COHEN & GRESSER

RAISING CAPITAL:

Private Placements

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This is the second of a new series of Cohen & Gresser client advisories on how to raise money in the U.S. capital markets. In the first advisory, we noted that private capital raising has dwarfed public capital raising in the U.S. over the past few decades. Companies are raising larger amounts of money in private markets and staying private longer. In this advisory, we examine some of the mechanics of private placements, how they have changed over the past ten to fifteen years, and how that has contributed to the extraordinary development of private markets.

In future editions, we will cover other types of offerings and issues affecting how growing companies in the U.S. and elsewhere raise capital in U.S. markets.

The Private Placement **Exemptions**

Any attempt to raise capital by the offer and sale of debt or equity securities in U.S. markets must be made with a publicly filed registration statement pursuant to section 5 of the Securities Act of 1933 (the "Securities Act"), unless an exemption from registration is available. Exemptions from the registration requirement are valuable because the registration process, especially for an initial public offering, or "IPO," is costly, rigorous, and leads to extensive ongoing compliance obligations under the Securities Exchange Act of 1934 (the "Exchange Act").

The most important and frequently used exemptions are provided by Rule 506(b) and (c) under the Securities Act. Rule 506(b), originally adopted in 1982, is the traditional private placement exemption, and with limited exceptions discussed below, does not allow solicitation of the general public as investors. Rule 506(c), adopted pursuant to the Jumpstart Our Business Startups Act ("JOBS Act") of 2012, is similar, but permits public solicitation so long as the company has taken "reasonable steps" to establish that each purchaser is an accredited investor.

Rules 506(b) and (c) are used by issuers of all sorts, in all sorts of transactions involving a sale of unregistered securities by the issuer, including venture capital and private equity financings.

Accredited Investors

The distinction between accredited and non-accredited investors is central to the Securities Act registration exemption scheme. An accredited investor is deemed to need less protection under the securities laws because the investor has the financial wherewithal, or holds some position or license, that enables the investor to fend for itself. For individuals, the net worth or income requirements are not particularly stringent, although they may exclude younger investors who wish to invest in an area that they know.

Rule 506(b) permits a company to sell securities to up to 35 non-accredited investors in any ninety-day period. All non-accredited investors must receive information about the company equivalent to what would be provided in an offering conducted pursuant to Regulation A under the Securities Act; if the company is not eligible to use Regulation A, it must provide the information required in a registered offering. By contrast, there are no specific information requirements for accredited investors. As a result, non-accredited investors are often excluded from Rule 506(b) offerings.

Under Rule 506(b), the company must have a reasonable belief that each investor that it counts as being accredited does in fact qualify as accredited. This reasonable belief is often based on a questionnaire completed by prospective investors; there must also be no "red flags" to indicate that the answers to the questionnaire were unreliable. In other cases, a reasonable belief that the investor is accredited can be based on the company's knowledge of who the investor is. For example, a bank or an executive officer of the issuer would be an accredited investor by definition, while the status of a well-known investment firm or ultra-high net worth individual might be reasonably inferred.

Rule 506(c) has a higher standard for diligence: the company must have taken "reasonable steps" to determine that an investor is accredited. Rule 506(c) contains a non-exclusive list of steps that could be taken, including the review of tax returns and brokerage statements, which provide a "safe harbor" for compliance if used. Some have read these steps as mandatory, even when the issuer knows that the investor is accredited. In a March 12, 2025 no-action letter addressed to Latham & Watkins, however, the U.S. Securities and Exchange Commission (the "SEC")

affirmed what was said in the adopting release relating to Rule 506(c): that what constitutes reasonable steps depends on the circumstances, and where there is a high minimum investment amount and the purchaser is able to meet those terms, it may be reasonable to take fewer steps, or possibly no steps, other than to confirm that the purchaser's cash investment is not being financed by a third party.

General Solicitation and Advertising

No general solicitation or advertising is permitted in a Rule 506(b) offering. Instead, either the issuer itself or a registered broker-dealer acting on its behalf should have a pre-existing relationship with each potential investor who is solicited, and no media or website outreach is permitted. In a Rule 506(c) offering, by contrast, there is no prohibition on general solicitation or advertising and thus no requirement of a pre-existing relationship, so long as all eventual purchasers in the offering are accredited (as determined through reasonable steps, as described above).

In recent years, the SEC has carved out some exceptions to the de facto requirement of a pre-existing relationship under Rule 506(b). Under Rule 148 under the Securities Act, as amended in November 2020, issuers can participate in so-called "Demo Day" activities (organized pitch presentations by one or a series of issuers under the auspices or sponsorship of a university, state or local government, nonprofit organization, angel investor group or accelerator), subject to certain conditions. At the Demo Day event, the issuer may not communicate any information about the offering itself, other than the fact that the issuer is in the process of offering or planning to offer securities, the type and amount being offered, the intended use of proceeds of the offering, and the unsubscribed amount in an offering. In addition, the Demo Day sponsor may make no investment recommendations at the event, may receive no commission and may not charge a fee for admission, other than reasonable administrative fees.

