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SEC amends rules to facilitate capital-raising under the exempt offering framework

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The U.S. Securities and Exchange Commission (SEC) recently adopted amendments[1] intended to harmonize, simplify, and improve the rules governing exempt offerings under the Securities Act of 1933 (Securities Act), which have grown increasingly complex to navigate—particularly in the last decade as the number of exemptions available to small and mid-sized businesses has increased. The amendments, which follow the SEC's June 2019 concept release on harmonization of the securities offering exemptions[2] and the March 2020 proposing release,[3] do not effect a major restructuring of the current framework but do, according to outgoing SEC Chairman Jay Clayton, address various "frictions and inefficiencies" under the current "patchwork system" of registration exemptions and safe harbors and provide "a more rational framework" aimed at facilitating capital formation for small and medium-sized businesses and benefiting investors in such offerings.[4]

The amendments adopted by the SEC address the following:

- **Integration of offerings**—the amendments establish a new, principles-based framework for analyzing whether two or more separate offerings conducted in the same general timeframe should be viewed as a single offering ("integrated") for purposes of determining the availability of an exemption from the registration requirements of the Securities Act, and provide four non-exclusive safe harbors against a finding of integration.
- **Offering communications and general solicitation**—the amendments broaden and clarify the availability of "test-the-waters" communications in the context of exempt offerings and permit certain "demo day" communications to not be deemed general

[1] See SEC Release No. 33-10844, Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets (Nov. 2, 2020)(the "Adopting Release").

[2] See SEC Release No. 33-10649, Concept Release on Harmonization of Securities Offering Exemptions (Jun. 8, 2019).

[3] See SEC Release No. 33-10763, Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets (Mar. 4, 2020).

[4] See SEC Press Release, SEC Harmonizes and Improves "Patchwork" Exempt Offering Framework (Nov. 2, 2020).

solicitation or general advertising, hallmarks of public offerings that often require registration, subject to specific conditions and procedural requirements.

- **Disclosure and eligibility requirements and bad actor disqualification provisions**—the amendments simplify and streamline certain eligibility and disclosure requirements applicable to various types of offerings, including those conducted pursuant to exemptions under Regulation D (the basis for most private offerings), Regulation A, and Regulation Crowdfunding and also harmonize the "bad actor" disqualification provisions applicable to such exemptions.
- **Increased offering and investment limits for certain types of offerings**—the amendments raise the offering limits applicable to Regulation A, Regulation Crowdfunding, and Regulation D Rule 504 offerings and also revise certain individual investment limits for offerings under Regulation A and Regulation Crowdfunding.

This Alert focuses primarily on the amendments relating to integration and those likely to be of greatest interest to companies conducting or contemplating exempt offerings under Section 4(a)(2) of the Securities Act, Rule 506 under Regulation D or Regulation S.

Integration of offerings

The Securities Act requires that every offer and sale of securities be registered with the SEC unless an exemption from registration is available. Integration analysis is necessary whenever a company conducts an exempt securities offering concurrently with, or in close proximity to, another securities offering. That analysis, which has evolved over the years based on a combination of SEC rules and interpretative guidance and Staff interpretations, focuses on assessing the particular facts and circumstances of the offerings based on five factors the SEC considers indicative of whether the offerings are actually separate or instead part of a single offering. In the event offerings are integrated, the entire combined offering would be required to comply with the requirements of a common exemption from registration. Integration analysis under this traditional five-factor test and related guidance often involves complex judgments within uncertain and subjective contours. Additionally, in recent years the SEC adopted various safe harbors applicable only to specific exemptions.

The amendments codify certain interpretative guidance and replace the prevailing five-factor test and exemption-specific safe harbors with a new, simplified framework applicable to all exempt offerings which includes a set of four non-exclusive safe harbors intended to facilitate compliance and provide additional clarity in the commonly arising situations addressed by those safe harbors, as well as guiding principles for a factual analysis in situations where the safe harbors are not applicable. The new integration framework is summarized below.

