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Private Equity Websites and General Solicitations: A Case of Overzealous Hypersensitivity?

It's a well-settled law of physics: for every action, there's a reaction. In some cases, there's overreaction – generally best avoided, but a phenomenon to which many private equity funds may have fallen victim. Here, we examine ways that private funds can utilize their websites and generally market themselves to facilitate acquisition deal flow, without compromising capital-raising activities or running afoul of SEC regulations that prohibit "conditioning the market" for future capital raises.

As a result of the passage of Dodd-Frank, private equity managers have become subject to SEC registration and periodic examination. With the SEC's laser focused on the private equity industry, funds may have overreacted by abandoning legitimate marketing techniques; scrubbing their websites of differentiating factors that could legitimately spur deal flow; omitting useful and relevant information when publicizing the sale of a portfolio company, including the internal rate of return on the transaction; and generally conducting their marketing affairs more timidly than necessary, particularly when considering long-standing SEC advice concerning the capital-raising activities of operating companies generally. While specific SEC guidance taking into account the nature of the private equity industry would be most welcome, private equity should not abandon their long-standing marketing practices while awaiting such guidance.

Like a bridge that takes three years to paint and needs painting every three years, private equity funds tend to raise capital on an ongoing basis, a function of the five prongs of PE activity: raising investment capital through private placements, acquiring platform businesses, acquiring add-on businesses and integrating them into platform companies, growing the profitability of their platform companies, and selling their platform companies at robust multiples, often higher than the multiples at which the businesses were acquired. Frequently, after four or so years, a fund will have invested substantially all of its capital, necessitating the need to begin the cycle again while still engaging in activities related to the other four prongs.

PE funds raise capital by privately soliciting sophisticated investors – individuals with at least $5 million in investments and institutions with at least $25 million of investments – with which it or its placement agent has a preexisting relationship. General solicitations or general advertising are prohibited. What constitutes general solicitation or general advertising, however, is often murky. Generally, any advertisement or article published in a newspaper, magazine or broadcast over the airwaves constitutes a prohibited general solicitation because it tends to condition the market for sales at the time or in the near future. Similarly, a seminar with attendees who have been invited through a mass email can also be a general solicitation.

Funds want to trumpet their successes to enhance acquisition deal flow, but they need to observe conditioning-the-market regulations – a natural tension involving competing interests. The stakes are high because funds compete with each other for both capital and companies to acquire, but they want to avoid running afoul of the regulations. Funds often have similar investment philosophies and investment criteria. Just as private equity seeks to acquire businesses that have experienced substantial growth and that are leaders in their market, sellers and management groups seek to partner with private equity organizations that have successful track records of portfolio company exits and whose growth patterns are also on an upward trajectory. Just as a public company is allowed to issue press releases disclosing new commercial contracts and other commercial developments even when the company is contemplating a public offering or is "in registration," so too should a private equity fund be able to disclose a successful portfolio company exit, the historical size of successive funds or the closing of subsequent capital raises.

What to do

So how can funds differentiate themselves from competitors, particularly with respect to their track records in acquiring and selling portfolio companies, while being circumspect enough to pass muster with the law?

- Make owners and management of potential acquisition targets aware of your fund's activities, including the successful sale of a portfolio company, the historical sizes of successive funds and the closing of subsequent capital raises. But do so for a limited period of time and only through the use of a password-protected portal on your website.

- Press releases announcing the sale of a portfolio company should be consistent as to form and content. If the internal rate of return is disclosed when announcing a successful sale, it should be announced on all sales. In addition, the methodology used for calculating the internal rate of return should not vary.

- PE principals should continue to attend industry conferences where attendees are invited by mass emails, even if they are seeking to raise capital. At such times, however, PE personnel should not speak about their capital-raising activities.

- PE personnel who speak regularly to reporters about general industry developments of specific portfolio companies should avoid on-the-record, for-attribution discussions while in fundraising mode. They should avoid at all times discussing with the press ongoing fundraising activity specific to their fund.

- A compliance officer should monitor a PE firm's website regularly. When significant changes to the website are contemplated, outside counsel should be consulted. Funds should retain earlier iterations of their websites to produce, if necessary, what the site disclosed at any time.

When raising capital – and, as mentioned earlier, that is most of the time – funds should:

- ensure that solicitation materials include appropriate disclaimers and are available only through a password-protected portal, where potential investors have established their qualifications;

- keep records of who has received copies of solicitation materials. All printed material should contain watermarks identifying the date printed and the recipient of the hard copy, in order to demonstrate if necessary that only qualified prospects received them;

- closely monitor the activities of agents or representatives assisting in the raise, and avoid unregistered finders;

- consult with outside counsel to craft disclosures pertaining to its track record.

Finally, private equity funds should carefully consider whether to take advantage of the JOBS Act, which permits general solicitations when all investors are accredited investors and "reasonable steps" are taken to verify that all investors are accredited. Doing so raises a myriad of concerns including privacy issues triggered by the receipt of backup information to verify accredited investor status, the extent to which solicitation materials are required to be filed with the SEC, and whether engaging in a general solicitation would jeopardize fundraising activities in other jurisdictions. To date, private equity firms have not sought to incorporate general solicitations in their fundraising activities.

Prudence is always warranted, but a private equity fund's survival depends on successful marketing. So PE funds should announce those successful sales of portfolio companies, just as they always did, as well as other favorable news, even when they are raising money. React to Dodd-Frank and the SEC, but don't overreact.

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