SEC Proposes To Modernize and Harmonize Exempt Offerings Rules

I. Overview

On March 4, 2020, the Securities and Exchange Commission (the "SEC") issued a release proposing amendments to the rules governing exempt offerings under the Securities Act of 1933, as amended (the "Securities Act").[1] The proposed amendments are intended to address, among other things, gaps and complexities in the current exempt offering framework. Specifically, the proposed amendments (1) discuss the ability of issuers to move from one exemption to another exemption or registered offering, (2) clarify and establish consistent rules applicable to offering communications, (3) address gaps and inconsistencies in the current rules relating to offering and investment limits, and (4) harmonize certain differences in the disclosure and bad actor disqualification provisions between exemptions.

II. Integration Framework

Current Rules: Determining whether a particular securities offering should be integrated with another requires a facts and circumstances analysis under Rule 502(a)'s five-factor test, which requires consideration of whether: (1) the sales are part of a single plan of financing, (2) the sales involve issuance of the same class of securities, (3) the sales have been made at or about the same time, (4) the same type of consideration is being received, and (5) the sales are made for the same general purpose.[2] Current rules generally provide safe harbor periods of six months for purposes of integration.

Proposal: Proposed Rule 152(a) would establish a general principle of integration, and proposed Rule 152(b) would set forth four new safe harbors from integration. References to proposed Rule 152 would replace the integration provisions of Regulation D, Regulation A, Regulation Crowdfunding, and Rules 147 and 147A.

1. *General Principle of Integration – Rule 152(a)*

Proposed Rule 152(a) would require an issuer to consider the facts and circumstances of an offering, including whether the issuer can establish that an offering complies with Securities Act registration requirements or that an exemption from registration is available. For an exempt offering that does not permit general solicitation, including an offering following either a registered offering or an offering permitting general solicitation, offers and sales would not be integrated if the issuer has a reasonable belief, based on the facts and circumstances, that in each exempt offering, the purchasers (1) were not solicited using general solicitation, or (2) established a substantive relationship with the issuer prior to the offering not permitting general solicitation (the "Integration Test").

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[1] For full text of the Release, see Securities and Exchange Commission, Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, SEC Release Nos. 33-10763; 34-88321, available at https://www.sec.gov/rules/proposed/2020/33-10763.pdf (March 4, 2020) [hereinafter, the "*Release*"]. Unless otherwise specified, quoted statements in this memorandum are taken from the Release.

[2] 17 CFR § 230.502(a).

2. *Safe Harbors – Rule 152(b)*

Proposed Rule 152(b) would include the following non-exclusive safe harbors from integration:

- Rule 152(b)(1): An offering will not be integrated with another offering made more than 30 days before the commencement of such other offering or 30 days after the termination or completion of such other offering provided that, for an exempt offering that does not permit general solicitation, the Integration Test is satisfied.

- Rule 152(b)(2): Offers and sales made in compliance with Rule 701 or Regulation S would not be integrated with other offerings. Further, concurrent offshore offerings made in compliance with Regulation S would not be integrated with domestic offerings that are either registered or made pursuant to any available exemption, including Rule 506(c) offerings, so long as the issuer does not generally solicit for the purpose of conditioning the market in the United States.

- Rule 152(b)(3): An offering for which a registration statement has been filed under the Securities Act would not be integrated if it is conducted after: (1) a terminated or completed offering that does not permit general solicitation, (2) a terminated or completed offering that permits general solicitation and is made to qualified institutional buyers or institutional accredited investors, or (3) an offering that permits general solicitation which was terminated or completed more than 30 days before the commencement of such offering.

- Rule 152(b)(4): Offers and sales made in reliance on an exemption that permits general solicitation would not be integrated if made subsequent to an offering that has been terminated or completed.

III. General Solicitation and Offering Communications

1. *Demo Day Communications*

Current Rule: The current Rule 506(c) exemption allows an issuer to solicit and generally advertise an offering if (1) the investors in the offering are all accredited investors, and (2) the issuer takes reasonable steps to verify that the investors are accredited.[3] Regulation D does not define "general solicitation" or "general advertising," but does include illustrative examples.

Proposal: Proposed Rule 148 would exclude certain "demo day" communications from being deemed general solicitation or general advertising, including communications "made in connection with a seminar or meeting by a college, university, or other institution of higher education, a local government, a nonprofit organization, or an angel investor group, incubator, or accelerator sponsoring the seminar or meeting."

2. *Solicitation of Interest*

Current Rules: In a registered securities offering, issuers may gauge market interest prior to or following the registration statement filing by communicating with qualified institutional buyers and institutional accredited investors. Similarly, subject to certain conditions, Regulation A permits issuers to "test-the-waters" by soliciting interest from the general public, before or after the filing of the offering statement.