New Rule 152 — General integration principles

New Rule 152(a) under the Securities Act sets forth a general principle: if the safe harbors in Rule 152(b) do not apply, in determining whether two or more offerings by an issuer are to be treated as one for the purpose of registration or qualifying for an exemption from registration under the Securities Act, offers and sales will not be integrated if, based on the particular facts and circumstances, the issuer can establish that each offering either complies with the registration requirements of the Securities Act or qualifies for an exemption from registration. In light of the objectives and policies underlying the Securities Act, however, the introductory language to amended Rule 152 makes clear that the provisions of the rule will not have the effect of avoiding

integration for any transaction or series of transactions that, although in technical compliance with the rule, is part of a plan or scheme to evade the registration requirements of the Securities Act.

New Rule 152(a) further addresses the application of the general principle in the following scenarios:

- **Rule 152(a)(1):** ***In the context of an exempt offering prohibiting general solicitation***, the issuer must have a reasonable belief, based on the facts and circumstances, with respect to each purchaser in that offering, that the issuer (or any person acting on the issuer's behalf) either (i) did not solicit such purchaser through the use of general solicitation or (ii) established a substantive relationship with such purchaser prior to the commencement of that offering.

  Under this principle, an issuer may conduct concurrent offerings under Rule 506(b) and Rule 506(c) of Regulation D, or any other combination of concurrent offerings involving an offering prohibiting general solicitation on the one hand and another offering permitting general solicitation, on the other hand, without integration concerns, so long as the provisions of Rule 152(a)(1) and all other conditions of the applicable exemptions are satisfied. Additionally, the SEC confirms in the Adopting Release that the existence of a pre-existing substantive relationship prior to the commencement of an offering is one means, but not the exclusive means, of demonstrating the absence of a general solicitation in a Regulation D offering.

  In the Adopting Release, the SEC reiterates its previous guidance indicating that (i) a "substantive" relationship is one in which the issuer (or a person acting on its behalf, such as a registered broker-dealer or investment adviser) has sufficient information to evaluate, and does, in fact, evaluate, an offeree's financial circumstances and sophistication, in determining his or her status as an accredited or sophisticated investor and (ii) investors with whom the issuer has a pre-existing substantive relationship may include the issuer's existing or prior investors, investors in prior deals of the issuer's management, friends or family of the issuer's control persons, or customers of a registered broker-dealer or investment adviser with whom the broker-dealer or investment adviser established a substantive relationship prior to the participation in the exempt offering by the broker-dealer or investment adviser.

- **Rule 152(a)(2):** ***In the context of concurrent exempt offerings that each allow general solicitation***, in addition to satisfying the requirements of the particular exemption relied on, general solicitation offering materials for one offering that include information about the material terms of a concurrent offering under another exemption may constitute an offer of the securities in such other offering, and therefore the offer must comply with all the requirements for, and restrictions on, offers under the exemption being relied on for such other offering, including any legend requirements and communications restrictions.

  Under this principle, an issuer may conduct concurrent offerings under Rule 506(c) of Regulation D and Regulation A or Regulation Crowdfunding without integration concerns, so long as the provisions of Rule 152(a)(2) and all other conditions of each of the applicable exemptions are satisfied.

New Rule 152 — Integration safe harbors

New Rule 152(b) under the Securities Act provides four non-exclusive safe harbors applicable to all securities offerings under the Securities Act, including registered and exempt offerings.

