**Sec. Reg. Attack**

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# Materiality

**Rule 10b-5** – any person directly/indirectly “**make** untrue statement of a **material** fact or to **omit** to state a **material** fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading” … in connection with a **purchase/sale**

* **NO GENERAL DUTY TO VOLUNTEER INFORMATION** (silence is golden)
* *Plaintiff has the burden of showing materiality when an affirmative misstatement or omission creating a misleading impression has been made*

**What is material?**

* *TSC Industries:* Info is material if there is a “(1*)* ***substantial likelihood* that the disclosure . . . would have been viewed by the** (2) ***reasonable investor* as having** (3) ***significantly altered*** (4) ***the total mix* of information made available**.”
  + **Exclude unreasonable testimony** and focus on mainstream investors. Unreasonable investors have… (1) hindsight bias, (2) overconfidence & over optimism, (3) availability bias – focus on readily available info and recent events, (4) endowment effects – preference for status quo
* **Forward-looking information** 
  + *Basic:* **standard – balance probability the event will occur and magnitude of event:** Materiality “will depend at any given time upon a balancing of both: the indicated **probability** that the event will occur and the anticipated **magnitude of the event** in light of the totality of the company activity.” [**probability X magnitude**]
* **Objective Tests:** 
  + **5% Rule -** SEC Staff Accounting Bulletin No.99: 5% à provides basis for preliminary assumption of materiality. (if it doesn’t reach this threshold, it’s unlikely to be material).
    - SEC says **just a quantitative starting point** and there are other **qualitative factors** to consider
    - *Litwin*: fall was below the 5%, but the omission is material based on qualitative factors (1, 4, 7). SAB No. 99 - **qualitative factors --** There may be qualitative factors that make even a small amount material to investors
      * **Masks a change in earnings or other trends**
      * Hides a failure to meet analysts' consensus expectations for the enterprise
      * Changes a loss into income or vice versa
      * **Concerns a segment or other portion of the registrant's business that has been identified as playing a significant role in the registrant's operations or profitability**
      * Affects the registrant's compliance with regulatory requirements
      * Affects the registrant's compliance with loan covenants or other contractual requirements
      * **The effect of increasing management's compensation**
      * Concealment of an unlawful transaction.
  + **Event Study** (typical for public companies)
    - **(1)** identify **information event date** - new information revealing past fraud is made public.
    - **(2)** identify **event window** – amount of time required to reflect price (depends on stock)
    - **(3)** identify **expected return** (the stock could drop for other reasons) and subtract from **actual return** for the company to generate an “**abnormal return**”.
      * **actual – expected = abnormal**
    - **(4)** calculate if **abnormal return is in fact statistically different from zero**.
      * If the difference is **significant** à courts may conclude **material**
    - *Merck* - even with this data and event study, the decision is still up in the air. **The judge has to decide what information in the event study is relevant.**
* **Is it a statistically significant price drop?** 
  + Courts are more willing to accept a statistically significant PRICE DROP (CHANGE IN PRICE) as materiality as opposed to anything else statistically significant.
  + *Matrixx* - SCOTUS says **you don’t need statistical significance, but you need more than the mere existence of reports**.
    - **Statistics alone won’t be decision maker**, especially the lack of statistical significance.
    - Court says statistical significance **≠** materiality. (not an automatic connection)
* **Total Mix –** might the statement not be misleading given the total mix? If investor already has the information, then it’s not material.
  + *Longman*: ***truth on the market defense***: if the material fact is already known to the whole market, it is already part of the total mix of info.
    - **Evidence of Materiality**: Presence/absence of the info. already in the investing public’s hands (the total mix)
    - “***Mere puffery***”à not material because not misleading.

# Security

ASK: Do the securities laws apply to this particular transaction?

**§ 2(a)(1) of the 1933 Act** gives a laundry list of items in its definition of security: “The term ‘security’ means any **note**, **stock**, treasury stock, security future, **bond**, **debenture**, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, **investment** **contract**, voting trust certificate, certificate or deposit for a security…”

* Categories of securities
  + Instruments commonly known as securities (e.g., stocks, bonds)
  + Instruments specified by the Act to be securities (e.g., fractional undiv. interest in oil, gas, mineral rights
  + Broad, catch-all phrase “investment contract” (courts determine whether it’s a security)

**What is an investment Contract?**

* *Howey*: Holding: Yes, *regardless of form, court should look to the substance of the contract*.
  + **Test is not a balancing test**. Must meet all 4 characteristics & **focus on substance over form**
    - (1) investment of money
    - (2) common enterprise
    - (3) expectation of profit
    - (4) solely through the efforts of others
* **(1) Investment of money** – ASK: Are other investments part of the decision set so that if there’s a lie in part of the market, that will cause money to go away to other investment substitutes?
  + *Int’l Brotherhood of Teamsters*
    - No need of cash. Can be investment of valuable goods and services.
      * (not this case) **Can labor be an investment?** Yes (e.g., a pro-rata share of profits based on the # of hours you worked)
    - Investment decision is defined by your set of choices/alternatives. Investments are about the future, but more importantly, relying on someone else in the future + looking at investment substitutes. **If investment substitutes à investment decision**.
    - Policy: we want to apply securities laws to transactions that affect the capital markets.
* **(2) Common Enterprise** – (**Circuit split**)
  + **horizontal commonality** – return to a group of investors are **pooled/correlated**
    - pooling funds of investors & **apportioned profits** based on **pro rata** investment in the pool.
    - *SEC v. SG Ltd* – Because it fits the facts of *Howey*, this is the rule.
    - *Wals v. Fox Hills* - SA req. promoters/issuers to make uniform disclosure to all investors and that req. makes sense only if investors are in horizontal commonality (if they’re getting same thing)
  + **vertical commonality** – **promoter’s efforts impact the individual investors collectively**
    - Investors don’t necessarily receive same return relative to their investment.
    - **broad** – promoter/manager doesn’t share return/risk
    - **narrow** – promoter/manager shares return & risk
* **(3) Expectation of Profits** - This prong distinguishes consumption and investment
  + *Forman*: staying true to spirit of *Howey* test, need to look to substance over form. Just because it’s labeled a stock doesn’t mean that it is.
    - **Profits** = either capital appreciation resulting from the development of the initial investment OR a participation in earnings resulting from the use of investors’ funds.”
    - **If the purchaser motivated by desire to consume purchase, securities laws do not apply.**
  + Post-*Forman* people think SCOTUS moving to a “**economic realities**” test (substance>form)
  + *Edwards*: a promise of a **fixed rate of return** can still be an **investment contract** (no distinction in case law used in *Howey* to come up with test)
* **(4) Solely Through the Efforts of Others** - Generally, look for *not too much* investor effort or power to control
  + General Partnerships – Typically not securities
  + Limited Partnership – Typically not securities
  + Limited Liability Partnership – Courts presume that they’re investment contracts, therefore securities.
  + *Merchant Capital* – **Yes**, IC b/c **no real voting power/expectation of control.** If any of these factors present amount the partners, it’s an IC (here, all three present)
    - (1) lack of power, (2) inexperience, (3) lack of ability to replace manager.
  + *Mutual Benefits Corp* (outside factor determining returns) – Promised return depended on life expectancy evaluation, but actual return depended on date of insured’s death. **Yes**, IC b/c **sig. pre-purchase managerial activities of promoters undertaken to ensure success of investment.**
  + *Life Partners* – **No**, not IC b/c although there was little investor effort, promoter didn’t affect investor’s return (some pre-purchase ministerial efforts, but no enduring effects on control).
    - **Look at post-purchase efforts, not pre-purchase efforts when determining effort/control.**

**Stock**

* **§ 2(a)(1) of the 1933 Act**: “The term ‘security’ **means any … stock**, treasury stock, …”
  + **Sale of business doctrine** à if you sell a stock that results in change of control, it’s not a security (substance > form)
    - **Only applied when 100% of stock is sold** (*Landreth*)
  + *Landreth* – Sale of “stock.” Yes, b/c has traditional characteristics of stock listed in *Forman*: **dividends, negotiability, transferability, voting rights & appreciation.** (NOTE: all aren’t needed)
    - **Rejects** application of **economic realities** test from *Howey* when instruments are not unusual and wouldn’t go into the investment contract category.
      * Stock is 100% a security in the context of a corporation (like traded in NYSE)
      * Powell reversing himself when he said look at substance > form, at least outside investment contract context.
    - **Rejects** application of **sale of business doctrine** b/c seller is still managing the business, so purchasers are like passive investors.

**Note**

* **§ 2(a)(1) of the 1933 Act -** “The term ‘security’ means any note…,”
* **§3 (a)(10) of 1934 Act** - “The term ‘security’ means any note…, … but shall **not include** currency or any note, draft, bill of exchange, or banker’s acceptance which has a maturity at the time of issuance of not exceeding nine months,…”
* **NOT -** List of things that aren’t securities: (1) things involving consumer purchase (Best Buy), (2) mortgages, (3) working capital (short term commercial loans)
* **Key Characteristics:** (1) fixed and certain interest payment, (2) high priority (relative to stock) in liquidation, (3) no voting rights, (4) fixed maturity date, (5) repayment of principal at maturity.
  + < 9 months à lower risk and less need to protect
* *Reves* – Courts should **presume anything called a “note” is a security** and then apply **family resemblance test** to rebut the presumption.
  + **Family Resemblance Test** - Balance the below to see if resembles listed “notes”
    - (1) buyers’ and sellers’ motivations –
      * **ASK**: Does buyer want profit? Yes à security
      * **ASK:** Does seller/borrower desire capital…
        + to fund consumption? à security
        + for a commercial purpose? à not security
        + to fund substantial investments or general business purpose à security
    - (2) plan of distribution
      * Capability to develop into common trading
    - (3) reasonable expectations of investing public
    - (4) other factors that would reduce risk (such as other regulatory schemes)
  + **Rejects** application of *Landreth* in the case of notes.

|  |  |
| --- | --- |
| *Howey* | *Reves* |
| Investment of money (motivation of the investor) | Motivations of Lender and Borrower |
| Common enterprise | Plan of Distribution (fungible) |
| Expectation of profits | Expectation of Investing Public |
| Efforts of another |  |
| Alternative Regulatory Scheme | Alternative Regulatory Scheme |

# Periodic Disclosures and the Role of Auditors

**Disclosure in the Secondary Markets**

* Mandatory Disclosure Issues
  + Issue #1 – Someone must determine what information must be disclosed.
  + Issue #2 – Someone must ensure disclosed information is truthful.
* Voluntary Disclosure Issue – (e.g., investor meetings, conference calls, etc.)
  + Without voluntary disclosure, market won’t be attracted.
  + Issue #1 – Made only if there’s something valuable to disclosure
  + Issue #2 – Incentives to lie to investors.