Disclosure

There are no information or disclosure requirements for accredited investors under either Rule 506(b) or 506(c). The anti-fraud provisions of the securities laws and regulations nonetheless apply, notably Securities Act section 17, Exchange Act section 10(b) and Rule 10b-5 thereunder. Thus, issuers need to make sure that all material information has been disclosed. The method of disclosure, however, varies with the circumstances and the expectations of investors in different sectors of the private securities markets.

In some cases, issuers prepare and investors expect a detailed private placement memorandum. In other cases, particularly for institutional investors like investment banks, venture capital firms and private equity firms accustomed to doing their own due diligence, the most significant disclosures may be made via representations in a stock purchase agreement, together with disclosure schedules and a due diligence deal room. In yet other instances, the disclosure package may consist of several pieces, such as an investor deck describing the business and the offering, a set of risk factors, the deal documents and financial statements.

Because there is no explicit information requirement for accredited investors, it is sometimes tempting to skimp on disclosures to investors. But good disclosure, however structured, helps to protect the issuer from subsequent investor complaints. The company may be able to show that a fact or risk was already disclosed, or that the company's actions or performance after the investment were consistent with the expectations outlined in the offering documents. Good disclosure also helps to tell the company's story, which may lead to better results in the offering and possibly a more productive relationship with investors following the offering.

Integration

Integration is a central concept under the U.S. securities laws. If two offerings occur at the same time or in close proximity, they may be "integrated," with the result that what is permissible under one offering will disqualify the other. In November 2020, the SEC amended Rule 152 under the Securities Act, making it easier to conduct two offerings in close succession and providing greater certainty as to when offerings will be integrated. Among other things, under amended Rule 152, any offering made more than 30 calendar days before the commencement of another offering, or more than 30 calendar days after completion or termination of any other offering, will not be integrated with the other offering, provided that for an exempt offering for which general solicitation is not permitted, the purchasers were not solicited through general solicitation.

Securities Law Filings

For offerings under Rules 506(b) and (c), the issuer must file SEC Form D within 15 calendar days of first sale. Filing is not, however, a condition of receiving the exemption, and there is no ongoing reporting requirement. Rule 506 securities are exempt from state "Blue Sky" requirements, but issuers may still need to file a copy of the Form D and possibly a consent to service of process in the states where investors are located. In addition, broker-dealers who aid in placing the securities may also have Financial Industry Regulatory Authority ("FINRA") filing obligations.

Liquidity and the Ability to Stay Private Longer

Securities acquired in a Rule 506(b) or (c) offering are "restricted securities" under Rule 144 under the Securities Act and, generally speaking, may not be resold publicly except pursuant to a secondary registration statement or as otherwise permitted under Rule 144. The investor's contractual rights to obtain liquidity through various means—such as a sale to the company or other investors; a secondary registration statement; or a sale of the company—is often an area of substantial negotiation in a private placement. But, as more companies stay private for a longer time, companies and practitioners have developed various ways to ease liquidity pressures that don't require the company to go public or sell the company to a third party. For example, companies may facilitate private secondary sales to lead investors or conduct tender offers to purchase shares from employees and smaller investors.

The ability of companies to stay private longer depends in part on the availability of private capital. In addition, as a result of changes to section 12(g) of the Exchange Act made in connection with the JOBS Act of 2012, companies are no longer significantly constrained by limits on the number of shareholders that a private company can before it is required to register its securities under the Exchange Act and become a reporting company. As a result of these amendments to section 12(g), a company may have up to 500 non-accredited investor shareholders and up to 2,000 total investors before it is required to register its securities under section 12(g).

Conclusion

Private markets remain robust in part because of the ease of compliance with Rules 506(b) and (c), and the adaptability of these rules to a wide variety of circumstances. The availability of private capital without the expense and ongoing reporting obligations of a public offering make private placements under Rules 506(b) and (c) the right solution for many companies.

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Bonnie leads the corporate securities practice at Cohen & Gresser and has over 30 years of experience as a corporate lawyer advising publicly and privately held companies and funds. Her practice focuses on securities law, capital markets, mergers and acquisitions, and executive compensation. Bonnie represents U.S. and internationally based companies, financial intermediaries, and investors in public and private offerings, including cross-border offerings and SPACs. She also regularly advises public companies and their boards of directors on public disclosure, SEC compliance matters, and corporate governance. She serves as counsel to companies and investment funds in early and later stage venture capital financing transactions and has significant experience in fund formation and investment. She regularly advises companies and executives on equity compensation issues.

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Owen is a partner in Cohen & Gresser's New York office. He advises companies, investors, and financial institutions on corporate, commercial, and regulatory matters across a range of technology-driven and highly regulated industries. His practice encompasses representation of both emerging and established businesses in the biotechnology and life sciences; communications and media; information technology, blockchain and digital assets; satellites and space; and venture capital and private equity sectors. Owen has extensive experience guiding clients through complex domestic and cross-border transactions, including mergers and acquisitions, private equity and venture capital investments, debt offerings of securitized bonds and debentures, including offerings qualified under the Trust Indenture Act, buyouts, divestitures, spin-offs, roll-ups, project and structured finance, joint ventures, and strategic collaborations. He also regularly advises on securities offerings, including private placements and SPAC transactions, as well as financial and strategic investments.