HAS THE NOTION OF "PRIVATE OFFERINGS" BEEN ABOLISHED BY THE PROSPECTUS REGULATION OF 14 JUNE 2017?[1]

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Abstract

Has the notion of "private offering" been abolished in the EU by the Prospectus Regulation of 14 June 2017? Has a change of this magnitude been made in such a subtle manner that it escaped the attention of commentators? These questions can be seriously raised in view of the upheaval that the new European provisions on the prospectus will cause in many Member States, such as France, where the 2003 Prospectus Directive was understood as drawing a distinction between a public offering, either subject to or exempted from the prospectus requirement, and a private offering, falling outside the scope of this prospectus requirement. Indeed, the 2017 Prospectus Regulation essentially removes this distinction in matters of securities and explicitly characterises transactions formerly analysed as private offerings as public offerings benefiting from a prospectus "exemption".

This paper offers a critical analysis of such an over-extensive conception of a "public offering" of securities, which voids this fundamental distinction of its substance in financial regulation and in company law, and underlines its impact in the field of prospectus regulation and its adverse collateral effects elsewhere.

1. Prima facie, the question raised appears provocative. It even seems incongruous for it is hard to imagine that a change of such magnitude could be made in a subtle manner and escape the attention of commentators. Moreover, an affirmative answer would be surprising: not only both in its revolutionary character, in that it would undermine well-established notions used by

[1] This is a non-official translation of an article that was published in French in the Bulletin Joly Bourse 01/01/2018 – n°1 – Page 60.

practitioners; and by its paradoxical nature in that it would seem to directly contradict one of the objectives and one of the key strands of "Prospectus Regulation" No. 2017/1129 of 14 June 2017, namely an increase in the number of situations in which a company is not obliged to publish a prospectus, which is intended to facilitate the financing of companies. In particular, from 21 July 2018 Articles 1 (3) and 3 (2) of the Regulation raise the threshold annual offering size for which a prospectus is required from €100,000 to €1 million, or, at the discretion of each Member State to any amount between €1 million and €8 million, instead of €5 million.

2. However, attentive readers of the new European rules, putting aside their initial astonishment, accept the reality and acknowledge, as a matter of principle, the inclusion of private placements into a new notion of public offering, which has become, as a result of the Regulation, extremely broad if not totalitarian. The fact that the notion of a private placement is not referenced in the Regulation is not the sole evidence. In the 2003 Prospectus Directive, private placements were barely noted, although they could be identified in its fifth recital. The substitution, as radical as it may be, arises implicitly. It results mainly from the removal of the distinction that could be inferred from the Prospectus Directive between, on the one hand, the non-application of the Prospectus Directive (i.e., the obligation to publish a prospectus for certain "categories of offers") and, on the other hand, the exemption from the obligation to publish a prospectus for certain "offers to the public".

3. This distinction appears to be based on the very nature of things. Indeed, either an offer is not deemed to be a "public offering", in which case the prospectus requirement is irrelevant because this requirement expressly applies only to a public offering, or an offer is deemed a "public offering", in which case a prospectus is relevant and required, unless special "exemptions" apply.

Thus, Article 1 of the Prospectus Directive provides that it does not apply to "offers" in Member States of securities for a total amount of less than €5 million, calculated over a period of twelve months; and, Article 3 provides that a prospectus is not required for "offers" of securities (i) intended solely for "qualified investors", (ii) to fewer than 150 persons, (iii) to investors acquiring securities for a total amount of at least €100,000, and/or offers of securities of a nominal unit value at least equal to €100,000. Moreover, an issuer may still draw up a prospectus in accordance with the Prospectus Directive when securities are "offered to the public".

In contrast, Article 4 provides for "exemptions", from the obligation to publish a prospectus for "offers to the public" of certain categories of securities, such as shares issued in exchange for pre-existing shares of the same class, securities offered in connection with a takeover by means of an exchange offer, shares allotted in connection with a merger, a dividend payment, and shares offered to a company's directors or employees.