**What is a Public Company?**

* **Three ways** become a public company under securities laws:

|  |  |  |  |
| --- | --- | --- | --- |
| **§** | **Trigger** | **Requirements** | **Termination** |
| **(1)**12(a) and (b) | List on a national securities exchange | -Periodic filings  -Proxy rules + annual report  -Tender offer rules  -Insider stock transaction  -Sarbanes Oxley | Delisting **AND**  <300 shrs **OR**  <500 shrs and <$10m in assets for 3 yrs |
| (2)12(g) | >500 holders  >$10m in assets   *but not* stocks held by people through employee comp. plan. | -periodic filings  -proxy rules + annual report  -tender offer rules  -insider stock transactions  -Sarbanes Oxley Act | Delisting **AND**  <300 shrs **OR**  <500 shrs **and** <$10m in assets for 3 yrs |
| **(3)**15(d) | Registered public offering | -periodic filings  -Sarbanes Oxley | <300 security holders **AND** 1 yr after offering (only suspended but see Rule 12h-6) |

**When must a company disclose?**

* **Integrated Disclosure** – Involves **Regulation S-K** and **Regulation S-X** that consolidates all the forms
  + **Regulation S-K** – Non-financial information. E.g., Item 303 - narrative discussion of issuer’s financial condition (trends or uncertainties that issuer reasonably expects to affect firm’s liquidity, capital, net sales, revenues, or income in the future.
  + **Regulation S-X** – Financial information.



* **Form 8-K: Event-Focused Disclosure** 
  + Within **4 days** of event.
  + **Materiality** & **8-K**? **Super-material –** Not everything that is material is required on the 8-K.
  + Definitely **must disclose** if
    - **(1) change in the company’s auditors** 
      * Item 4.01(a) Departure of an auditor – If resigns/dismissed, must disclose adverse opinion, termination recommended or approved by audit committee, accounting disagreement (e.g., over internal controls)
    - **(2) departure of principal officer** 
      * Item 5.02(b) Departure of chief officer – **Reason** for departure is **not necessary** 
        + Why not?Unnecessary embarrassment, defamation action, usurp decision-making process.
      * Item 5.02(a)(1) Departure of director **–** *In re HP* – **Reason** for departure is **necessary** if **disagreement** relating to registrant’s “operations, policies or practices” (brief description + correspondence).
    - **(3) conclusion or notice that security holders no longer should rely on company’s previously issued financial statements or related audit reports**.
    - **AND THE BELOW**

|  |  |
| --- | --- |
| 1. Registrant’s Business & Ops | * Entry into, a material amendment to, or termination of a “material definitive agreement,” defined as contracts *outside* the ordinary course of business * Filing of **bankruptcy** or receivership |
| 2. Financial Info | * Completion of acquisition or disposition of assets constituting >10% of total assets * Results of operations and financial condition (if disclosed by press release bf filing of 10-K or 10-Q) * Creation or triggering of an off-balance sheet arrangement * Costs associated with exit or disposal activities, including termination benefits for employees, contract termination costs and other associated costs * Material impairments to assets such as goodwill |
| 3. Secs & Trading Mkts | * Receipt of notice of delisting or transfer of listing * Unregistered sale of equity secs * Material modifications to rights of secs holders |
| 4. Matters Related to Accountants and Fin Statements | * Changes in company’s **outside auditor** (and reason for change) * Notice that **previously issued financial statements** or audit reports should no longer be relied upon |
| 5. Corp Governance & Mgt | * **Change in control** * Departure or election/appointment of **directors or principal officers** * Amendments to articles of incorp or bylaws * Changes in fiscal year * -Temporary suspension of trading under employee benefit plans * -Amendment to registrant’s code of ethics or waiver of reqs of code |
| 6. Asset-Backed Securities (ABS) | * Reserved for later use |
| 7. Regulation FD | * -Any disclosure req’d to comply with Regulation FD |
| 8. Other Events | * -At issuer’s option, anything issuer thinks would be of interest to the security holders |
| 9. Financial Statements & Exhibits | * -For businesses acquired by registrant |

* **Form 10-K** – business, properties, legal proceedings, market for common stock, MD&A (management discussion and analysis of financial condition and results of operation), directors and officers, executive compensation, security ownership of certain beneficial owners and management, certain relationships and related transactions, principal accounting fees and services.
  + **Item 103** à material pending legal proceedings (description of factual basis)

**The Problem of Selective (Voluntary) Disclosure – Regulation FD (Fair Disclosures)**

* Pre-2000, there was *selective disclosure* – companies could selectively favor analysts & institutional investors
* Regulation FD – **Restricts** **selective disclosure** (**only SEC can enforce**)by Dom. Exch. Act Reporting Companies
  + **Exception:** recipient owes a duty of trust/confidence
  1. Rule 100(a)“Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer **shall make public disclosure** of that information as provided in Rule 101(e):
     1. *simultaneously* in the case of an intentional disclosure
     2. *promptly* in the case of a non-intentional disclosure
  + **Elements**: (1) material non-public info. (2) eligible speaker, (3) eligible recipient, (4) public vs. non-public
  + **“eligible recipients**” à B/D, investment advisor, investment company, holder of securities (that will act on it)
  + *Siebel* - Regulation FD does not require that corporate official only utter verbatim statements that were previously publicly made…this would chill spontaneous communication.
  + **SEC List of “High Probability” Materiality**: earnings info, M&A, new products/discoveries, change of control, change of auditor, changes in issuer’s securities, bankruptcy.

# Securities Exchange Act Anti-Fraud Liability

Rule 10b-5: “It shall be unlawful for **ANY PERSON**, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange—

* (a) To employ any ***device, scheme or artifice to defraud***
* (b) To ***make any untrue statement of a material fact*** or to ***omit* *to state a material fact*** necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading
* (c) To engage in any act, practice, or course of business which operates or would operate as a **fraud or deceit** upon any person **in connection** with the **purchase or sale of *any security***

**10b-5 - Who Can Sue?**

* Courts have *interpreted* a **private cause of action** (it doesn’t appear in the Act)
* Blue Chip Stamps – You need to be **an actual purchaser or seller.** 
  + **Cannot be plaintiffs**:
    - potential purchasers who didn’t buy due to gloomy predictions/omission of favorable material.
    - actual shareholders who said they decided not to sell
    - shareholders, creditors, etc. who suffered a loss due to corporation or insider activities in connection w/purchase sale of securities that violated 10b-5.
  + Policy: Private deterrence (meritorious lawsuit) vs. stopping frivolous litigation.
* “**in connection with…”** – what does it mean?
  + **Contractual privity** à Always counts, but not enough, too narrow. (e.g., seller lies to buyer)
  + **But for causation** à Not enough, too many intervening causes.
  + **Foreseeability** (deterrence notion) + **Intrinsic Value Theory** à **Yes, enough**. If lie in way that is foreseeable that it will affects investors and affects the intrinsic value of the stock, then it’s “in connection with.
  + **Context** (*coincides* with a securities transaction) à Distinguish 2 situations. (1) after a conversion (theft), then (2) after legit securities transaction, there’s a theft of the proceeds.
    - Not enough:
      * lawful transaction was consummated, and broker stole proceeds
      * thief invests proceeds or routine conversion in the stock market.
    - *Zanford* – **Yes, enough**. Z’s fraud coincided with the sales themselves. Securities transaction + breach of duty coincide.
* **Class Actions – Lead Plaintiff** **(PSLRA)** 
  + **4-Steps:** 
    - (1) court identifies presumptive LP
    - (2) determines if presumption rebutted
      * Only class members can rebut
      * whether LP will do “fair and adequate” job (not if someone else is better)
    - (3) lead counsel
    - (4) attorney’s fees
  + § 21D(a)(3)(B) (iii)(I)-Rebuttable **presumption** that the **lead plaintiff** is the party that
    - **(1)** Has filed a motion/complaint
    - **(2)** Has the largest financial interest/greatest potential damages
    - **(3)** Otherwise satisfies the requests of FRCP 23 (typical and adequate)
  + § 21D(a)(3)(B) (iii)(II)-evidence to rebut. Can be rebutted if
    - (1) will **not fairly** and **adequately** protect class, **OR**
      * **Typicality** - whether the movant with largest loss “are markedly different or the legal theory upon which the claims are based differ from that other members’”.
      * **Adequacy**: should consider whether it “has the ability and incentive to represent the claims of the class vigorously, whether it has obtained adequate counsel, and whether there is a conflict between the movant’s claim and those asserted on behalf of the class.” (e.g., willingness to select counsel)
    - (2) is subject to **unique defenses** that render incapable of representing the class. Issue is not if some other party would do a better job.
  + 21D(a)(3)(B)(v) LP selects lead counsel (subject to court approval) (see *Cendant* for factors p.30)
  + 21D(a)(6) – Court review for “**reasonable” attorney fees –** presumption of reasonableness unless “clear excessiveness”
  + **Limits:** Can’t be a LP in > 5 securities fraud CA in period of 3 years; per-share recovery of LP can’t be >
  + *Cedant***:** Auctions may be used in certain circumstances, but here court abused discretion by conducting an auction. No need to “’simulate’ the market in cases where a properly-selected lead P conducts a good-faith counsel selection process”

