

PRIVATE FIRMS AND THEIR EXECUTIVES FACE SECURITIES EXPOSURES

ISSUE

Directors and officers at some private companies are *rightly concerned* about their potential U.S. securities exposures:

- Private companies that acquire public companies may run afoul of the securities laws in doing so (even though they are private).
- Those planning or considering a potential initial public offering (IPO) will be particularly sensitive to their public statements and positions during what may be the pre-offering stage; this may be especially on point for tech and new media firms.
- From a risk profile perspective, we often consider whether or not the private firm really *acts like* a public company in using some combination of stock or the proceeding from debt offerings to fund growth and acquisitions; these firms and their executives are likely to have securities exposures – both personally and organizationally.
- They may already have public securities filing requirements: firms with more than \$10 million in assets whose securities are held by more than 500 owners must file annual and

other periodic reports which are then available to the public through the SEC's EDGAR database.¹

- While “sales” of your securities to employees as a part of compensation can be exempt from securities filing requirements² if this exceeds \$5 million in value during a 12-month period, you'll need to provide limited disclosure documents to your employees.³

IMPACT

For some larger private firms, employees and others who hold the company's private or restricted shares may seek to trade or liquidate them, increasing the likelihood that these transactional exposures become real exposures.

- Recently, a number of new exchanges have popped up to facilitate these trades in private company shares.
- In at least one instance, a special purpose vehicle will be used to pool the private shares in a manner that would allow potentially *thousands* to invest while still keeping the investor count below the 500 that would trigger public reporting.⁴
- Following the money: one new exchange estimated it will execute \$400 million in trades for just 40 private firms in 2010, a fourfold increase year over year. With today's heightened enforcement prism, this almost *has to mean* formal scrutiny in some fashion.⁵
- This clearly includes the potential for securities enforcement actions (see “Stock Trading in Private Companies Draws S.E.C. Scrutiny”).⁶
- Those trading/accumulating private company shares are often sophisticated investors that are all too familiar with D&O litigation if their investment suffers.



ACTION

- Savvy private firms are conscious of this very real potential and are adjusting their internal compliance and governance structures to look more like their public company counterparts, post-Sarbanes-Oxley and Dodd-Frank.
- While looking to the strength of their organization's integrity, many are also considering their corporate executive indemnification provisions, compensation strategies and confidentiality provisions protecting their intellectual capital.
- They are also adjusting their Directors & Officers (D&O) liability insurance programs and limits of coverage accordingly.

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¹ From the SEC website: Corporate Reporting <http://www.sec.gov/about/whatwedo.shtml#laws>.

² You can sell at least \$1,000,000 of securities under this exemption, no matter how small the firm. You can sell even more if you satisfy certain formulas based on your company's assets or on the number of its outstanding securities (Exemption for Sales of Securities through Employee Benefit Plans – Rule 701). Note that this exemption is available only to companies that are not subject to Exchange Act reporting requirements. Source: Q&A: Small Business and the SEC, “A guide to help you understand how to raise capital and comply with the federal securities laws” <http://sec.gov/info/smallbus/qasbsec.htm#eod6>.

³ Please note that there are additional exceptions to the sale or issuance of stock by private companies, but the two discussed here may be the most prevalent.

⁴ “Goldman Sachs Facebook Deal Making A ‘Mockery’ of the SEC?” The Huffington Post, 01.04.11.

⁵ <http://www.adotas.com/2010/12/sec-pokes-nose-in-private-company-trading/>.

⁶ As reported in The New York Times DealBook on December 28, 2010, the Securities and Exchange Commission requested information from four private companies.