THE AMERICAN LAW INSTITUTE
Continuing Legal Education

Regulation D Offerings and Private Placements

March 2014

Rescission Offers Under Regulation D

By

Robert B. Robbins
Pillsbury Winthrop Shaw Pittman LLP
Washington, D.C.

Rescission Offers under Regulation D

Robert B. Robbins
Pillsbury Winthrop Shaw Pittman LLP

A rescission offer is an offer to rescind a transaction in which a securities violation occurred or is believed to have occurred. If a sponsor believes that it may have securities law liability arising out of an offering, and has the financial resources to repurchase the limited partners' interests, it may resort to a rescission offer to provide itself with insulation against liability. On occasion, a workout which involves an infusion of new equity becomes stalled because the new participant is concerned that one or more of the sponsor's partnerships may be a source of securities law claims. In those situations the new participant may sometimes provide financial assistance to permit a rescission offer to proceed before the workout goes forward.[1]

A. Effect of Rescission Offers

1. State law

The policy behind state rescission statutes is that if a sponsor is willing to rescind a transaction within the terms of the statute, an investor should not be able to refuse such an offer and then bring suit later if the investment declines. All but four states (Arizona, New York, Tennessee and West Virginia) have statutes which provide that all actions under the civil liability provisions will be barred if, before the suit is commenced, the purchaser received a written offer to refund the consideration paid with interest, less the amount of income received, and failed to accept the offer within 30 days. Thus, if an offer is made in accordance with state law, the effect is to release the sponsor from liability under the state securities laws. The rescission offer may not insulate the offeror, however, from liability for common-law fraud, and in some states will not bar liability under the anti-fraud provisions of the state blue sky law.[2]

2. Federal securities law

Violations of the registration provisions of Section 5 of the Securities Act of 1933 (the "1933 Act") give the purchaser a one-year right to rescind the transaction, pursuant to Sections 12(a)(1) and 13 of the Act, as against any "seller" of the securities who has violated Section 5.[3]

---

1 As to rescission offers generally, *see* Rowe, *Rescission Offers Under Federal and State Securities Laws*, 12 J. Corp. Law 383 (l987); Bromberg, *Curing Securities Violations; Rescission Offers and Other Techniques*, l J. Corp. Law l (l975).

2 Rowe, *supra*, at 424.

3 The purchaser may recover the purchase price for the securities, plus interest, less any distributions on the securities. Because the 1933 Act does not specify an interest rate,

Footnote continued on next page

When a violation of Section 5 is found after the expiration of the one-year rescission period, the purchasers no longer have an absolute right to rescind their purchases, but the issuer may continue to have exposure to liability for the violation. In this situation, it is often the case that the issuer will seek to cut off its liability by making a rescission offer to the purchasers.

There is, however, no federal statutory provision for rescission offers. In fact, Section l4 of the Securities Act of l933 and Section 29(a) of the Securities Exchange Act of l934 expressly provide that "any condition, stipulation, or provision binding any person to waive compliance with any provision of [the laws] shall be void." Since it is not possible for an investor explicitly to waive any claims he may have under the securities laws, it also is not possible to obtain an implied waiver by offering rescission. Further, the staff has taken the position that "liabilities under the federal securities laws are not terminated merely because potentially liable persons make a registered rescission offer."[4]

It should nevertheless be the case that any investor that *accepts* a rescission offer will have given up his rights under federal law, since he will have received a return of his original investment plus interest. In the case of an investor who *rejects* an offer, however, it is not clear that federal claims can be cut off. If, for example, the investors had "put" rights under Section 12(a)(1), it is unlikely that a rescission offer would cut off the one-year rescission period for violations of Section 5.

In addition, at least two courts have applied common law principles to bar action under the federal securities laws by plaintiffs who *rejected* a rescission offer. In *Meyers v. C & M Petroleum Producers, Inc.*, 476 F.2d 427 (5th Cir. l973), the court reversed a lower court decision holding that plaintiffs had *waived* their rights by rejecting a rescission offer, but stated in *dictum* that the rejection of the offer might have estopped the plaintiffs from later filing suit. In a more recent Fifth Circuit case, *Topalian v. Ehrman*, 954 F.2d 1125 (5th Cir. 1992), the rescission offer extended to investors in an oil and gas limited partnership helped shield the general partners from securities claims by investors. The court affirmed the district court's summary judgment for defendants because the investors had been adequately warned of the risks associated with the venture and had been offered a rescission opportunity. And, in *Electronic Specialty Co. v. International Controls Corp.*, 295 F. Supp. l063 (S.D.N.Y. l963), where suit had been filed following the circulation of a rescission offer, the court held that the offer had mooted the cause of action, since the offer was identical to the relief sought in the complaint.

Footnote continued from previous page

interest under Section 12(a) (1) is sometimes based on the applicable state rate (the state of the purchaser's residence, or in the absence in that state of an applicable rate, the state of the issuer's principal place of business).

4 *Steiger Tractor Co.* (avail. July 2l, l975). *See also, Stoiber v. Securities and Exchange Commission*, 161 F.3d 745 (D.C. Cir. 1998), *cert. denied*, 119 S.Ct. 1464, 143 L.Ed.2d 549 (1999) (rescission offer does not provide protection against sanctions imposed by the SEC).

The effectiveness of rescission offers to bar future claims was part of the disclosure in a 2007 rescission offer made by Google. Prior to its 2004 IPO, Google Inc. announced that it had granted options that may have violated the securities laws of certain states as well as Section 5. Google made a rescission offer to the affected purchasers -- 1,320 persons who had purchased 23.4 million shares of common stock – and also offered to rescind the grant of options to purchase 5.2 million shares of common stock held by 282 persons.