**10b-5 - Elements of the Cause of Action**

* SOL: 2 years after discovery (or reasonable P’s discovery) of fact constituting violation; 5 years after the violation
* **Elements: \*\*in connection with PURCHASE OR SALE\*\***
  + **(1)** **Misstatement of Material Facts**
    - Deception (*Santa Fe*)
    - Misstatement of Fact (*Virginia Bankshares*)
    - Omission (*Duty to Disclose*)
    - Forward-Looking Statement Safe Harbors
  + **(2)** **Scienter**
  + **(3)** **Reliance**
  + **(4)** **Loss Causation**
  + **(5)** **Damages**
* **(1)** **Misstatement of Material Facts**
  + Materiality (*Basic* above)
  + **Deception** (*Santa Fe*) – If no deception, there can’t be a 10b-5 action. (**deception is required**)
    - Rule 10b-5 doesn’t govern breaches of fiduciary duty (this is corporate law)
  + **Are Opinions Actionable as Misstatements of Fact?** (*Virginia Bankshares*) – **Opinions are actionable, *sometimes***.
    - Actionable if subject to **objective verification** (not unfounded fishing expedition)
    - **ASK:** is there objective evidence to corroborate the statement at issue?
    - Attempt to show that party didn’t actually believe the objectively verifiable thing he believed
  + **Omission/Duty to Disclose**
    - Form 8-K, Form 10-Q, Form 10-K, duty not to give a half-truth (saying something that conveys a misleading impression)
    - (*Gallagher*) - Companies are under no obligation to ensure that their public disclosures are kept continually up to date, outside the periodic disclosure event, such as 10-Q or 8-K. But the below situations do creates duties:
      * **Duty to correct** à duty to put out new info. to correct prior disclosed info. That was incorrect at the time of prior disclosure.
        + All circuits
        + **Argue scienter/cover up** à If decided not to correct, then you get scienter on the cover up (even if not on the initial honest mistake)
        + **3rd party statements?** Joint-auditor statements
      * **Duty to update** à duty to disclose info. when previously disclosed (and correct at time of initial disclosure) that turns out later to be misleading.
        + **8-K vs. duty to update prior 10K?** Scope of 8-K is major developments specifically enumerated. 8-Ks don’t require “all material information.” Duty to update would be a **major** expansion and this is up to Congress.
        + **Circuit Split** – Continuous disclosure regime

**7th Cir.** – doesn’t recognize it

**2nd Cir. –** recognizes it in some situations

* + - * + Policy: would create continuous and $ duty to make sure all 10-Ks up to date.
      * **Duty to avoid “half-truths”** – Rule 12b-20 = “In addition to the information expressly required to be included in a statement or report, there shall be added such further material information, if any, as may be necessary to make the required statement, in the light of the circumstances under which they are made not misleading.”
  + **Forward-Looking Statement Safe Harbors** (gives Ds a chance to win on motion to dismiss)
    - Applicability: Exchange Act reporting issuers (public companies) and those working on their behalf. (timely filing isn’t necessary to qualify for safe harbor)
    - Exclusions: (1) private company, IPOs, tender offers, offering securities for blank check, private transaction. (2) financial statements
    - Shields statements from liability in **three circumstances**
      * **(1)** if the statements are **immaterial** (*Basic*, total mix) – no need for safe harbor
      * **(2) Safe Harbor -** if statements (written and oral) are made **without actual knowledge** of their falsity
        + P fails to prove scienter, recklessness is not enough
      * **(3) Safe Harbor** -if statements (written and oral) are made **accompanies by meaningful cautionary statements** identifying **important factors** that could cause **actual results** to differ materially from the forward looking statement. (even knowing ones, if the cautionary statement is meaningful)
        + **Meaningful** = (*Asher*) Failure there was that cautionary language remained fixed despite the risks changing.

Don’t have to identify *all* important factors – enough to point at important ones/principal contingencies at the time of statement

Don’t need to identify actual risk that result will differ

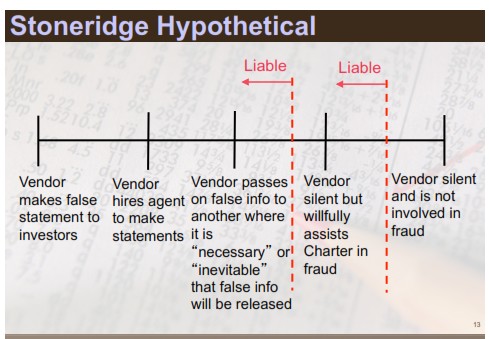
NOTE: Doesn’t have to accompany *every* statement b/c incorporated into stock price.

* **(2)** **Scienter**
  + state of mind: **actual motive** (intent to defraud), **actual knowledge** (of how market will be misled), **recklessness** (based on the presence of red flags)
    - (*Ernst & Ernst*) – Negligence isn’t scienter – “intentional or willful conduct”
      * NOTE: Hard to distinguish b/w negligence and recklessness (see p. 35 definition)
    - Forward-looking à knowledge
    - History à recklessness
  + Under PSLRA, P must plead with particularity facts giving rise to a **strong inference of scienter** (who, what, when, where, and how) (each statement that’s misleading and why it is)
    - (*Tellabs*) strong inference = **powerful and cogent**
    - SCOTUS tips: (1) court must accept all factual allegations as true, (2) inquiry is whether all of the facts alleged, taken collectively, give rise to evidence of scienter, (3) whether a reasonable person would deem the inference powerful and cogent.
    - **ASK** – Do *all facts* give rise to inference of scienter? Potential sources:
      * Insider trading (particularly if unusual volume, profits, and timing)
      * Divergence between internal reports and external statements on same subject
      * Closeness in time of an allegedly fraudulent statement or omission and the later disclosure of inconsistent information
      * Evidence of bribery of a top company official
      * Existence of an SEC Enforcement Action
      * Accounting Restatement
      * Sheer magnitude of a misstatement (i.e., how could a mistake so large occur without scienter)
      * Confidential Witnesses: will be discounted.
* **(3)** **(Transaction)** **Reliance** – P entered into the allegedly fraudulent transaction *because of* the statement (SEC doesn’t need/private plaintiff does)
  + **ASK**: Did the misstatement change the investor’s decision?
  + Problem: Many class members won’t have heard the misstatement before investing.

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|  | Face-to-Face | Open Market |
| Omission with Duty to Disclose | No reliance req’t (*Affiliated Ute*) | No reliance req’t (*Affiliated Ute*) |
| Affirmative Misrepresentation | Investor must show individual reliance | Presumption of reliance (*Basic*) |

* + **Omissions** – *Affiliated Ute*: In cases involving failure to disclose à **reliance isn’t required**. Just need facts that were withheld to be material.
  + **Presumption of Reliance** – *Basic*: **Fraud on the Market Presumption Elements:** (1) D made a public misrepresentation, (2) it was material, (3) shares were traded on an efficient market, (4) P traded shares b/w time of misrepresentation and time truth was revealed.
    - *Halliburton* – reliance not necessary b/c fraud was transmitted to the investor in market price.
    - **Rebuttal** à Any showing that “severs” link b/w alleged misrepresentation and either:
      * (1) market not efficient
      * (2) market not deceived
      * (3) corrective statements
      * (4) specific P would have bought/sold anyway for other reasons other than reliance on the market price (e.g., antitrust concerns, political pressures – but hard to show this fir every member of the class)
      * (5) no specific price impact (*Halliburton*)
  + **Price Impact** - (*Halliburton*) Show **lack of price impact** by showing either (1) no price drop when truth comes out (same with materiality and loss causation) **OR** (2) no price inflation when misleading information comes out [hard to separate from other information though]
* **(4)** **Loss Causation** **–** Fraud *caused* the loss (NOT: But for the fraud, P would not have bought/sold). **Expert testimony + account for extrinsic factors** (did the whole market fall?)
  + P must show that misstatements proximately caused the loses
  + Not enough to show that price was inflated at time of purchase. Need to **ALSO** show that drop was related to fraud. (*Dura Pharmaceuticals*)
    - A person who misrep. financial condition of a corp. to sell stock becomes liable to a relying purchase “for the loss” the purchaser sustains when facts become generally known and as a result share value depreciates
  + No causation – Stock dropped but not b/c fraud, b/c whole market dropped. Loss but no causation.
  + Policy: fraudsters aren’t insurers against national calamities (*Bastian*)

**10b-5 Defendants**

* Consider à **level of control** and **access to information** 
  + Board of Directors? They have ultimate authority, but also need scienter
  + CEO, agent or principle? They may have scienter, but not ultimate authority
    - Board of Directors can delegate authority to CEO, and then he would be liable (+ scienter)
  + So, seems that no one is liable other than the corporation itself.
* *Central Bank of Denver -* **No aiding and abetting liability** (only private causes of action)
  + Statute prohibits only making material misstatement/omission (not giving aid to person who does so)
  + **BUT** à doesn’t aiding/abetting exists in SEC enforcement actions after Exchange Act §20(e)
* *Stoneridge* – No liability for customer/supplier companies (with no role in disseminating statement) b/c investors did not rely on their statements or misreps.
  + In that case, suppliers’ actions are too remote from purchase/sale of securities to satisfy reliance. **Nothing they did made it necessary or inevitable** **for company to record transactions as they did.**
  + SCOTUS left it open for others to be liable under “**necessary or inevitable**”
  + Left line is D’s argument and right line is P’s argument.
    - 
* *Janus Capital* - Maker of the statement = person or entity with ultimate authority over the statement (content and whether/how to communicate)
  + w/o this authority, it’s not “necessary or inevitable” that any falsehood will be contained in the statement
  + **make ≠ create**
* §20(a) of Exchange Act: **Control Person Liability:** Any person who, directly/indirectly, controls any person liable **shall also be liable** 
  + **UNLESS** à acted in good faith and did not directly/indirectly induce the violation.