- **30-day safe harbor (Rule 152(b)(1))**: Any offering made more than 30 calendar days before the commencement of any other offering, or more than 30 calendar days after the termination or completion of any other offering, will not be integrated with the other offering(s); provided that, in the case where an exempt offering for which general solicitation is prohibited (such as an offering pursuant to Rule 506(b)) follows by 30 calendar days or more an offering that allows general solicitation (such as an offering pursuant to Rule 506(c)), the provisions of Rule 152(a)(1) will apply—meaning that, in that context, the issuer must have a reasonable belief, based on the facts and circumstances, with respect to each purchaser in the exempt offering prohibiting general solicitation, that the issuer (or any person acting on the issuer's behalf) either did not solicit that purchaser through the use of general solicitation or established a substantive relationship with that purchaser prior to the commencement of the exempt offering prohibiting general solicitation.

  This new 30-day safe harbor replaces the six-month safe harbor currently provided under Rule 502(a) of Regulation D, as well as rules applicable to various other exemptions. In order to protect against a significant increase in non-accredited investor participation in serial Rule 506(b) offerings by a single issuer, however, the amendments also revise Rule 506(b) to limit the number of non-accredited investors purchasing in Rule 506(b) offerings to no more than 35 within a 90 calendar day period.

- **Rule 701 and Regulation S safe harbor (Rule 152(b)(2))**: Offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan, or in compliance with Regulation S will not be integrated with other offerings, regardless of timing.

- **Subsequent registered offerings safe harbor (Rule 152(b)(3))**: An offering for which a Securities Act registration statement has been filed will not be integrated if it is made subsequent to:

  - a terminated or completed offering for which general solicitation is not permitted;
  - a terminated or completed offering for which general solicitation is permitted that was made only to qualified institutional buyers (QIBs) and institutional accredited investors (IAIs) (as defined under Rule 144(a)(1) and Rule 501, respectively); or
  - an offering for which general solicitation is permitted that terminated or completed more than 30 calendar days prior to the commencement of the registered offering.

  This safe harbor replaces the safe harbors currently provided under Rules 152 and 155 under the Securities Act.

- **Subsequent exempt offerings permitting general solicitation safe harbor (Rule 152(b)(4))**: Offers and sales made in reliance on an exemption for which general solicitation is permitted (such as Rule 506(c)) will not be integrated if made subsequent to any terminated or completed offering. The SEC indicates in the Adopting Release that the use of general solicitation in reliance on Rule 506(c) will not affect the exempt status of prior offers and sales of securities made in reliance on Rule 506(b), and that it is also not

necessary for an issuer to use different offering materials for offerings that rely on different exemptions, so long as the issuer satisfies the disclosure and other requirements of each applicable exemption.

New Rule 152 — Commencement, termination, or completion of an offering

New Rule 152(c) provides a non-exclusive list of factors to consider in determining when an offering has commenced for purposes of Rules 152(a) and 152(b). Similarly, New Rule 152(d) provides a non-exclusive list of factors to consider in determining when an offering is "terminated or completed" for purposes of Rules 152(a) and 152(b). In general, an exempt offering will be deemed to commence on the date the issuer or its agents first makes an offer of the issuer's securities in reliance on an exemption. Termination or completion of an offering will generally be deemed to occur when the issuer and its agents cease efforts to make further offers to sell the issuer's securities under that offering. The lists of factors cover both registered and exempt offerings, and each of Rules 152(c) and 152(d) provide additional and more detailed guidance to be applied to assessments of whether and when various types of offerings have commenced, terminated, or been completed.

Offering communications and general solicitation

Whether a communication constitutes an offer of securities is not always clear or intuitive. The term "offer" is defined very broadly under the Securities Act, and the SEC has historically interpreted that term expansively to include a variety of communications and activities, which may be deemed to have the effect of conditioning the mind of the public or arousing public interest in an issuer or its securities. Additionally, the terms "general solicitation" and "general advertising" are not defined in SEC rules, although the rules do provide some examples of general solicitation and general advertising, including advertisements published in newspapers and magazines, communications broadcast over television and radio, seminars where attendees have been invited by general solicitation or general advertising, and postings on unrestricted websites.