4. Although the Prospectus Directive does not explicitly use the term "private offerings" or "private placements" to describe the offers listed in Articles 1 and 3, such a characterisation is

induced by the differentiation from offers to the public listed in Article 4. Indeed, in principle, both types of offers are antithetical[2].

However, it is true that the Directive's drafting creates some ambiguity, potentially allowing for another interpretation. Indeed, it could be argued that the non-application of the obligation to publish a prospectus to certain categories of "offers" provided in Article 3 (2) is not justified by their private nature, but reflects instead the intention of the lawmaker to have such offers exempted for reasons of expediency. Some Member States appear more favourable to this interpretation, especially in the United Kingdom, where the types of offers referred to in Article 3 (2) of the Prospectus Directive are referred to as "exempt offers to the public" in Section 86 of the Financial Services and Markets Act 2000 (which implements the Article 3(2) of the Prospectus Directive in the UK), and potentially also in Luxembourg[3] and Sweden.

Nevertheless, if this interpretation were indeed in line with the Commission's original intentions, the least that can be said is that given its counter-intuitive character, it would have been preferable for it to be exposed and expressed in clearer terms, in order to avoid Member States, such as France, Germany, Italy, Spain, Belgium and Portugal[4], which have sought to maintain a genuine distinction between public offerings and private placements, from being accused of incompatibility with the European provisions.

In this regard, French law is more explicit, having codified the distinction hitherto in force between "public offerings" and "non-public offerings" for almost 15 years, without any conflict with the Prospectus Directive having been, to our knowledge, invoked. Thus, while the mere prospectus exemptions concerning public offerings are included in the AMF General Regulation, the French Monetary and Financial Code strongly consecrates the *summa divisio* between public and non-public offerings, by stating, in Article L. 411-1, what constitutes a "public offering" of securities and specifying, in Article L. 411-2, what "does not constitute a public offering", a category in which we find the cases that are not considered to be offers to the public by the Directive. The distinction is clear and instructive. It was introduced during the codification of the subject by Order No. 2000-1223 of 14 December 2000, in order to dispel the ambiguity of the earlier drafting of the law, of 2 July 1998, which appeared to present the cases of private placements less as explanations or negative illustrations of public offerings –

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[2] A. Pietrancosta, *The "public offering of securities" concept in the new prospectus directive"*, in G. Ferrarini and E. Wymeersch (eds.), *Investor Protection in Europe*, Oxford, 2006, p. 339.

[3] See the law of 10 July 2005 transposing the Prospectus Directive and CSSF Circular 05/225.

[4] In German law, a private placement is not considered as an offer to the public either, cf. A. Heidelbach, in: E. Schwark and D. Zimmer (eds.), Kapitalmarktrechts-Kommentar, § 2 WpPG paragraph 21; *adde*, K. Müller-Eising and T. Stoll, Equity capital markets in Germany: regulatory overview, A Q&A guide to equity capital markets law in Germany, 2015. The solution also seems to prevail in Spanish law, v. B. Gómez de Zayas, T. Mínguez and G. Oliete, Capital Markets: Spain, https://uk.practicallaw.thomsonreuters.com/3-523-1819; in Belgian law, T. L'Homme, A. Coibion, G. Nejman and I. Brouwers, Equity capital markets in Belgium: regulatory overview, https://uk.practicallaw.thomsonreuters.com/0-504-9628; in Italian law, S. Bianchi and P. Carlotti, Private mergers and acquisitions in Italy: overview, https://uk.practicallaw.thomsonreuters.com/w-006-4365 ; in Portuguese law, D. Ribeiro Duarte and P. Capitão Barbosa, Private equity in Portugal: market and regulatory overview, A Q&A guide to private equity law in Portugal, 2017.

at the time, referred to as "*appels publics à l'épargne*" –, which they were intended to be, rather than exemptions to a principle.