**Damages under 10b-5**

* **Out-of-Pocket Damages** – (most prevalent for publicly traded companies/class action)
  + **K price – value of security at time of transaction = damages** 
    - Purchasers à Purchase price – true value at time of transaction = damages
    - Sellers à Sale price – true value at time of transaction = damages
  + **Expert witness:** Creates a ***value line***à Price drop (loss causation); dissipation reflects prior inflation. Go backwards in time and subtract inflation at all points in time of the class period (debate**:** might not always be a constant drop e.g., iPhones in 2000)
  + Problem: *Too little and too much based on situation*
    - **Too little -** In primary transactions, damages = inflation (doesn’t seem high enough for deterrence, just takes away benefit to issuer)
    - **Too much** - In secondary transactions, issuers don’t benefit from the inflation, the sellers do. (fraud could go either way; maybe evens out if there’s fraud over time)
* **Face-to-Face Damages** (I lie to you and you buy from me) – Court not limited to out-of-pocket measures but **can apply usual remedies available at law**:
  + **Restitution** (disgorgement) – D gives P whatever profits she made (typical in insider trading)
    - *Pidcock* – P entitled to presumption that damages she suffered = profits realized upon sale of shares to 3rd party.
      * **Limit on disgorgement**: P can’t recover portion of profits attributable to D’s special or unique efforts (e.g,, aggressive and enterprising management)
  + **Rescission** – Used when fraud doesn’t go to the underlying value of the securities.
    - If purchaser defrauded P à return securities
    - If seller defrauded P à return the purchase price **OR** (original sale price – subsequent sale price by D)
  + NOT punitive damages

# Public Offerings

**Economics of Public Offerings**

* Underwriter (IB) - §2(a)(11) any person who purchased from an issuer OR offers/sells for an issue
* Types of Offerings:
  + **Firm Commitment**– (**+ common**) Issuer sells all shares to UW. UW sells to investors or other IBs.
    - Serve as “screeners” that bring only “good offerings” to market (charge higher fee)
    - Reduce risk by Reduce risk by **syndicating** (but lead UW gives the advice to the issuer)
  + **Best Efforts** – UW doesn’t buy any securities but acts as **agent** and gets paid by commission.
  + **Dutch Auction** – Potential buyers submit bids with #/$ before UW announces $.
  + **Underpricing** – UW leave money on the table. Next day price usually jumps. Done to avoid lawsuits, decrease risk that no one buys.
* Disclosure for Public Offerings
  + **Registration Statement** (S-1 or S-3)
    - S-3 – U.S. Corp., reporting corp. and filed in timely manner for past 1 year
      * Transaction: (1) **if agg. mkt. value of equity held by non-affiliates of registrant is >$75** million; (2) IG debt securities (optional); (3) any secondary offering if securities of same class are listed on national exchange; (4) rights offerings or conversions of convertible securities; (5) IG asset-backed securities (optional)
      * **Integrated disclosure** à incorporation by reference only for eligible reporting issuers with one annual report (only backward)
    - S-1 – (**almost always used**) Anyone who doesn’t qualify for S-3.
      * Risk factors, use of proceeds, description of securities to be reg., dilution, about the company, MD&A (qualitative), financials
      * **Integrated disclosure** à Can incorporate by reference any periodic report’ must include material changes to periodic filing.

**Gun-Jumping Rules**

* Goals: mandatory disclosure, distribution of prospectus, restrict information not in prospectus
* **Exchange Act Reporting Issuer**: **(Public Company)** listed on national exchange, over the counter stocks > $10 million, equity securities held by at least 2,000 persons (or 500 non-AI).
* **Issuer Categories:** 
  + **Non-Exchange Act Reporting Issuer (Private Company)**: no periodic reports
  + **Unseasoned Issuer**: EARIs (**public companies**) not eligible to file S-3 because <$75 million owned by non-affiliates. (need to file S-1)
    - Narrow category à maybe company that filed before but doesn’t have a float of equity in hands of non-affiliates.
  + **Seasoned Issuer**: EARIs (**public companies**) eligible to file S-3 (> $75 million owned by non-affiliates), but not WKSI (so < $700 million owned by non-affiliates).
    - Eligible for primary offerings but not well-known.
  + **Well-Known Seasoned Issuer** (WKSI) à S-3 eligible for primary offerings + $700 million in equity in the hands of non-affiliates. Basically, a seasoned issuer that has met certain market cap. minimums.
* **§5 of the 1933 Act (starting point for public offering and private placement) – BROAD PROHIBITION**
  + §5(a) “Unless a registration statement is in effect as to a security, it shall be unlawful for **ANY PERSON,** directly or indirectly
    - to … sell [a] security through the use or medium of any prospectus or otherwise; or
    - to carry … in interstate commerce … any … security for the purpose of sale or for delivery after sale.
  + §5(c) “It shall be unlawful for any person … to offer to sell or offer to buy … any security, unless a registration statement has been filed as to such security…



**Pre-Filing Period (Quiet Period) à MUST BE “IN REGISTRATION” à THERE ISN’T YET A RS**

* §5(a) prohibits all sales until registration statement becomes effective
  + §4(a)(1) Exempts from 5 transactions not involving issuer, underwriter or dealer. This applies for example a newspaper. This is a way that you could potentially speak.
  + §4(a)(4) exempts unsolicited broker’s transactions.
* §5(c) prohibits all offers prior to filing of registration statement. Only applies until statement is filed.
  + **Offer** – 2(a)(3) = “every attempt to offer to dispose of, or solicitation of an offer to buy, a security
    - *Arvida* = condition the public mind or arouse the public interest
    - SEC Release 3844/5180 = does the issuer’s communication ***intend*** to “**condition the market**”
      * **Motivation of the communication** à arranged after a financing decision (+ offer); changing of behavior, intended audiences
      * **Type of information** à Soft, forward-looking info is (+ offer);
      * **Breadth of distribution** à Broader (+ offer)
      * **Form of the communication** à Written (electronic/not real time = written) (+ offer)
      * **Mentioning facts about the offering** à naming UW (+ offer)
* Policy: Recognition that we need to open up this process some. Concern that small companies need to test the water (balance fear of driving investors into speculative frenzy).
* **Communications b/w lead underwriter and underwriter syndicate** 
  + 2(a)(3) à terms defined here shall not include preliminary negotiations b/w issuer and underwriter and potential syndicate underwriters. These are not deemed offers.
* **Safe Harbors**:
* 163A: **30-Day Cooling:** If it applies, gets you out of 5(c) **only** (not 5a or 10b-5)
  + If information is more than 30 days prior to the filing, so long as you not reference the offering, not set by underwriter, reasonable steps to stop further dissemination
  + Policy: If you believe investors will cool down, then there’s no trade-off.
* 163: **WKSI Rule:** If it applies, gets you out of 5(c) **only** (not 5a or 10b-5). Allowed: oral or written communications that offer the securities.
  + Policy: We allows WKSIs to test the waters (as opposed to small companies) because of shelf-registration
  + **Filing requirement.**
  + **UW for Issuer can’t use 163** à Policy: Risk of the offering not selling is on the underwriter. If a party has an incentive to mislead the market, maybe it’s the underwriter. Incentive to cause a speculative frenzy.
* 168 & 169: If they apply, they get you out of **5(c)** and **2(a)(10)** [seen in waiting period and in post effective period]
  + 168 à (**EARI**) Factual business info. + forward looking info. + ads (ordinary course of business/regularly released/same time/manner or form)
    - Policy: If EARI, need to worry about new and existing investors. Allows you to keep ordinary course of business w/existing investors.
  + 169 à (**non-EARI**) (typically what IPO issuers use) factual business information + ads (ordinary course of business/regularly released/same time/manner or form)
    - Policy: Same, continue customer ads.
* 163B: Emerging Growth Company (but any issuer can use it b/c not exclusive election) oral/written communication with QIBS and IAI. (institutions, not people)
  + **No filing requirement**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Safe harbor | Exemption | Type of Issuer (but see excl. issuers) | Type of Information Allowed | Mand. Info | Other Restrictions |
| Rule 135 | § 5(c) | All | Notice on public offering (tombstone) | Legend | -- Can include issuer name, security title, amount & basic terms, amount of offering by selling holders, brief statement of manner & purpose  -- Cannot name underwriter |
| Rule 163A | § 5(c) | All | --May not reference offering  --Reg FD applies | None | >30-days prior to filing of registration statement (issuer take reasonable steps to control further distribution)  --Not for U/W or Dealer participating in offering  --Excluded issuers |
| Rule 163B | § 5(c) | Emerging Growth Company (revenue < $1 billion)   (but really just all issuers/people acting on their behalf) | Oral or written comm. With potential investors that are QIBs or IAI   QIB = institutions own/discretionary authority over $100 million in securities  IAI = institutions that are AI (>$5 million total assets) | None | - N>30-days prior to filing of registration statement (issuer take reasonable steps to control further distribution)  -- **U/W or Dealers covered!**   * + - * + r |
| Rule 163 | § 5(c) | WKSI | Offers OK  Reg FD applies | Legend if written | --Must **file** written communication as free writing prospectus after filing of registration statement  --Not for U/W or Dealer participating in offering  --Excluded issuers  -- Legend and filing req. have built in forgiveness: immaterial, unintentional, file as soon as practical |
| Rule 168 | § 5(c) and 2(a)(10) | Exchange Act Reporting Issuer | Factual Info + Ads + Div. notice Certain Forward-Looking Info  --May not be part of offering activities  --Reg FD applies | None | --Not for U/W or Dealer participating in offering  --Prev. Released/Ordinary course of  --Consistent timing, manner, form  --Not inv. co. or Bus. Dev. Co. |
| Rule 169 | §§ 5(c) and 2(a)(10) | All | Factual Info + Ads  \*\***no future projections\*\***  --May not be part of offering activities  --Reg FD does not apply | None | -- Not for U/W or Dealer participating in offering  --Ordinary course of business  --Consistent timing, manner, form  --Non-Investor recipients/issuer’s agents historically provided such info  --Not inv. co. or Bus. Dev. Co. |