The amendments address general solicitation and offering communications in the following contexts:

New Rule 241 — Test-the-waters communications and general solicitation

New Rule 241 further expands the permitted uses of "test-the-waters" communications to generally permit an issuer, subject to certain conditions, to use generic solicitation of interest materials to gauge investor interest for an exempt offering of securities prior to determining which exemption will be used for the sale of the securities. The rule provides an exemption from registration only, however, and the solicitation will be deemed to be an offer of a security for sale for purposes of the antifraud provisions of the federal securities laws.

Generic solicitation of interest materials will be required to include certain specified disclosures notifying potential investors about the limitations of the generic solicitation. In addition, no solicitation or acceptance of money or other consideration, nor of any commitment, binding or otherwise, from any person is permitted until the issuer makes a determination as to the exemption on which it will rely and commences the offering in compliance with the exemption. If the issuer moves forward with an exempt offering following the generic solicitation of interest, it will be required to comply with an applicable exemption for the subsequent offering. If the generic solicitation is conducted in a manner that would constitute general solicitation, and the issuer ultimately decides to conduct an unregistered offering under an exemption that does not permit general solicitation, the issuer will need to analyze whether that solicitation and the subsequent

private offering will be integrated, thereby making unavailable an exemption that does not permit general solicitation.

New Rule 148 — Exemption from general solicitation for "demo days" and similar events

New Rule 148 permits issuers to participate in "demo days" and similar organized events without being deemed to be engaging in a general solicitation or general advertising, subject to certain conditions. To qualify:

- the event must be sponsored by a college, university, or other institution of higher education, a state or local government or instrumentality of a state or local government, a nonprofit organization, or an angel investor group, incubator, or accelerator;
- more than one issuer must participate in the event;
- the sponsor of the event may not make investment recommendations or provide investment advice to attendees of the event; engage in any investment negotiations between the issuer and investors attending the event; charge attendees of the event any fees (other than reasonable administrative fees); receive any compensation for making introductions or for investment negotiations between event attendees and issuers; or receive any compensation with respect to the event that would require it to register as a broker or dealer under the Securities Exchange Act of 1934, or as an investment adviser under the Investment Advisers Act of 1940;
- the advertising for the event may not reference any specific offering of securities by the issuer;
- online participation in the event must be limited to individuals who are members of or otherwise associated with the sponsor organization; individuals that the sponsor reasonably believes are accredited investors; or individuals who have been invited to the event by the sponsor based on industry or investment-related experience; and
- communications by or on behalf of the issuer must be limited to notification that the issuer is in the process of offering or planning to offer securities; the type and amount of securities being offered; the intended use of the proceeds; and the unsubscribed amount in an offering.

In addition to new Rules 148 and 241 summarized above, the amendments include various revisions to the communications rules specific to offers and sales made pursuant to Regulation A and Regulation Crowdfunding which are outside the scope of this Alert.

Rule 506(c) — Accredited investor verification requirements

Rule 506(c) of Regulation D permits general solicitation, so long as all purchasers in the offering are accredited investors whose status the issuer has taken reasonable steps to verify.

Rule 506(c) provides a principles-based method for verification of accredited investor status, as well as a nonexclusive list of verification methods. The principles-based method of verification requires an objective determination by the issuer, or those acting on the issuer's behalf, as to whether the steps taken are "reasonable" in the context of the particular facts and circumstances of each purchaser and transaction. Rule 506(c) also includes a non-exclusive list of verification methods that issuers may use, but are not required to use, when seeking to satisfy the verification requirement with respect to natural person purchasers.

As amended, Rule 506(c) includes an additional safe harbor which will permit an issuer to rely on reasonable steps the issuer took within the prior five years to verify an investor's accredited investor status as of the time of a subsequent sale, if the investor provides a written representation that the investor continues to qualify as an accredited investor and the issuer is not aware of information to the contrary.

