Updates
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SEC Makes it Easier to Fundraise—Streamlines Exempt Offering Rules

The U.S. Securities and Exchange Commission (SEC) recently announced that it adopted final rules to simplify the "patchwork" framework for exempt offerings under the Securities Act of 1933. These amendments generally follow the SEC's March 2020 proposing release, but incorporate comments received from market participants and feedback from the SEC Small Business Capital Formation Advisory Committee and the 2020 Small Business Forum on the SEC's June 2019 concept release.

Highlights of these amendments include:

- A new integration framework for registered and exempt offerings, including four safe harbors
- Expanded use of "Test-the-Waters" and "Demo Day" communications
- Modified disclosure requirements for Rule 506(b) exempt offerings that include unaccredited investors

This update summarizes key takeaways for companies conducting private offerings and offers practical advice.

Implementation Date

The amended rules generally become effective 60 days after publication in the Federal Register (the effective date).

Four Integration Safe Harbors

Under a complex mixture of existing SEC rules and guidance, if securities offerings are connected in a meaningful manner, they are "integrated" and treated as if they were a single offering for the purposes of analyzing securities law compliance. This integration doctrine prevents companies from artificially dividing a single offering into multiple offerings to take advantage of Securities Act exemptions that would not otherwise be available for the integrated offering. The recent rule amendments establish an integration framework that confirms that the analysis should focus on whether the company can establish that each offering either complies with the registration requirements of the Securities Act, or that an exemption from registration is available for the particular offering.

The recent amendments also set out four non-exclusive safe harbors from integration that include, most notably, shortening from six months to 30 calendar days the applicable time period for offerings that are considered separate based solely on the timing of offers and sales. As adopted, these new integration rules also provide a

non-exclusive list of factors for companies to consider when determining when an exempt or registered offering will have commenced or completed for the purposes of applying the integration doctrine.

New 30-Day Integration 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 such other offering(s).

- **Special Rule for General Solicitations.** Where an exempt offering for which general solicitation is *prohibited* follows by 30 calendar days or more an offering that *allows* general solicitation, the company 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 company (or any person acting on the company's behalf) either did not solicit such purchaser through the use of general solicitation or established a substantive relationship with such purchaser prior to the commencement of the exempt offering prohibiting general solicitation.

Practical Tip: Consult With Legal Counsel Regarding Compliance Strategy

Companies currently conducting, or considering, a private offering should consult with legal counsel regarding the impact of these rule amendments on their exemption analysis and consider whether to make any changes to their planned timing and/or compliance strategy.

No Integration for Rule 701 and Regulation S Offerings—Rule 152(b)(2). The amendments confirmed that an offer or sale 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. Additionally, the amendments confirmed that offshore transactions made in compliance with Regulation S will not be integrated with registered domestic offerings or domestic offerings that satisfy the requirements for any other exemption from registration under the Securities Act.

No Integration With Subsequent Registered Offerings in Certain Circumstances—Rule 152(b)(3). The amendments confirmed that an offering for which a Securities Act registration statement has been filed will not be integrated with an earlier unregistered offering in each of the following circumstances:

- An earlier offering for which general solicitation was not permitted was terminated or completed
- An earlier offering for which general solicitation only to qualified institutional buyers and institutional accredited investors was permitted was terminated or completed
- An earlier offering for which general solicitation was permitted terminated or was completed more than 30 calendar days prior to the commencement of the registered offering

No Integration Where Earlier Offering Completed or Terminated Before New Offering Involving General Solicitation—Rule 152(b)(4). The amendments confirmed that offers and sales made in reliance on an exemption for which general solicitation is permitted will not be integrated with prior offerings that were terminated or completed.

New Exemption for "Test-the-Waters" and "Demo Day" Communications

These recent amendments revise SEC offering communications rules with respect to permitted "demo day" and "test-the-waters" communications.

"Demo Day" Communications—Rule 148. The amended rules provide that a company's presentation at a "demo day" or similar event would not be considered to be a "general solicitation" if the communications are made in connection with a seminar or meeting sponsored by a college, university, or other institution of higher education, a state or local government or an instrumentality of a state or local government, a nonprofit organization, or an angel investor group, incubator, or accelerator.