**Waiting Period à BEGINS WITH REGISTRATION STATEMENT WITH SEC**

* §5(a) still applies (no sales) but §5(c) does not apply. **Offers may begin!**
* §5(b)(1): It shall be unlawful for ***ANY PERSON*** to transmit **any prospectus** relating to any security with respect to which a registration statement has been filed (only applies after filing of registration statement) under this title, **unless such prospectus meets the requirements of §10**.
  + **SO TWO WAYS TO COMMUNICATE HERE à either (1) NOT A PROSPECTUS or (2) §10 PROSPECTUS**
  + §10 prospectus
    - §10(a) prospectus: **final, statutory prospectus** with price information
    - §10(b) prospectus: SEC defines what it is
      * Rule 430 **preliminary 10(b) prospectus** is only used up to the effective date (draft of the final 10a prospectus), do not have to contain price or info related to price
      * Rule 433 §10(b) prospectus, **free writing prospectus**
* **Prospectus** 
  + §2(a)(10) definition: “any prospectus, notice, circular, advertisement, letter, or communication, written or by radio or television (broadcast), which **offers any security** for sale or confirm the sale …” (oral communications are excluded)
  + 2(a)(3) à says what an offer is
  + **Oral communications (road shows) are not prospectuses**
  + Rule 405 **Written communications** (including media graphics BUT NOT à live stiff (q&a)
  + Rule 405 allows for **pre-recorded** road shows which would otherwise be prohibited (electronic road shows)
* Escaping 5(b)(1):
  + **Be outside §2(a)(10) (not a prospectus)**
    - oral communication (road show, phone calls)
    - Rules 168, 169, 163B
  + **Be a valid §10 prospectus**
    - Policy: How much should we open up communication? Usually when UW start testing the waters – lots of communication with institutional investors. In the name of protecting people, we keep things quiet in the pre-filing period. In waiting period, we open up communications (largely because oral communications are allowed). But asymmetry that institutional ones get more information than retail (in the name of protecting them). **Dilemma led to** Rule 433.
    - Rule 433 makes **free writing prospectus** a §10(b) prospectus
* How to make offers in the waiting period:
  + Preliminary prospectus (§10(b))
  + Road show (oral) à with q&a
  + Waiting Period Tombstones (optional)
  + Free Writing Prospectus
* **Free Writing Prospectus** 
  + **Traditional Free Writing Prospectus** § 2(a)(10)(a) à Issuers can send additional supplementary material **after the effective date** (in addition to the final prospectus). This info. is allowable after effective date and it’s not a prospectus. You can get sent out a **supplemental glossy brochure** **and 5(b)(1) doesn’t apply.** 
    - Needs to be accompanied by 10a (final statutory prospectus)
    - BUT à this doesn’t help here because this is the waiting period!
  + **Free Writing Prospectus** Rule 405 à defines FWP expansively to include written communications that offer security for sale, even if they don’t qualify as §10(b) prospectus
    - Policy: Because broker wasn’t allowed to send supplemental information to retail investors during waiting period, SEC came up with the FWP (enable more communication to more investors in the waiting period)
    - It’s a **prospectus** (written communication offer to sell or solicitation of offer to buy) **OTHER** than (the below) that is used **after** the **RS has been filed**.
      * Statutory prospectus [10(a), Rule 430 Red Herring, Rule 430 A, Rule 430B, Rule 430C]
      * Traditional free writing prospectus
      * Asset back securities prospectus
      * 163B or 5(d)
    - **EXAMPLE: GLOSSY BROCHURE DISTRIBUTED BROADLY!**
  + **OPERATIVE RULE -** Rule 433: **makes a FWP a prospectus under 10(b)** for purposes of 5(b)(1)
    - **Requirements:** 
      * (1) for all issuers applies **only after RS filed** w/SEC (WKSI can use 163 in pre-filing in with which they can send out written communications + 163B that everyone can use for QIBs and IAIs)
      * (2) **prospectus delivery** requirement for certain issuers
        + Non-reporting and unseasoned issuers must ensure §10 prospectus precedes or accompanies FWP
        + NOT: WKSIs and seasoned S-3 filers
        + Exception: If already provided and no material difference
        + 10(b) only okay in waiting period. Once 10(a) available, must use that.
        + Can delivery via **hyperlink**.
      * (3) **Contents:** 
        + Cannot contain conflicting info w/RS, §10 prospectus (or supplement) or periodic/current reports (*if inconsistent à violates 5(b)(1)*)
        + Must contain **legend requirement** and email address to obtain prospectus
      * (3) **filing requirement** (forgiveness under 164)
        + Issuer à heaviest requirement

Must file all issuer FWP (including those prepared on behalf of issuer or referred to by an issuer)

Must file any issuer info contained in FWP prepared by or on behalf of any other participant.

Must file FWP describing final terms of issuer’s securities in offering

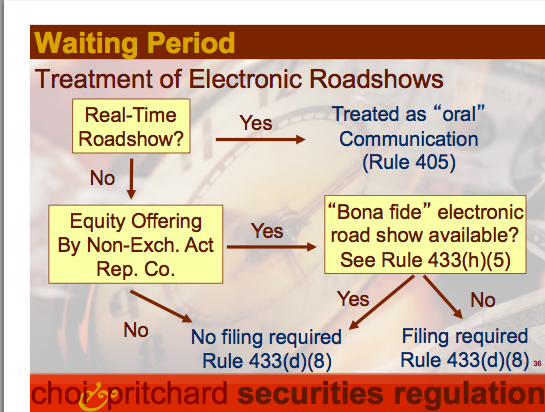
* + - * + Offering participants (e.g., underwriter) à Only need to file their FWP if distributed in a manner reasonably designed to lead to broad/unrestricted dissemination
        + When FWP doesn’t contain “substantive” change from previous FWP à No filing requirement.
      * (4) **record retention** à everyone for 3 years
      * (5) **media FWPs** à (if approved by issuer for a media source). Issuer or offering participant must file w/I 4 days of publication. Media FWP is exempt from prospectus delivery, legend, and filing requirement.
  + **FORGIVENESS PROVISIONS** - Rule 164:
    - (a) immaterial/unintentional **failure/delay in filing** a FWP is **not a violation of 5(b)(1)** if (1) good faith/reasonable effort to comply AND (2) FWP filed as soon as practicable after discovery of failure
    - (b) immaterial/unintentional **failure to include legend** in FWP is **not a violation of 5(b)(1)** if (1) good faith/reasonable effort to comply, (2) FWP is amended to include legend ASAP after discovery AND (3) if transmitted w/o legend, FWP retransmitted substantially same means.

|  |  |  |
| --- | --- | --- |
| **Rule 164/433 Requirement** | **Non-reporting & Unseasoned** | **Seasoned & WKSI** |
| Eligibility | Only after filing of reg statement | Only after filing of reg statement (WKSI may use 163 in Pre-Filing Period) |
| § 10 Prospectus (Rule 433(b)) | Must have filed; must accompany or precede | Must have filed |
| Info (Rule164(c)/433(c)) | -No info conflicting with reg statement + periodic reports  -Legend | -No info conflicting with reg statement + periodic reports  -Legend |
| Filing (Form FWP) (Rule 164(b)/433(d)) | FWP must be filed with SEC no later than first use | FWP must be filed with SEC no later than first use |
| Record Retention (Rule 164(d)/433(g)) | -Three years (if not filed) | -Three years (if not filed) |

Diagram

Description automatically generated

* **Electronic Roadshow** – Default**:** no filing requirement (see p. 61 for special rules)
  + Key question: is something **real time** or **not?**
  + Rule 433 à gave rise to a lot of online roadshows
    - If pre-recorded, very much like a FWP
    - Policy: Before Rule 433, only way you could communicate in waiting period was oral (giving advantage to institutional investors who would get to meet with issuers 1-1). Rule 433 allowed for broad dissemination of pre-recorded roadshows (that get to everyone).
      * Has this leveled playing field? Retail investors still can’t ask questions while institutional ones can. But if you’re truly retail, would you even watch this?



* **Process of Going Effective** 
  + §8(a): RS effective on 20th day after its filing (or before when SEC determines)
    - Issuers normally wait for SEC approval à issuers and UW file an acceleration request w/SEC a few days before the desired effective date.
  + Why wait? (1) wanting to wait to set price, (2) free legal advice by SEC, (3) don’t want to alarm SEC
  + **SEC’s powers**: 8(b) refusal, 8(d) stop order, 8(e) investigatory powers

**Post-Effective Period à CONCERNED ABOUT PROSPECTUS DELIVERY (TO WHAT EXTENT DO WE WANT TO GET THE FINAL PROSPECTUS OUT THERE?)**

* ~~§5(a)~~ prohibition on sales disappears
* §5(b)(1) continues to apply (note that §5(b)(1) is applicable “**any person**,” not only issuers
  + **Unless exemption (see below)**
* §5(b)(2) starts to apply (generally in practice it does not apply to delivery of equity security)
* **Must use final §10(a) prospectus**
* **Prospectus Delivery** à Required to exempt the written confirmation of sale
  + Written confirmation of sale (WCS) is prospectus as per §2(a)(10)
  + §5(b)(2) - Unlawful for any PERSON to carry such security for the purpose of SALE – **UNLESS ACCOMPANIED BY A 10a PROSPECTUS** [FINAL STATUTORY PROSPECTUS of 10a]
  + §5(b)(1) - **Prohibits transmission of written sales confirmation (WCS)** because it’s a prospectus that doesn’t meet requirements of §10
  + §2(a)(10)(a) - **Excludes WCS from definition of prospectus** if preceded or accompanied by §10(a) prospectus (***prospectus delivery***)
* **How long does the obligation last?** Prospectus delivery requirement lasts **UNTIL YOU GET AN EXEMPTION:**
  + §4(a)(1): **Exempts transactions not involving an issuer, underwriter, or dealer** (e.g., WSJ)
    - No need to do
  + §4(a)(3) & Rule 174 – **Broker’s exemption** Doesn’t apply to transactions by a **BROKER/DEALER** **no longer active as an UW.**
    - Broker/dealer - As long as not an UW, you may take advantage of 4(a)(3) to escape Section 5.
    - **Takeaway 1:** dealers **don’t have to worry about prospects delivery** unless they’re also serving as an UW.
    - See what kind of issuer you’re dealing with. Before the relevant time period, broker/dealers (not acting as UW) cannot send things w/o a prospectus
      1. 174(b) Exchange Act Reporting Issuer à Obligations lasts **0 days**
      2. 174(d) Non-Exchange Act Reporting Issuer (All Persons) à Obligation lasts **25 days**
      3. Seasoned Offering (Non-IPO) & not in Rule 174 à Obligation lasts **40 days**
      4. IPO & not in Rule 173 (4(a)(3)) à Obligation lasts **90 days**
  + §4(4): **Exempt brokers** participating in an **unsolicited broker’s transaction**.
  + §2(a)(10)(A) **Safe Harbor** – **If a formal statutory prospectus is included then communication is no longer deemed to be a prospectus and no §5(b)(1) violation**
* Step 1 – (5)(b)(1) obligation of prospectus delivery applying to **any person**
* Step 2 – starting point is **effective date** 
  + 174(b) Exchange Act Reporting Issuer à Obligations lasts **0 days**
  + 174(d) Non-Exchange Act Reporting Issuer (All Persons) à Obligation lasts **25 days**
  + Seasoned Offering (Non-IPO) & not in Rule 174 à Obligation lasts **40 days**
  + IPO & not in Rule 173 (4(a)(3)) à Obligation lasts **90 days**
* Step 3 – **Access Equals Delivery** à **Don’t have to deliver the prospectus!** 
  + Rule 172(a) & (b) allows access equals delivery, which eliminates physical delivery.
    - Doesn’t apply to all prospectuses (**not analyst reports/glossy brochures**) à just applies to **WCS** and **Delivery of Securities**
  + Rule 172(c) **Conditions**:
    - (1) RS is effective
    - (2) None of the issuers, UW, participating dealers subject to 8A proceedings
    - (3) issuer must file **10a statutory prospectus with SEC** (**filing requirement**) OR good faith effort to file within time period in Rule 424 (2bd) or as soon as practicable
* Step 3 - **Instead** à Rule 173 imposes a notice delivery requirement during prospectus delivery period. Failure to comply with Rule 173 doesn’t violate §5.
  + Example: During prospectus delivery period for an IPO issuer, underwriter sells securities and includes a notice that the sale was pursuant to a RS and that no final prospectus was mailed under Rule 172.

