

Private Offering Do's and Don'ts: Dealing with the Press; Avoiding a General Solicitation

The ability of a fund manager to raise money in the United States by selling limited partnership interests (i.e., securities) is contingent in large part on ensuring that it is done in a “private offering” and not in a “public offering” that would require registration of the securities and registration of the fund as an investment company, both of which are undesirable results for a typical private fund manager. To determine whether a public offering has occurred, determine whether the issuer engaged in a “general solicitation” or made a “general advertisement.” The following is a summary of the basic “Do’s and Don’ts” to observe in avoiding a determination that the fund manager made a “general solicitation” or “general advertisement” under Rule 502(c) of the Securities Act of 1933 (the Act). If the fund—or a representative—takes part in a general solicitation, neither the private offering exemption under federal securities law nor the applicable exemptions from registration under the Investment Company Act of 1940 would apply.

Legal Background

Rules 504 through 506 under the Act allow issuers to offer and sell securities without registration when the offering meets certain conditions. Among other conditions, the exemption from registration contains the following limitation under Rule 502(c):

[Except with offerings not exceeding \$1 million], neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, the following:

- (1) Any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and
- (2) Any seminar or meeting whose attendees have been invited by any general solicitation or general advertising.

The rule provides no further clarification of the phrases “general solicitation” or “general advertising.” A number of Securities and Exchange Commission (SEC) No-Action Letters, however, do provide some guidelines for determining what actions the SEC will deem general solicitations.¹ Three basic principles provide the framework for the guidelines: (1) a substantive

1. Because the SEC or its staff can reconsider positions taken in No-Action Letters, their predictive value in determining how the SEC might respond to a given set of facts is not certain.

preexisting duty between the investor and general partner must exist, (2) the issuer must generally personally direct the offer to the offeree, and (3) the general partner must have some basis to believe the investor meets sophisticated or accredited investor status. Using these principles, the following “Do’s and Don’ts” summary represents an analysis of the SEC’s positions in some of these No-Action Letters.

General Solicitation “Do’s”

Do limit offers and solicitations to persons with whom the Partnership (or its agent) has a “preexisting substantive relationship.” A substantive relationship exists where the Partnership has information regarding a potential offeree such that the Partnership can evaluate the prospective offeree’s sophistication and financial circumstances. Such a relationship qualifies as preexisting where it occurs *before* the offering of the specific investment opportunity. *See* E.F. Hutton & Co., SEC No-Action Letter, 1985 WL 55680 (S.E.C.), at *5 (Dec. 3, 1985).²

A preexisting substantive relationship can also exist where a general partner in a limited partnership has preexisting substantive relationships with persons who invested previously in other limited partnerships sponsored by the general partner. *See* Woodtrails-Seattle, Ltd., SEC No-Action Letter, 1982 WL 29366 (S.E.C.), at *2 (Aug. 9, 1982) (SEC allows mailing of written offers to 330 persons who invested in limited partnerships sponsored by the general partner within the last three years).

Do monitor the activities of any agents or representatives to ensure that they are not performing general solicitations. A partnership may use an outside agent to serve as an intermediary between the investor and the partnership, although the outside agent must have a substantive preexisting relationship with the investor. *See* E.F. Hutton, 1985 WL 55680, at *1; Alan J. Berkeley, Krista A. Sweigart, *Use and Compensation of “Finders” to Locate Purchasers in Private Placements*, SD55 ALI-ABA 37, 39 (Mar. 11, 1999). Assuming the use of outside agents, the Partnership should ensure that the agents’ procedures and methods do not violate the general rules described in this document.

Do prepare a list of likely investor targets as early in the process as possible and stick to it. One way to assure regulators that you are not out to attract investors is to limit your investors to those identified prior to any press attention and turn away any late arrivals no matter how qualified. Exceptions can be made after careful consideration, but should be done so only in limited circumstances and in consultation with your counsel.

Do develop scripted responses for staff to unsolicited inquiries. The standard response to all cold inquiries should be to assume that it is from a securities regulator and reply: “This is a private placement only for qualified purchasers who are personally known to us or to our placement agent. We do not send our private placement memorandum in response to unsolicited

2. The SEC has also allowed issuers to use a 30-day waiting period where the nature of the investment—in this case, an open-ended hedge fund that offered securities on a continuous basis, i.e., quarterly or annually—makes it impractical to limit investment opportunities to only those commencing after the establishment of the substantive relationship. Lamp Technologies, Inc., SEC No-Action Letter, 1997 WL 282988 (S.E.C.), at *6 (May 29, 1997).

inquiries. Thank you for your interest in us.” Inquiries from known industry professionals, private equity competitors, entrepreneurs, etc. will generally be more for “information” and not with a view to invest. Anyone who sent a private placement memorandum under these circumstances should probably have it stamped “For information only” or something to that effect.

