisitions of foreign companies.
  - f) Section 3(a)(10): Exemption for exchange transactions upon determination of fairness after hearing.
2. Regulation D
  - a) Rule 504: Offerings by non-reporting companies of less than \$1,000,000 in a 12-month period.

- b) Rule 505: Offerings by any issuer of less than \$5 million in a 12-month period to:
  - (1) Unlimited number of accredited investors, plus
  - (2) 35 additional persons
- c) Rule 506: Offerings by any issuer, with no size or time limitation, to:
  - (1) Unlimited number of accredited investors, plus
  - (2) 35 additional persons

### C. Applying Regulation D to Mergers or Acquisitions

#### 1. When is there an “offer”?

- a) In this context, an “offer” of securities occurs when there is submitted for the vote or consent of shareholders a plan or agreement for a statutory merger or consolidation or similar plan of acquisition in which securities of such company will become or be exchanged for securities of any other person. Securities Act, Rule 145(a)(2).
- b) Offering company must comply with the registration requirements of the Securities Act, unless an exemption exists. Securities Act, Section 5.
- c) Regulation D exemptions are specifically available for business combinations that involve an offer and sale by virtue of Rule 145. Regulation D, Preliminary Note 5.

#### 2. Rule 506: Unlimited Offering Size

- a) Typically, issuers will rely on Rule 506, since the offering size is not limited.
- b) No more than 35 purchasers who are not “accredited investors.”
- c) Issuer must “reasonably believe” that each purchaser who is not an accredited investor is “sophisticated.”
- d) Sophisticated persons, either alone or with a purchaser representative, have “such knowledge and experience in financial and business matters that they are capable of evaluating the merits and risks of the prospective investment.”
- e) Must comply with Rules 502 (discussed below) and 503 (requiring filing of Form D).

#### 3. Rule 502: Integration

- a) All sales that are part of the same offering must be “integrated” for purposes of determining the offering size and duration.
- b) In a Rule 506 offering related specifically to a merger or acquisition, this should not be an issue.

#### 4. Rule 502: Required Disclosure

- a) Non-reporting issuers
  - (1) No specific disclosure must be made to accredited investors.
  - (2) Must, at a reasonable time prior to the sale, furnish to non-accredited investors any information material to an understanding of the issuer, its business and the securities being offered. Issuers must generally provide information called for in Part I of registration statements under the Securities Act.
  - (3) Extent of financial information to be disclosed depends on size of offering.
- b) Reporting issuers
  - (1) Generally must provide annual report and proxy statement or Form 10-K.
  - (2) Must provide documents filed with the SEC since filing of proxy statement or 10-K, as well as a brief description of the offering.
- c) Advisable to provide information to all potential investors, in view of federal and state anti-fraud provisions.
- d) Rule 502(b)(2)(vi): Form S-4
  - (1) Applicable to business combinations.
  - (2) In addition to foregoing, must provide to each purchaser at the time the plan is submitted to security holders, or, with an exchange, during the course of the transaction and prior to sale, written information about any terms or arrangements of the proposed transactions that are materially different from those for all other security holders.
  - (3) A non-reporting issuer may satisfy the requirements of Part I.B. or C. of Form S-4 by compliance with Rule 502(b)(2)(i). (See I.C.4.a., above)
- e) All issuers must provide to non-accredited investors the right to review, a reasonable time before sale, all material information furnished to accredited investors and must provide all investors the right to ask questions of the issuer. Rule 502(b)(2)(iv),(v).
- f) Written disclosure of any resale restrictions must be delivered to every investor. Rule 502(d)(2).

## II. Soliciting Target Shareholders

### A. Rule 502(c): General Solicitation and Advertising

1. Other than as provided in Rule 135(c) and Rule 135(e), neither the issuer nor an agent may offer or sell the securities by any form of “general solicitation or general advertising,” including, but not limited to:

- a) Any communication published in a newspaper, magazine or similar media, or broadcast over television or radio; and
- b) Any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.

2. Target security holders are readily identifiable and presumably limited in number, so general advertisement is not an issue.