5. However, it is to exactly this outcome that the Prospectus Regulation of 2017 rather bizarrely brings us. It essentially discards, in matters of securities, any potential distinction between private offerings and exempted public offerings, explicitly assimilating the former to the latter. The Prospectus Regulation of 2017 provides:

- in Article 1 (3), that the Regulation does not apply to a "public offering" of securities with a total amount in the European Union which is less than €1 million;

- in Article 1 (4), that the obligation to publish a prospectus does not apply to the following types of "public offering" of securities, which include not only the old cases of waivers provided for in the Directive but also the cases of this obligation in the event of "offers" which are not intrinsically public, namely those intended for "qualified investors" only, to less than 150 persons, to investors acquiring these securities for an overall amount of at least €100,000, and/or offers of securities of a nominal unit value at least equal to €100,000.

Recitals (12), (13), (20) and (25) of the Regulation demonstrate that the removal of the existing distinction is not the result of an error, but rather stems from the spirit of a system which assumes, as a general principle, that any offer of securities is made to the public and that the non-applicability of the obligation to publish a prospectus may, therefore, only result from a legal exception. And while the distinction seems to be re-appear from recital (22) of the Regulation, which rejects the use of the term "public offering" for certain allotments of securities not based on an individual choice of recipients, this exclusion actually appears to be based on the absence of any "offer", which implies decision-making on the part of the beneficiaries, and not on the lack of an offer "to the public". An argument may also be drawn, in support of the new globalising conception of the public offering, that the ability of an issuer to draw up a prospectus on a voluntary basis, provided for in section 4 of the Regulation, is no longer expressly dependent on the "public" nature of the offer.

6. The interpretation of these new provisions leads to the question of whether there remain any limits on the scope of public offerings. Indeed, if offering securities to a very small number of persons or a few qualified investors is no longer sufficient to be excluded from the category of public offering, it is perfectly legitimate to question the survival of the very concept of private offerings. Such an extension would be conceivable for certain types of so-called private placements only based on their overall amount, irrespective of the number, characteristics of the recipients or the use of publicity. However, describing an offer intended solely for a "restricted" group of investors as "public" is a contradiction in terms and contributes to this artifice. The notion of "private placements", still referred to by the draft reform of the European

provisions presented by the Commission on 20 September 2017[5], is therefore only an unnatural species of public offerings.

7. By a mirror effect, the notion of public offering is itself challenged as a category, since its excessive dilution strips it off any distinctive content. Its positive definition in Article 2 (d) of the Regulation is of little help in seeing any *"communication in any form and by any means whatsoever to persons and with sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide whether to purchase or subscribe to these securities."* In practice, it is quite difficult to conceive of any offer of securities which does not resemble such a *"communication"*, which the text leads us to understand *lato sensu*[6], subject to the exceptional reserve of offers, in order to repeat the wording used by the Court of Luxembourg in a case relating to an enforcement proceeding, that *"are not intended to participate in an economic activity on the securities market"*[7]. At least, the plural form used by the European text to refer to the "persons" receiving the offer seems to exclude an offer made to a single person, or even to a single entity. In French law, it is noted that, in order to formulate exclusions from the category of offers to the public based on the quality or the number of recipients, Article L. 411-2 of the French Monetary and Financial Code also mentions the plural, by targeting offers to "persons" providing the third-party portfolio management investment service, to "qualified investors" or to a "limited circle of investors", which would suggest that offers addressed to a single person are, by sole virtue of Article L. 411-1 of the French Monetary and Financial Code, inaccessible to the qualification of public offering.

8. Thus far, and as we have stated[8], the uncertainty resulting from an imprecise definition of public offerings could be alleviated by an examination of the express exclusions from the obligation to produce a prospectus. However, this reassurance necessarily implies the exclusion of the private placement characterisation as a public offering merely exempted from a prospectus requirement and its recognition as an autonomous and symmetrical concept of the public offering. This interpretation is therefore no longer true when the Regulation does not exempt from a prospectus an offer for the reason that it is not intended for the public but for the reason that it simply falls into one of the cases of exemptions stated by the text. This way