[3] 17 CFR § 230.506.

Proposal: Proposed Rule 241 would permit an issuer to solicit interest in an exempt offering, orally or in writing, before deciding the specific exemption the issuer would rely upon, subject to (1) such issuer not identifying the specific exemption it may rely upon for a subsequent offer and sale, and (2) the materials used bearing a specified legend or disclaimer. An issuer that uses Rule 241 to solicit interest and then, within 30 days of the most recent generic solicitation materials or communication, (i) opts to rely on Regulation Crowdfunding for an offering, would be required to file such materials as an exhibit to the Form C, (ii) opts to rely on Rule 506(b) to sell securities to a purchaser that is not an accredited investor, would be required to provide such materials to such purchaser a reasonable time prior to sale, or (iii) opts to rely on Regulation A, would be required to file such materials as an exhibit to the Form 1-A.

IV. Rule 506(c) Verification Requirements

Current Rule: As discussed, the current Rule 506(c) exemption allows an issuer to solicit and generally advertise an offering if the issuer takes reasonable steps to verify that the investors are accredited. The rule requires an objective determination by the issuer (or those acting on its behalf) as to whether the steps taken to verify the accredited status of an investor are reasonable in light of the specific facts and circumstances of such purchaser and transaction.

Proposal: The SEC is proposing to add a new item to the non-exclusive list in Rule 506(c) that would allow an issuer to establish the accredited status of an investor in a subsequent sale if (1) the issuer previously took reasonable steps to verify that such investor was accredited, (2) the investor provides a written representation that he, she or it is an accredited investor, and (3) the issuer is not aware of any contradictory information.

V. Harmonization of Disclosure Requirements

1. *Rule 502(b) of Regulation D*

Current Rules: In a 506(b) offering, an issuer is required to furnish any non-accredited investor with certain material information specified in Rule 502(b). Issuers conducting offerings under Regulation A are also required to provide certain financial statement and non-financial statement information to investors. However, the information requirements under Regulation D are generally more burdensome than those under Regulation A.

Proposal: The proposed amendment to Rule 502(b) would modify the financial information that non-reporting companies must provide to non-accredited investors and align these provisions with the requirements in Regulation A. For Regulation D offerings of up to $20 million, issuers would become subject to the requirements applicable to Regulation A Tier 1 offerings set forth in paragraph (b) of Part F/S of Form 1-A. The disclosure requirements for Regulation D offerings greater than $20 million would entail (1) providing audited financial statements and (2) complying with Regulation S-X.

2. *Confidential Information Standard*

Current Rules: Registrants are permitted to redact provisions or terms of exhibits to be filed, provided they are not material and would likely cause "competitive harm" if publicly disclosed. The Supreme Court recently ruled that "where commercial or financial information is both customarily and actually treated as private by its owner and provided to the government under an assurance of privacy, the information is 'confidential' under

Exemption 4 [of the Freedom of Information Act]."[4]

Proposal: The Release proposes changing the exhibit filing requirements by removing the "competitive harm" requirement and replacing it with a standard aligned with the Supreme Court's definition of "confidential" discussed above. The change would allow information to be redacted from material contracts if the information is (1) of the type that the issuer customarily and actually treats as private and confidential and (2) not material.

3. *Regulation A Compliance*

a. *Redacted Exhibits*

Current Rules: To redact immaterial confidential information included in a material contract or other information required to be filed as an exhibit to Regulation A disclosure documents, a registrant must first apply for confidential treatment of that information.

Proposal: The SEC would amend Item 17 of Form 1-A to provide registrants with the option to file redacted material contracts and other information required to be filed, as exhibits to Regulation A disclosure documents. Redacted exhibits would continue to be subject to compliance reviews by the SEC.

b. *Offering Statement Filing Procedures*

Current Rules: Under Regulation A, non-public documents confidentially submitted to the SEC for review must be publicly filed as an exhibit to a publicly filed offering statement. Emerging growth companies may also submit their draft registration statements and amendments to the SEC for confidential review, but they may satisfy the public filing requirement by releasing such documents to the public via the EDGAR system.

Proposal: The SEC is proposing to remove Item 17.17(a) of Form 1-A such that Regulation A issuers could make non-public documents available to the public on EDGAR using the same process applicable to registered offerings.

c. *Incorporation by Reference*

Current Rules: Registrants meeting certain eligibility standards are permitted to incorporate by reference certain information required by Item 11 of Form S-1, including financial statement information. Regulation A issuers, however, must include financial statements in in their offering circular distributed to investors.

Proposal: The SEC is proposing an amendment to allow incorporation by reference of previously filed financial statements into a Regulation A offering circular so long as (1) the issuer is current in its reporting obligation under Rule 257 or the Securities Exchange Act of 1934, as amended, (2) the incorporated financials are made readily available and accessible on the issuer's website, and (3) the issuer discloses in the offering statement that such financials will be provided upon request.