The prospectus for the rescission offer stated that "[i]t is unclear whether or not you will have a right of rescission under federal securities laws after the rescission offer. The staff of the Securities and Exchange Commission is of the opinion that a person's right of rescission created under the Securities Act of 1933 may survive the rescission offer." It also stated that Google might remain liable to recipients of the rescission offer who rejected the offer (or took no action in response to the offer). Finally, it stated the company's belief that any remedies a person might have after the rescission offer expired, whether or not that person accepted the offer, would not be greater than the amount that person would have received in the rescission offer.

The prospectus for the rescission offer also referred to a pre-IPO interview with the company's founders in Playboy and to the risk that if the interview were held to have violated the 1933 Act the company could be required to repurchase shares sold in the IPO for a period of one year "following the date of the violation." It stated the company's intention to "contest vigorously" any claim that the interview violated the 1933 Act. The prospectus also offered a summary of remedies and statutes of limitations in 20 states.

B. Regulation

1. Regulation as a Tender Offer

If the security is registered under Section l2 of the l934 Act, or the issuer is required to file periodic reports pursuant to section l5(d) of the l934 Act, the tender offer provisions of Rule l3e-4 (if the offer is made by the issuer) and Regulation l4D (if the offer is made by an affiliate of the issuer or a third party) must be followed in the rescission offer.[5]

While the states generally do not regulate issuer tender offers, rescission offers made by an affiliate or third party may be subject to state tender offer regulation.

2. Regulation as an Offering

[5] Note that SEC Rule 13e-4, which governs tender offers by issuers for their own securities, provides an exemption for "An issuer tender offer made solely to effect a rescission offer: Provided, however, That the offer is registered under the Securities Act of 1933 (15 U. S. C. 77a et seq.), and the consideration is equal to the price paid by each security holder, plus legal interest if the issuer elects to or is required to pay legal interest . . ." Rule 13e-4(h)(6).

While most practitioners readily understand regulation of a rescission offer as an offer to buy, few understand that it is the SEC's position that a rescission offer is also an offer to sell the underlying security that must be registered under Section 5 of the l933 Act if no exemption is available.[6] Several states have taken similar positions. Their reasoning is that a rescission offer to repurchase securities actually is an offer to sell the security again because the decision an investor must make is not only whether to sell the security, but also whether to retain it.[7] Thus, if the original offering of securities was made pursuant to Regulation D, there must be a new determination whether a rescission offer may also be made within the provisions of Regulation D, and there must be compliance with its provisions (including, for example, the filing of a Form D).[8] Concerns have been expressed that the rescission offer could be integrated with the original, flawed offering, which could make the private placement exemption unavailable. Generally, however, practitioners have been satisfied with using the private placement exemption to offer rescission for a failed private offering, where the terms of the exemption can be met in the rescission offer.[9]

If the rescission offer cannot be made as an exempt offering, registration under Section 5 will be required.[10] A company with an effective shelf registration statement on Form S-3 should be able to use the registration statement for purposes of the rescission offer.

State securities laws must also be reviewed to determine whether the state law requires

---

6 2 Loss & Seligman, Securities Regulation 1138.20 n.522 (3d ed. rev. 1999), citing SEC Release No. 33-6653 (1986); *but see* Meyers v. C&M Petroleum Producers, Inc., 476 F.2d 427 (5th Cir. 1973), *cert. denied*, 414 U.S. 829 (1973) ("Since…the [unregistered rescission offer]…was an offer to provide the remedy prescribed by statute, we find no merit in the…argument…that the repurchase offer itself violated the registration requirements of the Act").

7 Rowe, *supra*, at 393.

8 Note that, in determining whether a rescission offer must be aggregated with other private offerings by the issuer, the SEC has indicated that the rescission offer should relate back to the original offering that is the subject of the rescission offering. An issuer that is conducting a rescission offer for an offering that took place more than 12 months earlier therefore can undertake a private placement under Rules 504 or 505 without having to count the amount of the rescission offer against the maximum offering permitted under the applicable rule. *Interpretive Release on Regulation D*, Release No. 33-6455, March 3, 1983, 17 CFR 231.6455, at question 69.

9 Since the rescission offer is treated by the SEC as a new offering for cash, rescission offers do not qualify as exempt exchange offers under Section 3(1)(9) of the 1933 Act.

10 If the rescission offer is registered, Rule 457(j) states that the registration fee is based on the amount for which the securities were sold. If the rescission offer is in connection with an employee benefit plan, Rule 457(h) may provide an alternative basis for computing the fee.

registration of rescission offers in the absence of an exemption. States specifically requiring that rescission offers comply with the registration requirements of their blue sky laws include California, Georgia, Nebraska, Oregon, Pennsylvania, and Wisconsin.

3. Disclosure Considerations

Rescission offers raise several distinctive disclosure concerns. If viewed as a renewed offer to sell, the disclosure emphasis logically should be forward-looking disclosure of the issuer's prospects and the risks of continuing to hold the securities. If, on the other hand, the rescission offer is considered to be a repurchase offer, the emphasis should be on the purpose and effect of the offer and the risks of relinquishing the securities. In framing disclosure, it is prudent to consider the disclosure document as both an issuer tender or repurchase offer and a registration statement or Regulation D offering memorandum.

It is essential that the disclosure be sufficient to enable the investor to exercise an informed decision regarding whether or not to rescind. Thus, there should be a detailed statement of the facts surrounding the alleged violation and the estimated amount of the contingent liability. It is not necessary, however, to affirmatively admit a violation or to waive the statute of limitations.