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Client Alert

Providing Strategic Legal Guidance to the Global Financial Services Industry

FINANCIAL SERVICES

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Considerations for Hybrid Rule 144A and 4(a)(2) Transactions

I. INTRODUCTION

Sophisticated investors in structured finance products are increasingly demonstrating an interest in entering the market via direct private placements pursuant to Section 4(a)(2) of the Securities Act of 1933, either in private placement offerings to a small group of investors without the a traditional offering memorandum and offering process or in private placements of certain classes of securities that are consummated concurrently with more broadly-offered "Rule 144A" private placements, which themselves may have a more traditional offering process.

Section 4(a)(2) provides an exemption from the Securities and Exchange Commission (SEC) requirement for registration for non-public offerings of securities and can be relied on by both public and private issuers. Rule 144A provides a safe harbor for the resale of securities purchased in a private placement to qualified institutional buyers or "QIBs".

While Rule 144A technically exempts resales, as opposed to initial issuances, the investor community often refers to "Rule 144A offerings", where securities are privately placed with "initial purchasers" (that is, quasi-underwriters) who then immediately resell the securities under Rule 144A, such that the transaction resembles a traditional underwriting, albeit with an investor audience restricted to QIBs and offshore investors.

Taken together, we have seen such issuers looking to raise such capital in three ways in recent months:

- a private placement pursuant to Section 4(a)(2) to a small cadre of investors;
- a "Rule 144A offering" to a larger group of investors with an orderly marketing process conducted by an "initial purchaser"; or
- a "Rule 144A offering" process with a concurrent Section 4(a)(2) private placement.

Concurrent Section 4(a)(2) placements alongside Rule 144A offerings allow issuers the opportunity to directly negotiate specific terms of specific

classes of securities with strategic investors and even "test the waters" with respect to certain features and asset classes, while still running a more broadly-marketed 144A process for the majority of the offering. Such 4(a)(2) investors may want to negotiate a separate class or series of securities with different rates or other protective terms relevant to such individual investor.

II. CONSIDERATIONS

Information Requirements

While the statutory information requirements for a Rule 144A offering are relatively manageable, because initial purchasers will generally require protections such as a lawyer's negative assurance letter and an auditor's comfort letter to establish a due diligence defense, Rule 144A offering documents tend to be nearly as extensive as registered offerings. In contrast, a Section 4(a)(2) private placement does not bear underwriter liability for the initial purchasers. As a result, a "pure" 4(a)(2) private placement can proceed without extensive development of offering documents and instead can rely on direct diligence by an interested investor, allowing an investor to tailor their diligence and information requests to their particular needs. In the case of a concurrent placement and more broadly marketed Rule 144A offering, negotiations with a 4(a)(2) investor can run in tandem with the development of the offering memorandum for a wider audience. Because it is incumbent on 4(a)(2) private placement investors to conduct their own diligence, much of the disclosure contained in a traditional 144A offering memorandum will be valuable to them and could cut down on the level of diligence materials typically requested for a 4(a)(2) offering—i.e. the provision of an offering document to both classes of investors could help satisfy the diligence needs of both.

Timing

Notwithstanding the potential diligence efficiencies created by providing 4(a)(2) investors with one or more versions of the Rule 144A offering memorandum, new investor entrants to the market may need additional time to review a particular transaction and to allow for negotiation and incorporation of an investor's comments into marketing materials prior to a formal launch of the transaction. Given this, the increase in the trend of utilizing pre-marketing processes can be useful to allow investor(s) the opportunity to provide feedback on the proposed terms prior to launch. Any pre-marketing materials generally should be provided to prospective investors confidentially pursuant to non-disclosure agreements in consideration of Rule 10b-5 and Regulation FD liability. With respect to Regulation FD in particular, consideration must be given to whether the information a public issuer discloses to investors under a non-disclosure agreement constitutes material non-public information. If so, the issuer must also publicly disclose or "cleanse" such information prior to releasing prospective investors from the restrictions of their non-disclosure agreement.

Initial Purchaser's Dual Role as Placement Agent

Transaction parties should consider whether one of the initial purchasers in the transaction will also act as a placement agent with respect to the 4(a)(2) private placement investors. A placement agent may wish to enter into a placement agency agreement with the issuer, setting forth the indemnification it will receive from the issuer, as well as certain representations and warranties made by the issuer to the placement agent, similar to those it would receive under a note purchase agreement in a 144A transaction. Alternatively, some placement agents are comfortable being made a third-party beneficiary of the note purchase agreement or subscription agreement entered into between the 4(a)(2) investors and the issuer. One benefit of this latter approach is that the placement agent can also avail itself of the typical 4(a)(2) "big boy" representations made by the 4(a)(2) investors without entering into a separate "big boy" letter, by which such representations can also be made separately to the placement agent. Regardless of the form of such protections, it is important that placement agents ensure that they receive the benefit of typical issuer representations, warranties and indemnities, as well as "big boy" representations from the applicable investors.

Counsel Representation – Separate and Designated

Lenders in a 4(a)(2) offering can choose to be represented by individual counsel, or the issuer and/or placement agent can arrange for a "designated" purchasers' counsel to advise all 4(a)(2) investors who wish to utilize such counsel's services. In the case of designated purchasers' counsel, such appointment may be made under a designated purchaser's letter with the issuer, such that the issuer pays the fees directly from the deal proceeds. It is important that the "designated" purchasers' counsel remain an independent advisor to the purchasers notwithstanding the fee arrangement. Sometimes—in particular, if there are investor-specific regulatory matters, for example—a 4(a)(2) purchaser will also want separate counsel to represent its interests alone, along with the engagement with the "designated" purchasers' counsel.

Sequencing of Pricing and Closing in Parallel 144A and 4(a)(2) Deals

If a Section 4(a)(2) private placement and more broadly marketed 144A offering proceed in parallel, it is relevant to consider when each should price and then close. While in a typical 4(a)(2) private placement, the note purchase agreement is entered into at the close of the transaction, if you have parallel transactions, ideally, the note purchase or subscription agreement for the 4(a)(2) transaction should be executed concurrently with the 144A note purchase agreement to minimize execution risk, with each then specifying the relevant (often simultaneous) closing and funding date. Otherwise, in the alternative, a note purchase or subscription agreement could be executed prior to the closing date and require that funds from the 4(a)(2) purchasers are held in escrow pending the Rule 144A closing.

III. CONCLUSION

The inclusion of 4(a)(2) investors in private securitizations, typically offered solely on a 144A basis, may be attractive to issuers as it offers additional liquidity. However, for a successful closing of the overall transaction, additional process concerns arising from a parallel 4(a)(2) deal should be addressed properly, and it is important to consider these and manage them as early as possible.