[4] *Food Marketing Institute* v. *Argus Leader Media*, 139 S.Ct. 2356 (2019).

d. *Abandonment Provision of Regulation A*

Current Rules: Under Rule 259(b), the SEC may only declare an offering statement abandoned. The SEC may not declare a specific post-qualification amendment abandoned.

Proposal: Rule 259(b) would be amended to grant the SEC the ability to declare a specific post-qualification amendment abandoned rather than the entire offering statement, thus aligning Rule 259(b) with Rule 479, which applies to registered offerings.

VI. Offering and Investment Limits

The SEC is proposing to increase the offering and/or investment limits applicable under Regulation 504, Regulation A, and Regulation Crowdfunding, as described below:

- Rule 504: The offering limit would be increased from $5 million to $10 million in a 12-month period.
- Regulation Crowdfunding: The offering limit would be increased from $1.07 million to $5 million in a 12-month period. No investment limits would apply for accredited investors, and non-accredited investors would be able to determine their investment limit based on the greater of their annual income or net worth.
- Regulation A (Tier Two): The offering limit would be increased from $50 million to $75 million. The offering limit for secondary sales would be increased from $15 million to $22.5 million.

VII. Regulation Crowdfunding and Regulation A Eligibility

1. *Regulation Crowdfunding Eligible Issuers*

Current Rule: Investment companies, as defined in the Investment Company Act of 1940 (the "Investment Company Act"), are precluded from using the Regulation Crowdfunding exemption. The prohibition extends to special purpose vehicles ("SPVs") that invest in a single company, to the extent they are investment companies.

Proposal: Proposed Rule 3a-9 would create an exclusion from the definition of "investment company" under the Investment Company Act, for limited-purpose vehicles ("crowdfunding vehicle") that function as a conduit for investments in a business seeking to raise capital through a crowdfunding vehicle, subject to the crowdfunding vehicle satisfying certain conditions. The exclusion would extend to SPVs meeting the definition of a crowdfunding vehicle.

2. *Regulation Crowdfunding Eligible Securities*

Current Rules: There are no limits on the types securities offered and sold in reliance on Regulation Crowdfunding. Offerings under Regulation A are limited to equity securities, debt securities, and securities convertible or exchangeable to equity interests, and guarantees of any such securities.

Proposal: The proposed amendment to Regulation Crowdfunding would limit the types of eligible securities to equity securities, debt securities, securities convertible or exchangeable for equity interests, and guarantees of any such securities, thereby harmonizing the rule with the eligible securities provision of Regulation

A. As a result, offering of certain non-traditional instruments, such as Simple Agreement for Future Equity, or SAFE, would no longer be able to rely on Regulation Crowdfunding.

3. *Regulation A Eligibility Restrictions for Delinquent Exchange Act Filers*

Current Rules: For an offering under Regulation A, the issuer must have filed with the SEC all required reports pursuant to Rule 257, during the two years prior to the filing of the offering statement.

Proposal: Regulation A would be amended to include a similar eligibility requirement covering Exchange Act reports by providing that an issuer required to file ongoing reports under Section 13(a) or 15(d) of the Exchange Act would be ineligible to use Regulation A for an offering if the issuer has not filed with the SEC all such reports during the two years prior to the filing of a Regulation A offering statement.

VIII. Bad Actor Disqualification Provisions

Current Rules: Felons and "bad actors" are disqualified from relying on Regulation D, Regulation A, or Regulation Crowdfunding, to offer and sell securities. The look-back period for disqualification begins (1) from the time of the sale in an offering under Regulation D, and (2) from the time the issuer files an offering statement under Regulation A and Regulation Crowdfunding.

Proposal: The bad actor disqualification provisions in Rule 262(a) of Regulation A and Rule 503(a) of Regulation Crowdfunding would be amended to add "or such sale" to look-back provisions that make reference to the time of filing. Because an offering statement must be filed before the first Regulation Crowdfunding sale, Rule 503(a) would be amended further to include: "any promoter connected with the issuer in any capacity at the time *of filing, any offer after filing, or such sale*."

IX. Conclusion and Next Steps

With the proposed amendments in the Release, the SEC seeks to "facilitate formation and increase opportunities for investors by expanding access to capital for entrepreneurs" and believes that such proposed amendments would "simplify, harmonize, and improve aspects of the exempt offering framework while preserving or enhancing important investor protections." The SEC is seeking comments on the amendments proposed in the Release until 60 days following its publication in the Federal Register.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email authors Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; Joseph E. Cho at 212.701.3589 or jcho@cahill.com; or Eboney J. Hutt at 212.701.3259 or ehutt@cahill.com; or email publications@cahill.com.