3. Pursuant to the JOBS Act, the Commission has proposed to amend Rule 502(c) to provide that the prohibition against general solicitation and general advertising contained in Rule 502(c) of Regulation D would not apply to offers and sales of securities made pursuant to Rule 506, provided that all purchasers of the securities are accredited investors. The proposed amendment to Rule 506 would also require that, in Rule 506 offerings that use general solicitation or general advertising, the issuer take reasonable steps to verify that purchasers of the securities are accredited investors. When adopted, this amendment will provide a clear basis for private offerings of securities in connection with mergers and acquisitions, provided that the only target shareholders who may accept the offer are accredited, and that the offeror takes reasonable steps to verify their accreditation. (SEC Rel. 33-9354 (August 29, 2012))

#### B. Pre-existing, substantive relationships

1. A general solicitation is not present when there is a pre-existing, substantive relationship between an issuer, or its broker-dealer, and the offerees. SEC Division of Corporation Finance interpretive letters *Woodtrails--Seattle, Ltd.* (Aug. 9, 1982); *E.F. Hutton Co.* (Dec. 3, 1985). *H.B. Shaine & Co., Inc.* (May 1, 1987); and *Bateman Eichler, Hill Richards, Inc.* (Dec. 3, 1985).

- a) Substantive: Ex.: satisfactory responses to a suitability questionnaire. Note that any contacts must be generic in nature, without referencing any specific investments.
- b) Pre-existing: Substantive relationship must be established before offering.

2. Problem: Acquiring companies do not have a pre-existing, substantive relationship with the target shareholders.

#### C. Soliciting Target Shareholders

1. How do you determine whether the target shareholders are accredited investors or sophisticated purchasers without a general solicitation?

2. Problems related to evaluating offerees in merger or acquisition context:

- a) Offerees have a relationship with the target company, but not the acquiring company
- b) Offerees generally are not clearly defined by knowledge and expertise with a particular investment

3. Broker-dealers facilitating the sale of securities as part of a merger or acquisition may be considered “underwriters” under the Securities Act.

### III. Solutions

A. If the offering of securities by the acquiring company can be limited to accredited investors, the proposed amendments to Rule 502(c) will, when adopted, permit general solicitation in private offerings so long as the only purchasers are accredited investors, and the offeror takes reasonable steps to verify their accreditation. (SEC Rel. 33-9354 (August 29, 2012)). As a result, an acquirer will be able to privately offer its securities to a target company’s shareholders, provided that only shareholders who are accredited will be permitted to accept the offer of securities. The solicitation must provide that shareholders who are not accredited will receive only cash in the acquisition.

### IV. After the offering

1. Rule 503 notice filing required within 15 days from the date of the first sale. When? Deemed to occur at closing, but file ASAP. In unconditional tender offer context, sale would occur when issuer is obligated to purchase any of the securities tendered.
2. Resale restrictions: Securities issued to the target company’s holders in a private placement are restricted securities and, pursuant to Rule 145, must be resold in compliance with Rule 144 to gain the safe harbor provided in that rule from being considered an “underwriter.”<sup>1</sup>
3. Rule 144 amendments: The 2008 amendments to Rule 144 broaden the range of options available to a reporting company that desires to maintain or increase its liquidity when engaging in an offering of securities by (i) shortening the holding period applicable to both affiliates and non-affiliates that wish to resell restricted securities pursuant to Rule 144, and (ii) relaxing the other Rule 144 requirements applicable to resales of restricted securities by non-affiliates. These amendments are designed to increase the liquidity of privately sold securities and may, therefore, affect a company’s analysis of whether to engage in a Regulation D offering. (The amendments to Rules 144 and 145 became effective on February 15, 2008, and are applicable to securities acquired both before and after such date.) *See* Release No. 33-8869.

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<sup>1</sup> Prior to the 2008 amendment to Rule 145, an affiliate of a target company who received securities even in a registered transaction was deemed to be an underwriter of those securities, and could avoid the presumption of underwriter status only by reselling the securities in accordance with Rule 144 (apart from the holding period). The amendments to Rule 145 eliminate this “presumptive underwriter” doctrine, except with respect to transactions involving shell companies. Affiliates of the target company who receive shares registered on Form S-4 are now able to freely resell them immediately, unless they are also affiliates of the acquiring company. *See* Release No. 33-8869.