Do be very circumspect in any interactions with the press. It is very important that every conversation with any reporter begin and end with a clear statement that, while you would like to be cooperative, the securities laws prohibit any discussion that might lead to publicity. It is likely that good reporters, such as those from *The Wall Street Journal*, will have independently sourced information. You don’t have to go into denial or permit false information to be published. But whatever is reported should reflect that you stated that you could not comment because of requirements of securities laws. Also, when you drop below the WSJ and reliable reporters that you personally know, you cannot count on anything being reported accurately, and it’s probably better not to talk.

Do keep strict control over the dissemination of offering materials. You and any placement agent should number your private placement memoranda and keep a list of who receives them.

Do use password protection and online questionnaires to prevent nonaccredited investors from accessing investment information on a website. The SEC has approved of schemes where a website provides information regarding exempt offerings, but only where the issuer established a preexisting substantive relationship through the use of an online questionnaire; before completion of the questionnaire, the issuer prevented investor access to the information through the use of passwords. See IPONET, SEC No-Action Letter, 1996 WL 431821 (S.E.C.), at *6 (July 26, 1996).

Do review your website content. Ensure that your website does not contain any reference to fundraising or investor returns or other material that could be construed as priming the market.

General Solicitation “Don’ts”

Don’t use mass-communication methods to publicize investments that the Partnership offers. Prohibited methods include newspaper, magazine, and broadcasts over television or radio. Similarly, billboard advertisements, trade magazine advertisements, mass mailings, and “cold calling” all constitute general solicitations.

Don’t announce business changes and business events to the media. Although the general solicitation rule applies only to “offers and [sales],” the SEC might construe certain general announcements to the media regarding the Partnership’s business as implied offers or sales.

Don’t speak at industry seminars and events about your fundraising or new business plans. Such appearances, which can lead to statements about your fundraising, may also be construed as implied offers or as an effort to prime the market much like the announcement of business changes cited above.

Don't field calls from an interested investor with whom no preexisting relationship exists.

In these cases, the issuer has made no independent solicitation to the individual. Despite this, the issuer would still need to gather information regarding the individual's suitability as an investor. Although the SEC has provided guidance stating that an issuer can use questionnaires to establish a substantive relationship where none existed before, *see* E.F. Hutton, 1985 WL 55680, at *5, the costs of compliance and risk of exposure of jeopardizing the entire offering outweigh any benefit the Partnership might receive in soliciting those few investors. Thus, the Partnership should inform such unsolicited investors that they must be introduced by someone with a business relationship—for example, referrals from entrepreneurs, lawyers, etc.—to pursue investment with the Partnership. *See* SEC Release No. 34-36950, Self-Regulatory Organizations (1996); Berkeley & Sweigart, SD55 ALI-ABA at 40 (finders in private placements “might be entrepreneurs, accountants, lawyers, or other investors”).

Don't provide prepared materials to unaffiliated investment newsletters. The SEC found a general solicitation where companies provided materials to an investment newsletter that described companies intending to have exempt offerings in the future. *See* J.D. Manning, Inc., SEC No-Action Letter, 1986 WL 65354 (S.E.C.), at *6 (Jan. 29, 1986).

Don't make generalized, nonpersonal offers to investors. Examples of such communications might include letters to CEOs of Fortune 500 companies, Rolls-Royce owners, or attorneys or physicians in a particular area. Even in situations where an issuer could reasonably expect targeted recipients of certain communications to be qualified investors, the SEC staff has tended to find that such communications are general solicitations. *See, e.g., In re Kenman Corp.*, [1984–85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 83,767 (Apr. 19, 1985).

Don't engage unregistered “finders.” Anyone who receives compensation for introducing you to an investor and such compensation or “finder's fee” is based upon the amount of the investor's commitment is acting as a broker-dealer and should be registered as one. Use of unregistered brokers is a violation of the securities laws and can result in rescission rights or other sanctions imposed by securities regulators.

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For more information on the issues discussed here, please contact your Morgan Lewis [Private Investment Funds Practice](#) attorney.

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