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[5] Recital (56) of the "*Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 1093/2010 establishing a European Supervisory Authority (European Banking Authority); Regulation (EU) No 1094/2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority); Regulation (EU) No 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority); Regulation (EU) No 345/2013 on European venture capital funds; Regulation (EU) No 346/2013 on European social entrepreneurship funds; Regulation (EU) No 600/2014 on markets in financial instruments; Regulation (EU) 2015/760 on European long-term investment funds; Regulation (EU) 2016/1011 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds; and Regulation (EU) 2017/1129 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market*;"

[6] See, in this respect, the interpretation adopted by the aforementioned Luxembourg Circular CSSF 05/225, ruling out any possible distinction between public and private communication.

[7] CJUE 14 September 2014 aff. 441/12, 2e ch. ; Droit des sociétés, no. 11, Nov. 2014, comm. 170, S. Torck.

[8] A. Pietrancosta, Offre au public de titres financiers et admission aux négociations sur un marché, Dict. Joly Sociétés, 2017, n° 080.

of proceeding by exception tends to emphasize, by an *a contrario* interpretation, that the two transactions are not essentially distinguishable and that, as a consequence, the "qualified investors" or the individuals closely related to the issuers are indeed part of the "public".

Such a totalizing interpretation of the public offering notion would also undermine another proposal put forward to reject the inclination to an *a contrario* interpretation of Article L. 411-2 of the French Monetary and Financial Code to the extent that such an interpretation would not lead to the recognition of a freedom but to the imposition of a set of constraints. A liberal interpretation of the European and French provisions made it possible to consider these different cases of exemptions as mere safe harbours, consisting of setting precise conditions that an issuer only needs to satisfy in order to benefit from the legal exemption, while preserving for the latter the possibility to demonstrate in other circumstances the absence of an offer "to the public"[9]. Such an articulation would correspond to the applicable regime in the United States, where regulations and case law have established the notion of "non-public offerings"[10], conferred on it a substantial content, distinguished these from "public offerings", including "exempt public offerings", and secured them with safe harbours[11]. As exemptions from prospectus are, by the terms of the European Regulation, almost exclusively based on "derogations", it becomes difficult to continue to claim that these exclusion cases do not exhaust all conceivable situations of restricted or closed placement.

9. The obliteration of the distinction between private and exempted public offerings, as well as, more fundamentally, the introduction of a very broad notion of public offering, introduces a notional confusion. In terms of principles, it weakens a legislative, regulatory and doctrinal block that was thought to be stabilized. It denies the existence of private offerings as a legitimate, independent concept. Private offerings are henceforth automatically labelled 'public' and submitted to the obligation to publish a prospectus, unless they can benefit from an exemption.

The inversion of logic should not be neutral in the field of interpretation because, as everyone knows, provisions protecting a freedom are not interpreted with the same rigour as those setting out exceptions to a principle. It is therefore surprising that, to the best of our knowledge, this reform of the Prospectus system has not given rise to any particular discussion or public explanation to help understand its justification. Such justification could be found in the attempt to further harmonise the legislations of Member States which, as we observed earlier, do not all enforce a clear distinction between public and private offerings. However, a harmonisation of the European rules following a model mostly prevailing in the UK would, in times of Brexit, prove to be quite paradoxical. Why deconstruct standards that have been integrated after more than a decade by market players and expose European law to a risk of misunderstanding and

[9] A. Pietrancosta, Offre au public de titres financiers et admission aux négociations sur un marché, Dict. Joly Sociétés, 2017, n° 100.

[10] Not. Section 4 (a) of the Securities Act of 1933, which removes the obligation to register with the SEC and the obligation to publish a prospectus in the case of *"transactions by an issuer not involving any public offering*".

[11] T. L. Hazen, The Law of Securities Regulation, West Academic, 7th edition, 2017, p. 158 and s.

being singled out at international financial level? The coherence of the intellectual construction that has been built until now in the terminology will disappear in a simplistic alternative: prospectus exemption or not.