**Shelf-Registration**

* Non-Shelf Offering à Transaction focused. But there’s firm information + transaction information.
* Shelf Registration à Recognition that firm-specific registration doesn’t have to be included in the transaction document. Firm information will be provided over time **through incorporation by reference**.
* Rule 405 – **automatic shelf-registration by Form S-3 WKSIs** 
  + Post-effective period is 30 days after S-3 (if sell beyond that it’s fraudulent) (usually they sell first day/minutes)
  + 415(a)(1)(x) – If registered under this, **can start selling immediately**, **can sell continuously** (beyond 30 days) OR **can sell on a delayed basis** (register on day X and sell whenever)
  + **Requirements:** Rule 415(a)(2-3-4-5)
    - (2) 2-year limit (but doesn’t apply to WKSIs so ignore)
    - (3) optional
    - (4) at the market equity offering (selling at an exchange at market price) (automatically met for our purposes b/c only focusing on WKSI)
    - (5) *only requirement that matters*à **3-year re-registration requirement**.
* Interaction with Rule 163 (test the waters) à Allows you to make offers all the time!

# Public Offerings Anti-Fraud Liability

§ 11 focuses on accuracy in registration statement (as of the **effective date**)

* § 11 - In case any part of the registration statement, when such part became effective, ***contained an untrue statement of a material fact or omitted to state a material fact*** required to be stated therein or necessary to make the statement therein misleading, ***ANY PERSON******ACQUIRING SUCH SECURITY*** (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction sue…
  + Must be a **buyer** (vs. 10b-5 à buyers and sellers)
  + Assess registration statement as of **effective date** (vs. 10b-5 à broader, across time)
  + **Elements: only required to show material misstatement or omission** in RS as of effective date
    - **NO**: scienter (so strict liability), reliance, loss causation
* **Tracing Requirement** à *Krim* – Only purchasers who have shares that can be traced back to RS have standing to sue. **Can’t rely on “mere probability” to show tracing.** (Court found 99% not enough)
  + Curtails liability for WKSI or companies already in secondary market doing seasoned offering
  + Policy: Makes less § 11 useful and usually only applicable to **debt securities, IPOs, initial buyers**
* **Opinion** à Under § 11 cannot seek dismissal based on **state of mind**. (vs. 10b-5 à where you need scienter)
  + *Omnicare* – Opinion doesn’t constitute “untrue statement of fact” even if opinion proves incorrect (yet if the real facts are otherwise, but not provided, the opinion statement will mislead by omission).
* **Statutory** **defendants** à (vs. 10b-5 à primary violator, person who is speaking = ultimate authority over words that are spoken)
  + 1 – people that **sign the registration statement** (issuer, CEO, CFO)
    - 6(a) – issuer is forced to sign the registration statement
  + 2-3 – **directors** (no distinction b/w inside/outside/independent/time)
  + 4 – **experts** who prepared registration statement (limited liability)
    - **auditors/attorneys just liable for the financial statement/legal opinion**)
  + 5 – **underwriters** (non-expert) (IB, broker/dealer)
    - Syndicates can all bring DD defense although lead UW takes care of investigation
  + §15 **controlling persons of any of the above** (normally parent-sub)
* **Due Diligence Defenses** 
  + Issuers à DO NOT HAVE DEFENSES
  + Whistleblowers à Have a defense b/c encourages them to become whistleblowers
  + § 11(b)(3)(A): No person other than the issuer shall be liable if:
    - (1) **Reasonable objective investigation**
    - (2) **Reasonable objective ground to believe**
    - (3) **Did subjectively believe** (usually this is where high up people fail the DD defense *Escott* )
    - At the effective date, you SUBJECTIVELY and OBJECTIVELY thought that the RS was accurate and you took reasonable investigation into the accuracy and you had reasonable objective grounds to believe it was accurate.

|  |  |  |
| --- | --- | --- |
|  | D Experts 11(a)(4) | D Non-Experts (1, 2, 3, and 5) |
| Expert Section of RS | Reasonable investigation  Reasonable (objective) and actual (subjective) belief in statements | No investigation (b/c there’s an expert!)  Reasonable (objective) and actual (subjective belief in statements  \*\***RELIANCE DEFENSE\*\* by many courts** |
| Non-Expert Section of RS | N/A b/c no liability | **\*\*vast majority of RS\*\***  Reasonable Investigation  Reasonable (objective) and actual (subjective belief in statements |

* + “**reasonable**” à 11(c) reasonable investigation and reasonable ground for belief = **prudent man in the management of his own property**
  + “**reasonable investigation**”
    - *Escott* 
      * Not to re-audit the firm.
      * But an oral representation is not enough.
      * Must verify the info that company gave you using written documentation.
      * Unclear what’s required so err on the side of doing more.
  + Rule 176 – “reasonable investigation” or “reasonable ground for belief” consider…
    - Identity of D
    - Reasonable reliance on officers, employees and others
    - If UW à type of UW arrangement, role of person as UW, availability of info w/r/t registration.
    - If person had responsibility for the fact or document at time of registration/incorporation
  + **Is your DD defense based/affected by your position?** 
    - *Escott* – CEO, Director, Treasurer, CFFO did not get DD defense. They argued they were too high up to know, but it isn’t credible that they didn’t know.
      * **Position matters! If you’re too high up, probably won’t get DD defense.**
      * **Reliance defense easy to get if you’re NOT the expert.**
* **Damages** à (compare to 10b-5 à)
  + 11(e) à **damages** = **price paid** (capped - but not greater than offer price) – **value at time of suit filing** (market price – most commonly used proxy)
    - Offer P = $20, price rises to $35 and then value goes down when suit filed to $10
    - (compare to 10b-5 à potentially price drop from 35 to 10
    - 11(e) à 20 (offer cap) – 10
      * **PRO TIP:** Bring section 11 and 10(b)(5) together à Bring in people that can’t trace through class in 10(b)(5). It can be broader in terms of P and have broader damages.
  + **Loss Causation Defense** – **BoP of price drop** (hard!) = need to show what % of price drop is due to fraud and what % is due to other causes.
    - (compare to 10b-5 à BoP of price drop is on the P)
    - 11 - BoP of price drop is on the D
      * 11 has **built-in loss causation defense, so it’s better for the D.** Drop from 35 to 20 is automatically out of damages.
      * **BUT à** 11 also **worse for D** in that now you have the BoP of showing loss causation from 20 to 10.
    - **Underwriter** à liability cap is at UW’s allotment

§ 12(a)(1) - violation of §5 gives **CRUSH-OUT LIABILITY**). *Not about inaccuracy, about compliance with* §5

* Applies to **ANY PERSON** (**who offers/sells**) in relation to a **violation of** §5
* **Requirements** (very few for P):
  + Just show **violation of** §5 **somewhere in the transaction**.
  + Strict liability (no scienter)
  + **NO**: reliance, loss causation
  + **NO**: recission or recessionary damages
* **Defendants** à Direct **sellers** of the security (pass title) **OR** those who **solicit in exchange for value** (*Dahl*)
  + **Integration Doctrine** à Treats all securities transactions in similar time period/purpose as the **same transaction**. If there’s a violation in that transaction, anyone involved in the transaction can be a defendant and people that didn’t even suffer the violation can be plaintiffs.
    - **“the crush out element**” **broad & covers the entire offering** (any person offering/selling can still be liable even if they themselves weren’t involved in the violation)
    - E.g., mailroom forgets to put stamp on 1/10k prospectuses. Entire transaction liable. (but **forgiveness** for **mail room errors** in access = delivery rule)
* **Secondary Liability** à if you’re in the background, and you’re a substantial factor, are you liable?
  + 10b-5 – No (**cuts out anyone w/o ultimate authority**)
  + Section 11 – Maybe as an UW
  + Section 12 – No, but those who solicit, yes.
  + **Justifications for differences:** 10b-5 is definitely narrower than 11 and 12. Cutting out anyone without ultimate authority.
    - Justification 1: 10b-5 is broader in applicability (*any person purchase sale*). Because of breadth, we may want to narrow liability to ultimate authority.
    - Justification 2: 11 and 12 focus on primary offerings (narrower) and maybe these pose greatest risk to investors (speculative frenzy). Also, primary offering is where issuer has more incentive to mislead (as opposed to secondary where they aren’t getting $).

|  |  |  |
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| Rule 10b-5 | §11 | §12(a)(1) |
| *Central Bank*; *Stoneridge* | 11a | *Dahl* |
| Focus on “primary violator” who has ultimate authority | list of defendants  - Issuer  - Top officers  - Directors  - Experts (Auditor)  - Underwriters | Privity; solicitations \*if you didn’t solicit or pass title, you aren’t liable” |
| aiding and abetting only for SEC |  | Rule 159A  Item 512a6 |

* **Standing** à
  + Section 11 **-** Issuer à Underwriter à Investor #1 à Investor #2 à Investor #3
    - All three of the investors can sue the issuer in an IPO assuming there’s tracing.
  + Section 12 **-** BUT with 12(a)(1) the footprint is much narrower
    - Investors #2 and #3 won’t be able to sue issuer because of exemption 4(a)(1) à transactions in secondary markets are exempt from Section 5.
    - Investor #1 can only sue the UW b/c the UW is passing title, unless it’s a shelf-registration offering (because in that case the issuer agreed to be a valid D)
    - **After IPO universally understood that the chain is cut. Everything after is a separate transaction.** (this is not true in private placements where you seek to ask if the intermediaries UW or not)
  + **Cuts off secondary market purchasers!** (vs. 11 where every investor in the secondary market can sue as long as there is tracing)
* **Defenses** à NONE
* **Damages** à get your **money back**!
  + **Rescission** (upon tender of the security)
    - Damages = consideration (plus interest) – income received
    - **NOTE:** People won’t exercise 12 rights unless market price drops below purchase price.
    - **Jump for initial purchasers (IPO)** – this typically happens. Purchasers then resell and that second purchaser can’t sue under 12 b/c no privity.
      * **Thus, there won’t be a** 12 **suit if initial purchasers make money**
    - UW Normal Pricing à
    - UW Underpricing à
  + **Recessionary Damages** (if sold security) à Puts you back in position you would have been if you hadn’t purchased the securities in the first place. 
    - Consideration (+interest) – Amount Realized – Income Received
  + No loss causation defense.
    - Rationale: Fewer court errors because there’s a bright line between whether there was a §5 violation or not, as opposed to determining materiality under §11.
    - But this rationale is flawed because there is still uncertainty here: figuring out who is a “seller” can be difficult