- **What Is an Angel Investor Group?** For purposes of these rules, an "angel investor group" means a group with all of the following characteristics:
    - Made up of accredited investors
    - Holds regular meetings and has defined processes and procedures for making investment decisions, either individually or among the membership of the group as a whole
    - Is neither associated nor affiliated with brokers, dealers, or investment advisers

This new exemption is available if the sponsor does *not*:

- Make investment recommendations or provide investment advice to attendees of the event
- Engage in any investment negotiations between the company and investors attending the event
- Charge attendees of the event any fees, other than reasonable administrative fees
- Receive any compensation for making introductions between event attendees and companies, or for investment negotiations between the parties
- 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

Additionally, any advertising regarding the event may not reference the company's offering and information conveyed at the event regarding the offering must be limited to:

- Notice of the offering
- The type and amount of securities being offered
- The intended use of offering proceeds
- The unsubscribed amount in the offering

Permit Generic Solicitation of Interest—Rule 241. Reflecting the SEC's view that "it is helpful for companies to be able to gauge interest in a securities offering prior to incurring the expense of preparing and conducting an offering," the amended rules permit companies to issue certain communications in order to gauge prospective investors' interest without triggering offering requirements under the securities laws. Specifically, the amended rule provides an exemption permitting a company to use generic solicitation of interest materials to "test-the-waters" for an exempt offer of securities prior to determining which exemption it will use for the sale of the securities, provided that the solicitation meets certain criteria. However, no solicitation or acceptance of money or other consideration, nor of any commitment, binding or otherwise, from any person is permitted until the company makes a determination as to the exemption on which it will rely and commences the offering in compliance with the exemption.

Practical Tip: Consult With Legal Counsel Before Participating in a "Demo Day" Event or Making "Test-the-Waters" Communications

Companies currently conducting, or considering, a private offering should consult with legal counsel regarding how they may participate in "demo day" or similar events.

Companies considering a private offering should consult with legal counsel regarding whether to "test the waters" prior to launching the offering, and consider implementing more stringent controls to ensure that no solicitation or acceptance of money or other consideration, nor of any commitment, binding or otherwise, occurs before determining on which exemption the company will rely for the offering.

Eased Requirements for Exempt Offerings Under Rule 506(b) With Unaccredited Investors

These amendments also modified certain requirements that apply to offerings conducted in reliance on Rule 506(b) that include any investors that are not accredited investors. Specifically, amended Rule 506 permits sales to up to 35 unaccredited investors within a 90-calendar-day period (which significantly loosens the current restriction that applies the 35-unaccredited-investor limit to the entire offering with no time limit).

In addition, amended Rule 502(b) modifies the requirements governing the financial information that non-reporting companies are required to provide if a Regulation D offering includes any investors that are not accredited by aligning the Regulation D financial information requirements with existing Regulation A financial information requirements. Specifically, the amended rule removes the requirement for Rule 506(b) offerings under $20 million that financial statements must be audited, and also eliminates the requirement that certain companies may provide only an audited balance sheet if it cannot obtain audited financial statements without unreasonable effort or expense.

Trap for the Unwary: Consult With Legal Counsel Before Making an Offer to Any Unaccredited Investor

Including unaccredited investors in any securities offering involves significant risks and burdens. The modest improvements to the availability of Rule 506(b) and the financial statement delivery requirements effected by the recent rule amendments for a private offering do not reduce these risks and burdens. Companies should consult with legal counsel before making any offer or sale of securities to an unaccredited investor.

Other Useful Improvements

In addition, the amended rules:

1. **Harmonize Lookback Period for Covered Person Disqualification.** The amended rules make the lookback period for determining whether a covered person is disqualified from relying on Regulation D the same as for offerings relying on Regulation A or Regulation Crowdfunding.
2. **Permit Use of Written Representation to Confirm Continued Accredited Investor Status.** The amended rules amend Rule 506(c) to provide that a company that previously took reasonable steps to verify an investor as an accredited investor in connection with a prior securities offering conducted in reliance on Rule 506(c) may rely on a written representation that the investor continues to qualify as an accredited investor if the company is not aware of information to the contrary. The investor must also make the written representation within five years following the date of the previous verification.

As exempt offerings have become increasingly important to the capital markets, these amended rules provide a welcome update to the complex mixture of existing SEC rules and guidance that govern exempt offerings. However, the improvements to the exempt offering rules remain modest and companies currently conducting, or considering, a private offering should consult with legal counsel.

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