In the Adopting Release, the SEC reaffirmed and updated its prior guidance with respect to the principles-based method for verification, highlighting that the principles-based method was intended to provide issuers with "significant flexibility in deciding the steps needed to verify a person's accredited investor status and to avoid requiring them to follow uniform verification methods that may be ill-suited or unnecessary to a particular offering or purchaser in light of the facts and circumstances."[5]

Harmonization of disclosure requirements

The amendments include revisions to Rule 502(b) to align the financial statement information requirements for Regulation D offerings to non-accredited investors with those applicable to Regulation A offerings and address confidential treatment standards for certain exhibits, each of which is summarized below. The amendments also address particular areas of compliance with Regulation A that are more complex or difficult than for registered offerings and revise Regulation A and Regulation Crowdfunding to harmonize the bad actor disqualification provisions of those exemptions with the existing bad actor disqualification provisions of Regulation D.

Rule 502(b) — Financial statement requirements

When non-accredited investors are participating in an offering under Rule 506(b), the issuer must furnish to such non-accredited investors the information required by Rule 502(b), including certain specified financial statement and non-financial information, within a reasonable time prior to the sale of the securities. The issuer must also provide the non-accredited investors with the opportunity to ask questions and receive answers about the offering.

As amended, Rule 502(b) requires non-reporting issuers to provide financial information to non-accredited investors participating in Regulation D offerings as follows:

- For offerings of $20 million or less, Rule 502(b) as amended refers issuers to paragraph (b) of part F/S of Form 1-A, which applies to Tier 1 Regulation A offerings; and
- For offerings of greater than $20 million, Rule 502(b) as amended refers issuers to paragraph (c) of part F/S of Form 1-A, which applies to Tier 2 Regulation A offerings.

The amendments eliminate the current Rule 502(b) provisions that permit an issuer, other than a limited partnership, that cannot obtain audited financial statements without unreasonable effort or expense, to provide only the issuer's audited balance sheet. Non-reporting foreign private issuers will also be required to provide financial statement disclosures consistent with the Regulation A requirements and prepared in accordance with either U.S. GAAP or International Financial Reporting Standards (IFRS).

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[5] Adopting Release at page 110.

Confidential information standard

The amendments revise the SEC's exhibit filing requirements by removing a "competitive harm" requirement and replacing it with a standard that permits information to be redacted from material contracts if it is the type of information that the issuer both customarily and actually treats as private and confidential, and which is also not material. This aligns the SEC's confidential treatment standard with the standard adopted by the U.S. Supreme Court in *Food Marketing Institute v. Argus Leader Media*, 139 S. Ct. 2536 (2019), in which the Supreme Court rejected the longstanding test for determining what information is confidential under Exemption 4 of the Freedom of Information Act (FOIA) and adopted a new definition of "confidential" that does not include a competitive harm requirement.

Offering and investment limits

The amendments increase the offering and investment limits for certain exemptions, as follows:

- **For Rule 504 of Regulation D**: The maximum offering amount is increased from $5 million to $10 million.
- **For Regulation A:** The maximum offering amount under Tier 2 is increased from $50 million to $75 million, and the maximum offering amount for secondary sales under Tier 2 is increased from $15 million to $22.5 million.
- **For Regulation Crowdfunding**: The offering limit is increased from $1.07 million to $5 million, and the various investment limits are increased for non-accredited investors. Additionally, existing temporary relief providing an exemption from certain Regulation Crowdfunding financial statement review requirements for issuers offering $250,000 or less of securities in reliance on that exemption within a 12-month period is extended.

What's next?

The amendments will become effective 60 days after publication in the *Federal Register*, except for the extension of the temporary Regulation Crowdfunding provisions, which will be effective upon publication in the *Federal Register*.

Issuers contemplating securities offerings in early 2021 will want to consider the impact of the amendments on their capital-raising plans. In particular, the amendments to the integration framework may provide additional flexibility for future offerings. For more information about the topics discussed in this alert, please contact your Nixon Peabody attorney or:

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