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **C/L** | **§10(b)** | **§ 11** | **§12(a)(1)** |
| **Misstatement or Omission** | YES | YES | YES | NO |
| **Materiality** | YES | YES | YES | NO |
| **State of Mind** | Scienter | Scienter | (Due Diligence) | Strict Liability |
| **Reliance** | YES | Transaction causation | No – until 1 yr earnings statute | NO |
| **Causation** | YES | Loss causation | (loss caus. def.) | NO |
| **Damages** | Unlimited | Unlimited \*21D(e)(1) | Offering price | Rescission |

# Private Placements

* Goal à Avoid §5 liability (violation of which would lead to recission under §12(a)(1)
  + **Exemption from § 5:**
    - **Mandatory disclosure** (e.g. registration statement and periodic filings)
    - **Gun-Jumping Rules**
      * Restrictions on info disclosure
      * Distribution of prospectus
      * Prospectus (registration statement) updating
    - **Heightened Antifraud Liability** (§11)
* § 4(2) offerings - “The provisions of §5 **shall not apply** to – (2) *transactions by* ***an issuer not involving any public offering***”
* **Definition of “Public”** – Offerees, not purchasers, matter. Must have disclosure/access to info. Investor sophistication is an important factor (experience, wealth)
  + SEC 1935 Factors: Provided factors focusing on # of offerees, their relationship to each other, and their relationship to the issuer. **Information, relationship may be more important than size.** 
    - (1) Size of offering, Number of units
    - (2) Relationship to issuer
    - (3) Relationship with each other
    - (4) Broad based solicitation
    - (5) Over 35 offerees
  + *Ralston*: SEC factors aren’t dispositive. Instead think of purpose of §5 (protecting investors who need it).
    - **Test:** If the investors can **fend for themselves**, it’s a transaction “not involving any public offering.”
    - Example: *“Executive personnel who b/c of their position have* ***access to the same kind of info*** *that the act would make available in the form of a* ***registration statement****”*
  + *Doran*: Sophistication alone isn’t enough. Sophistication cannot do anything without information.
    - **Requirements:** (1) **sophistication of offeree** & (2) **information access/disclosure**
    - Two ways to get information similar to that in the RS: (1) **access** & (2) **disclosure**
    - If the **transaction, as a whole, fails** to qualify for § 4(2) because some of the offerees are unable to “**fend for themselves**”, then even sophisticated purchasers may sue for violation of §5. [Even if the unsophisticated offeree didn’t buy]
* **Regulation D Safe Harbor** – SEC’s response to the uncertainty in the definition of “**public**”
  + Goal – Greater certainty to issuers and allowing small companies access to capital markets.
  + **Two Safe Harbors:** 
    - (1) Rule 504 – Not available for public companies. So relatively small companies that take place within one or a few states (so they follow the state’s security’s regime).
    - (2) Rule 506 (big one) – Commonly referred to as Rule 144(a) Offering.
      * If 506 applies, it gives you an **exemption** from Section 5 under 4(a)(2)
  + **Requirements for 504/506 Offerings** 
    - (1) **Aggregate Offering Price** 
      * Rule 504 – Limit is $5 million (*but actually reduced by the particular calculation*)
        + Particular calculation = shall not exceed $5 million – the aggregate offering price for all securities sold within 12 months.
      * Rule 506 – No monetary limit.
    - (2) **Number of Purchasers** 
      * Rule 504 – No limit.
      * Rule 506 – 35 or fewer purchasers (that aren’t accredited investors – these are unlimited) + **sophistication** required for non-accredited investors)
        + **BUT** à **Accredited Investors** don’t count for the total 35 (unlimited)
        + NOTE à entities formed with specific purpose of investing in the offering will be looked through.
        + Definition of “**Accredited Investor**” - Rule 501(a) Only focus on 3,4,5,6 for exam.

501(a)3 à **entities** with total assets of more than **$5 million**

501(a)4 à **directors** and **officers** of the issuers

501(f) defines **executive officer** – president, any VP in charge of principal business unit, **division or function** (such as sales, admin or finance), any other officer who performs a policy making function, or any other person who performs similar policy making functions for the issuer.

**501(a)5** à Natural person **wealth test** **[$1 million excluding your primary residence**]

501(a)6 à Natural person **income test** [**200k individually, or 300k with a spouse**]

Examples: financial institutions, pension plans, venture capital, etc.

* + - * + Purchaser **Sophistication** – if selling to non-Accredited Investors, how to assess?

Hire a **purchaser representative** (although this doesn’t eliminate uncertainty – so issuers tend to avoid altogether by just selling to AI)

Need to make sure that: (see p. 84 of outline for laundry list)

* + (502(c) **Limitation on General Solicitation** 
    - 502(c): **Issuer** (or person acting on its behalf) **SHALL NOT offer/sell** securities in “**general solicitation or general advertising**” including:
      * (1) any ad, article, notice or comm. in newspaper, magazine or similar media or broadcast on TV or radio **AND**
      * (2) any seminar or meeting attendees invited by g. solicitation or advertising
    - *Kenman* – solicitation = when issuer and offerees don’t have a “**pre-existing relationship**”
    - *Mineral Lands Research* – “**pre-existing relationship**” = Only relationships that allow issuer to determine the “financial circumstances or sophistication” of the offerees or are otherwise of “some substance and duration.” (not mere social relationships)
      * **pre-existing relationship** à important factor in making general solicitation determination(but not only way of knowing if there’s been a violation)
    - Limit has most impact on small, pre-IPO issuer (who has few pre-existing relationships)
      * Can get around it by hiring a **placement agent** (IB) – indispensable for small issuer
    - **Jobs Act Changes** 
      * 506(c): conditions to be met in offerings NOT subject to limitation on manner of offering
        + **Specific conditions**:

All investors sold to must be AIs

Issuer shall take reasonable steps to verify that purchasers are in fact AI

* + - * **General solicitation OK if you ONLY sell to AIs and have someone verify AI status**
  + **Informal Requirements:** 
    - Rule 504 – Exempt if you meet state law requirements
    - Rule 506 – When information must be furnished, if issuer sells to **ANY PERSON** who is **NOT an AI**, the issuer shall **furnish information** specified in 502(b)(2) BUT do NOT need to provide to the AIs you sell to.
      * 502(b)(2) – (1) brief description of material information given to any AI; (2) have a chance to ask questions and get answers
  + **Limitation on Resale:** Cannot freely resell private placement securities
    - Rule 506 – Securities acquired in a transaction under Reg D shall have status of securities acquired in a transaction under 4(a)(2) and **cannot be resold w/o registration or an exemption therefrom** (rule 502(d))
      * **Issuer must take reasonable care to discourage investors from reselling.**
* Assuming the above requirements for Reg D offering are met (aggregate offering price, number of offerees, limit on general solicitation, informal requirements, limit on resale) **what counts as a “transaction”?** 
  + **Integration**: two transactions that occur (SEC Release No. 4552) (**balancing test –** don’t need all)
    - For the same class of securities;
    - During the same time period;
    - For the same type of consideration;
    - To raise capital for the same general purpose; AND
    - Under a single plan of financing
      * Are considered, the same transaction
  + 502(a) provides some certainty through a **safe harbor** that **gets out of integration**!
    - In a vacuum, if 2 transactions are so close together (factors), SEC says you integrate and consider them one transaction.
    - **Lookback: MORE THAN ONE YEAR THEY WONT BE INTEGRATED – UNLESS there’s one WITHIN THIS ONE YEAR THAT SIMILAR** 
      * + 6-month look back from the start of Reg D offering
      * + 6-month look forward from the end of Reg D offering
    - **“**Offers and sales that are made… [**timing above**] will not be considered part of **that** Reg D offering, **SO LONG AS** during those six-month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Reg D
    - **Note: one-sided integration** b/c only looking at one offering (anchor)
      * If two offerings, A & B, each must be assessed for safe harbors. One could have one and the other might not. Possible for A to be integrated into B, but B not be integrated into A.
* Analysis:
  + Step 1: Choose offering as **anchor** offering (Start with A but must do for all Reg D offerings)
  + Step 2: Are there offerings that may be **integrated** into the anchor?
    - Step 2A: Ask whether the **anchor offering has a safe harbor** (502(a))
      * Look at 6 months prior to START and 6 months after END
        + Sales outside of the window are NOT integrated EXCEPT when the anchor offering loses its safe harbor.
    - Step 2B: If **safe harbor is LOST,** then ask whether the offerings are **integrated using SEC 4552 test above.** (are they similar enough)
      * NOTE: Don’t just look at offerings within the 6-month period (a 3rd offering 7 months out should also be analyzed using the balancing test)
  + Step 3: Look at the integrated offering, would the **integrated** offering **exceed the restrictions in Reg D?** 
    - Look at all requirements of Rule 504 and Rule 506 to see if the fully integrated offer meets the safe harbor:
      * Aggregate Offering Price
      * Number of Purchasers
      * Sophistication Requirement
      * General Solicitation Limitation
      * Information Disclosure
      * Resale Limitation
  + Step 4: If NO Reg D applies, see if another safe harbor applies (4(a)(1)-(4))
    - 4(a)(1) – exempt transactions in secondary markets (not involving issuer, UW, or dealer)
    - 4(a)(2) -
    - 4(a)(3) – exempt for broker/dealers not acting as UW
    - 4(a)(4) – exempt unsolicited broker transactions
    - NOTE: still under the integration framework – whether or not something is integrated always applies.
  + Step 5: If NO EXEMPTIONS apply, anchor A does NOT qualify as a private placement, and presumably w/o the adherence to the mandatory disclosures and gun-jumping rules, § 5 has been violated.
    - **Result:** heightened antifraud liability § 11, § 12(a)(1), and Rule 10b-5.
    - Integrated transaction is one transaction and one violation (which matters for who can be held liable)
  + Step 6: Continue Steps 1-5, choosing the other offerings as anchor offerings.
    - NOTE: Even if there is a safe harbor found for one of the offerings in a series, such that there is no integration, ask whether there is still a § 5 violation.
* **Forgiveness** - § 5 is strict liability, but over years SEC has added forgiveness (e.g., access = delivery).
  + Rule 508 for Reg D - A failure to comply with a term, condition or requirement of Reg D will **NOT result in loss of exemption**…. if the issuer shows:
    - (1) Failure to comply did NOT pertain to a requirement directly intended to protect that particular P filing a § 12(a)(1) lawsuit….; and
    - (2) Failure to comply was insignificant w/r/t offering as a whole;
      * BUT failure to comply with Rule 502(c), Rule 504(b)(2), or Rule 506(b)(2)(i) shall be deemed significant w/r/t the offering; and
    - (3) Good faith and reasonable attempt made to comply with all applicable requirements
  + **NOTE**: you only need forgiveness provision IF there is something to forgive (i.e., if there is a built in excuse in Rule 506 then you do NOT need forgiveness)
    - E.g., 501(a) says issuer just needs to “reasonably believe” the investors are accredited
      * May be that the investors are lying but if the issuer reasonably believes them then its fine and there is nothing to forgive
    - List of **built-in excuses** such that Rule 508 might not be necessary
      * Accredited investor definition - "reasonably believes" (501(a));
      * Purchaser sophistication - "reasonably believes" (506(b)(2)(ii);
      * Purchaser representative definition - "reasonably believes" (501(h));
      * Number of purchasers - "reasonably believes" (505(b)(2)(ii), 506(b)(2)(i))
      * Resale limitation - "reasonable care" (502(d))