10. From a practical point of view, as has just been mentioned, it will give rise to difficulties of interpretation and increase the level of legal uncertainty, running counter to the efforts made thus far in this area. Will it be argued that the Regulation has not completely buried the notion of non-public offers but simply thought it useful to specify cases of offers to the public quantitatively limited in number of recipients or amounts? Such a constructive interpretation would raise border disputes. Issuers of financial securities will have to carry out a careful review of the authorization voted or proposed during Annual General Meetings of Shareholders, to ensure their compatibility with the extension of the notion of public offering to the detriment of private placement.

11. Special attention should be drawn to the considerable collateral effects that this extreme dilution of the notion of public offerings entails. Thus, in French law, the distinction between offers to the public and non- public offerings articulated in Articles L. 411-1 and L. 411-2 will inevitably disappear by 21 July 2019 in the field covered by the European Regulation, under the principle of direct application. But, outside this field, the question arises whether or not to refer to it to define the notion of public offering, omnipresent in our law. There is a long list of occurrences of the expression within the French Monetary and Financial Code, which uses it in particular – most often without reference to Article L. 411-1 – to prohibit or authorize the public offering of negotiable debt securities, certificates of deposit, financial securities, financial instruments or shares, or to define the scope of the French Financial Markets Authority's competencies, consisting, according to Article L. 621-1, of protecting the savings invested in financial instruments giving rise to a "public offering" and all other investments "offered to the public". The same holds true in civil or commercial law, which refers to the concept of public offerings to attach various legal consequences, independent of the obligation to draw up a prospectus, whether it is the Article 1841 of the French Civil Code prohibiting private companies from offering their shares to the public, Article L. 223-11 of the French Commercial Code authorizing SARLs to issue bonds only privately, Articles L. 225-2 et seq of the French Commercial Code on the founding of stock corporations with or without a public offer, Article L. 225-136 of the French Commercial Code on the issuance of equity securities without preferential subscription rights, Article L. 225-145 of the French Commercial Code on the back stopping of the share issuances, Article L. 227-2 of the French Commercial Code prohibiting an SAS from making a public offering of its securities, or certain aggravating penal provisions in the event of public offerings (Article L. 242-1, L. 242-17, 244-3).

It is remarkably easy to see how this would constitute a legal earthquake in these areas, where the notion of public offering is often understood as in the context of the Prospectus Regulation. Such an extension would defy common sense. It would result in the generalisation of special mandatory provisions and their application to purely private operations against all logic and higher principles of our legal order. Can one imagine the virtual suppression of the "private"

setting of a corporation; the virtual prohibition for any entity not expressly authorized to offer its titles “to the public”, to “offer” them at all, including in the most private circle; or the extension of the mission assigned to the AMF to almost all offerings of financial instruments, regardless of the number and quality of the recipients?

Clearly, the excessively broad understanding of the notion of public offerings in the Prospectus Regulation should lead to its disqualification as a general notion of reference. It should, on the contrary, result in the reconsideration of the various hypotheses envisaged and lead, in most cases, to the misalignment of the notions. One wonders whether it would be wise to avoid retaining an identity of expressions, unlike British law[12] but following the example of Luxembourg law[13], and to establish at national level a notion endowed with truly operational content. In France, will this lead to a resurrection of the operation – if not the status – of “*appel public à l’épargne*”, whose content could be inspired by the criteria currently set forth in Articles L. 411-1 and L. 411-2 of the Monetary and Financial Code, which would thus survive the amputation of the prospectus portion of their scope? This revenge of a notion that the legislator had intended to eradicate in 2009 would not fail to spike. Given the importance of what is at stake, it is urgent for the national legislative bodies to make the necessary amendments before the full application of the Regulation in July 2019, with doctrine taking hold of the subject to contribute to the analytical process.

[12] Regarding the ban on a private company offering its shares to the public, see Section 756 of the Companies Act which defines what is meant by "offer to the public" and is working to clarify the types of non-tender offers to the public.

[13] See in company law, which uses the terms "public subscription" and "public issue" exclusively.