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"Private" placements of securities: a London view of the Facebook saga

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According to a story in the *New York Times*, on Sunday night, 2 January 2011, Goldman, Sachs & Co. sent a number of its wealthy U.S. clients an e-mail offering them the opportunity to invest in an unnamed "private company that is considering a transaction to raise additional capital." The story identified the company as Facebook and the offering a US $1.5 billion sale of common stock with a US $2 million minimum investment and a lock-up until 2013. On 21 January, Facebook announced that Goldman Sachs had "completed an oversubscribed offering to its non-U.S. clients in a fund that invested $1 billion in Facebook Class A common stock." Goldman Sach's decision to exclude its U.S. clients from the Facebook offering highlights some fundamental differences between U.S. and European securities regulation and practice and has prompted the U.S. Securities and Exchange Commission (SEC) to re-evaluate its private placement rules.

Facebook's Offerings

Facebook operates a popular social networking website with more than 600 million active users. Experian®Hitwise® reported that during the first 11 months of 2010 **www.facebook.com** was the most visited website, logging 8.9% of all Web visits in the United States. Google's main site was second with 7.2%. Clearly, public awareness of, and interest in, Facebook is remarkably high.

In December 2010, Facebook sold US $500 million of Class A common stock to a Russian investment fund, Goldman Sachs and funds managed by Goldman Sachs. The January 2011 offering would be through a Goldman Sachs special purpose entity that would purchase shares on substantially the same terms as the December sale-in effect, a second closing of that offering. Both offerings were intended to qualify as private placements not subject to registration under U.S. securities laws.

Requirements of a U.S. Private Placements

The U.S. Securities Act of 1933 prohibits offerings in the United States of securities such as Facebook's common stock without either a registration statement filed publicly with the SEC or an exemption for the transaction. If the securities are privately placed in a "transaction by [a company] not involving any public offering," a registration statement is unnecessary. The statute does not define what constitutes a public offering, but the SEC has adopted Regulation D, a safe harbour for private placements.

Goldman Sachs appeared to comply with the Rule 506 of Regulation D: offerees would be pre-qualified as sophisticated and wealthy. Although not required to do so, Goldman Sachs did provide offerees a private placement memorandum of more than 100 pages describing the offering, and required them to keep it strictly confidential. Goldman Sachs has not stated publicly how many offerees received the memorandum, but it would not be surprising if they numbered in the triple digits.

In addition to requiring that the offerees meet a standard, Regulation D prohibits making the offer of securities "by any form of general solicitation . . . including . . . [a]ny . . . article . . . or other communication . . . published in any newspaper." Certainly Goldman Sachs endeavored to keep its e-mail, the memorandum and the existence and terms of the offering confidential, and just as certainly they failed.

The press covered the proposed offering in voluminous and startlingly accurate detail. Goldman Sachs attempted to offer, on a confidential, private basis, shares of a company with the most widely viewed website in the United States and more than 600 million users. Substantial publicity was probably unavoidable, if not entirely foreseeable. The press reported that on Sunday, 16 January, Goldman Sachs informed its U.S. clients that they would not be permitted to purchase in the offering. The next day, Goldman Sachs announced that "the level of media attention might not be consistent with the proper completion of a U.S. private placement under U.S. law."

The Question and Different Answers

It did not take long for many to ask what is the problem with general solicitation of offerings of securities that may only be accepted by sophisticated, wealthy investors or by institutional investors that manage at least US $100 million in investments? In March, Congressman Darrell Issa asked those questions of the SEC in a letter he made public. In April, Mary Shapiro, Chairman of the SEC, replied with a public, 26-page letter. Whilst that question continues to be addressed in the United States, the answer in the European Union has been known for some time.

The EU regulates public offers of securities by means of the EU Prospectus Directive, which has been implemented into national law by each EU member state. Those rules require a prospectus to be produced by any company who wishes to offer transferable securities to the public unless one or more of the exemptions are satisfied.

An "offer to the public" is widely defined; there is an offer to the public if "there is a communication to any person which presents sufficient information on the transferable securities to be offered and the terms on which they are to be offered to enable an investor to decide to buy or subscribe for the securities in question". The communication can be in any form and by any means, and it includes a placing of securities through a financial intermediary. Clearly the sort of solicitation Goldman Sachs undertook in the Facebook case would for these purposes be an offer to the public.

However, as noted above, companies can avail themselves of one or more of the various statutory exemptions to offer shares to the public without having to produce a prospectus; the commonly used exemptions include offers made or directed:

- at qualified investors (including banks, investment institutions and certain small and medium sized entitles and natural persons meeting prescribed criteria). Member states operate self-certification and registration systems for natural persons and small- and medium-sized entities meeting the criteria;
- at fewer than 100 persons, other than qualified investors, per European Economic Area state;
- where the minimum consideration that may be paid per investor is €50,000;

- where the securities being offered are denominated in amounts of at least €50,000.

These terms of the exemptions are changing, however, and EU members are required to implement amending legislation by 1 July 2012 to amend the definition of "qualified investor" to refer to investors considered to be or treated on request as professional clients or recognized as "eligible counterparties" under the Markets in Financial Instruments Directive. Companies will also be permitted to offer securities to up to 150 persons per EEA state, however the minimum consideration and denominations are also increasing to €100,000. The UK has already indicated that it will implement certain of these changes well ahead of the July 2012 deadline.

Prominent among the matters that Ms. Shapiro has instructed the SEC's staff to review is whether the general solicitation ban should be revisited in light of "current technologies, capital-raising trends and [the SEC's] mandate to protect investors and facilitate capital formation." London and the EU's regulatory regime can offer some useful guidance.

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Sean Geraghty's experience includes mergers and acquisitions (both public and private, for corporate clients and private equity clients), IPOs (on the Official List, AIM and overseas), secondary offerings, joint ventures and general corporate matters. Mr. Geraghty has acted for major European and international corporate clients and financial institutions on substantial transactions.

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Since 2007, Mr. Karras has been designated as a leading lawyer for corporate/mergers and acquisitions and private equity by *Chambers USA*, a referral guide to leading lawyers in the United States. In recent editions, *Chambers* has described Mr. Karras as "highly regarded and very talented" and his work as consistently "exceptional." He is also praised for his "good judgment and good responsiveness." Mr. Karras is also listed in *The Best Lawyers in America* and in *The Legal 500* (U.S.), where he is praised for his "'excellent responsiveness and quality of work'" and for being "'flexible, creative, [and] highly intelligent'" with "'great business sense.'"

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