# Secondary Market Resales

* **Broad prohibition on resales** - 5(a): **UNLESS** an R/S is in effect as to a security, it shall be unlawful for any person [including an outside investor seeking to sell in secondary market], directly or indirectly -
  + (1) to make use of any means or instruments of transportation or communication in interstate commerce….to sell such security
  + **NOTE**: R/S register *specific* securities not class of securities (like 1995 common stock vintage is different than 1998 common stock vintage)
* **Broad transaction exemption** – 4(a): Provisions of §5 **shall NOT apply to** – (1) transactions by **any person** **OTHER THAN** **issuer**, **underwriter** or **dealer**.
  + If there’s an UW, issuer, or dealer à entire transaction loses exemption and everyone in the transaction could have potentially violated §5.
  + **KEY** à **split the transaction**!
    - Issuer à Y à Z
    - Y à Z could be exempt if deemed separate transaction (but if whole thing deemed one transaction, then not exempt)
* **Parties:** 
  + **Issuer** – very straightforward 2(a)(4) – but see **Control Persons** below
  + **Dealer** – (includes both brokers and dealers) those in the business of buying/selling for their own accounts OR those who are in the business of assisting others sell their own 2(a)(12)
  + **Underwriter** – 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
    - Sweeps broadly – not necessary to be in the business of UW
    - offer for issuer in distribution OR purchase with view to a distribution (like conduits)
    - **Who is an issuer**? **Is this one OR two transactions? Issuer à Y à Z** 
      * Step 1: Start with § 5 (prohibition to **any person** and **any transaction**)
        + Does § 5 apply?
        + Is there an exemption to § 5?

**Key exemption** is § 4(a)(1)

* + - * Step 2: § 4(a)(1) exempts “any transactions by any person other than an issuer, underwriter, or dealer”
        + If **Y** is an **UW**, then assess all as **one transaction** from issuer to ultimate purchaser **Z**.
        + If **Y** is **NOT an UW**, then assess as two transactions.
    - How do we know if someone is a conduit or not? “**with a view to**…**distribution**”
      * **Distribution** = it’s a **public** sale of securities *Gilligan*
        + “**public**” *Purina* - When Gilligan sells to broad public, he is engaged in public offering to the extent the public is not able to “**fend for themselves**”
        + \*\*could have avoided if he sold to those that could fend for themselves”
      * **View to** = if you bought with an **investment intent**, **no view to distribution**.
        + *Gilligan -* Can prove by showing that a subsequent **change in circumstance** is what led you to distribute.

Change in circumstance *of the personal investor* (better if it’s a result of an external event)

**BUT NOT**à poorly performing issuer ≠ change in circumstances, and thus can’t allow investor to make resale w/o being deemed an UW.

* + - * + SEC Rule of Thumb for Investment Intent:

Presumption of **view to distribution** if sold within **2 years** of purchase.

Can still rebut with **change in circumstance**

Presumption of **investment intent** if you sell between **2-3 years of purchase**.

Irrebuttable presumption of **investment intent** if you sell **after 3 years of purchase**.

* **Control Person Resales** 
  + Policy: Worry about CP having information advantage.
  + A control person = issuer and thus subject to §5
  + 2(a)(11) - “**Issuer**” also includes any person directly/indirectly **controlling or controlled** by the issuer OR any person under direct/indirect common control with the issuer
  + Rule 405 - **“Control”** means **possession**, direct or indirect, of **power to direct/cause direction** of the **management and policies of a person**, whether through the ownership of voting securities, by contract, or otherwise.
  + Definition:
    - large share ownership
    - top officer positions (especially if you have those first two like Bill Gates)
    - Directors? à **most courts say no unless special position in board**
  + **BUT à** May be able to get out of §5 through an **exemption**! Provisions of §5 shall not apply to -
    - 4(a)(1) transaction by any person other than an issuer, UW, or dealer
    - 4(a)(2) transactions by an issuer not involving a public offering
    - 4(a)(4) unsolicited broker’s transactions
  + Ask two questions with regards to control persons
    - Question 1: **is the control person an UW for the issuer?** (exact same question as before, not unique to CP)
    - Question 2: **is there an UW (3rd party) for the control person?** 
      * Brokers who assist the CP are UW
      * If there’s an UW, must comply with §5 b/c 4(a)(1) exemption has disappeared.
      * *Wolfson* - *CP* can’t rely on 4(a)(4) b/c that’s a **broker’s exemption**, CP needs to find his/her own.
  + Section 4(a)(1 ½) Exemption for Control Persons – CP with dilemma “**how can I resell**?”
    - Mechanics
      * § 5 Prohibition that says no sales
        + §4(a)(1) exemption focusing on transactions involving “issuer, underwriter, or dealer” – **BUT** à CP can’t use this one b/c there are often UW for them.
        + Controlling person isn’t “issuer” for purposes of §4(a)(1)
        + **So how to resell?!**
      * The 4(a)(1½) Exemption
        + §2(a)(11) focuses on “**distribution**” of securities
        + Courts equate “**distribution**” with “**public offering**”
        + Apply *Purina* notion of “**fend for themselves**” to determine if “**public offering**” took place in controlling person’s resale offering
        + SO à if CP sells to someone that can “fend for themselves,” not public under *Purina* so we’re fine

**Broker would NOT be an UW for CP AND CP can take advantage of** §4(a)(1)

* + - Inquiry #1: Is the controlling person an underwriter for the issuer?
    - Inquiry #2: Is there a third party underwriter for the controlling person?
      * Who might be an underwriter:
        + Can be a brokerage firm assisting CP in resale
        + Can be investor purchasing from CP if she resells securities to another investor
      * But see if CP is selling to investors who can fend for themselves (a 4(a)(2) idea). If so, it is not public, no distribution
      * But if the investor turns around and sells the securities one day after buying from the CP, she may be an underwriter.
        + Note there’s no 502(d) forgiveness for the CP here, because Reg D only applies to issuers. And CP is only an issuer for purposes of 2(a)(11).
  + Summary:
    - Individuals selling on behalf of CP are UW if they sell through “distribution”
      * Presence of UW defeats use of §4(a)(1)
      * If no UW à §4(a)(1) is available
    - Resale for CP permitted if not “distribution”
    - §4(a)(1½) Exemption follows §4(a)(2) factors
      * Private resale isn’t a “distribution
* **Rule 144** 
  + Designed to deal with resale of restricted securities
  + If Rule 144 applies, person will **not be deemed to be engaged in a distribution**
    - Any **affiliate** who sells restricted securities, and **any person** who sells restricted securities on behalf of the affiliate of the issuer à **deemed not to be engaged in distribution!**
    - If **no distribution** à **no UW** (people who buy with “view to distribution”)
    - Result: **chain is cut!** Everything that happens before is a separate transaction so you can freely resell.
  + **Definitions:** 
    - **affiliate** is basically the same thing as a control person: “a person that directly, or indirectly…controls, or is controlled by, or is under common control with, such issuer”
    - Rule 144(a)(3): **Restricted securities include**:
      * (1) those acquired directly/indirectly in chain of transactions **NOT involving a public offering**
      * (2) those acquired from the issuer that are subject to resale limitations of **Reg D**
        + Reg D – Issuer à Y à Z
        + Is Y and UW for the issuer?

Option 1: – Look at case law: change in circumstance? Did he hold for 2-3+ years? Did he sell or offer to those who can fend for themselves so no distribution?

Option 2: Look at Rule 144 – implies Y is automatically not an UW (certainty!)

* + Rule 144(b) **Safe Harbors** à If safe harbor applies à NOT deemed UW à can use 4(a)(1) to resell
    - **(1)** Non-Affiliates (and not an affiliate w/in prior 3 months)
      * Exchange Act Reporting Issuer
      * Non-Exchange Act reporting issuer
    - **(2)** Affiliates (+ “on behalf” of affiliates)
  + **Requirements** for Rule 144:
    - **(1)** 144(d)(1): **Holding Period for Restricted Securities:** 
      * Only applies to restricted securities
      * **Time period** – Runs from the later of the acquisition of the securities from (1) the issuer OR (2) the affiliate.
        + 6 months from when public company issuer sells through private placement **OR**
        + 1 year for a private company
    - **(2)** 144(c): **Current Public Information Holding Period –** “Adequate public info with respect to the issuer of the securities must be available”
      * \*does not apply for private companies\*
      * Applies only for public companies à 1 year period