SEC Eases Rules Governing Private Placements

November 12, 2020

On November 2, 2020, the SEC adopted final amendments to many of the rules, regulations and SEC guidance currently governing exempt offerings (commonly known as "private placements").[1] The amendments are intended to harmonize, simplify and improve the rules applicable to private placements. In the adopting release, the SEC highlighted that the amendments seek to "promote capital formation while preserving or enhancing important investor protections [and] close gaps and reduce complexities in the exempt offering framework that may impede access to investment opportunities for investors and access to capital for businesses and entrepreneurs."[2] The amendments, among other changes:

- establish a new integration framework for registered and exempt offerings, replacing the prior five-factor integration test and shortening the existing six-month integration safe harbor under Regulation D to a 30-day integration safe harbor;
- update rules governing offering communications; and
- conform the disclosure requirements under Regulation D with the less burdensome requirements of Regulation A for offers to non-accredited investors.

The table below provides an overview of the key characteristics of selected commonly used offering exemptions, as amended by the new rules:[3]

Type of Offering	Offering Limit within 12-month Period	General Solicitation Permitted	Issuer Requirements	Investor Requirements	SEC Filing Requirements	Investor Receives Restricted Securities	Preemption of State Registration and Qualification
Section 4(a)(2)	None	No	None	Transactions by an issuer not involving any public offering. *See SEC v. Ralston Purina Co.*	None	Yes	No

[1] The SEC Release, including the full text of the final amendments, is available here.

[2] See SEC Release at page 1.

[3] See also SEC Release at pages 9-11, summarizing the key characteristics of commonly used offering exemptions, including summaries of additional offering exemptions that are not included in the table above.

Type of Offering	Offering Limit within 12-month Period	General Solicitation Permitted	Issuer Requirements	Investor Requirements	SEC Filing Requirements	Investor Receives Restricted Securities	Preemption of State Registration and Qualification
Rule 506(b) of Regulation D	None	No	"Bad actor" disqualifications apply	Unlimited accredited investors Up to 35 sophisticated but non-accredited investors in a 90-day period	Form D	Yes	Yes
Rule 506(c) of Regulation D	None	Yes	"Bad actor" disqualifications apply	Unlimited accredited investors Issuer must take reasonable steps to verify that all purchasers are accredited investors	Form D	Yes	Yes

Highlighted below are the key takeaways from the final amendments.

New Integration Framework

The amendments create a new Rule 152 under the Securities Act, which establishes four non-exclusive safe harbors from integration and a general integration principle for offerings not covered by the safe harbors. As compared to the current integration framework, the amendments not only provide clear bright-line rules for issuers but also drastically decrease the types of offerings that will be limited by fears of integration.

Integration Safe Harbors (New Rule 152(b))[4]

a. 30-day Integration Safe Harbor (New Rule 152(b)(1)): Any offering made more than 30 calendar days before the commencement of or after the termination or completion of any other offering will not be integrated with the other offering.

- However, in the case of a private placement where general solicitation is prohibited that follows (by 30 calendar days or more) after an offering that allows general solicitation, the issuer needs to have a reasonable belief, with respect to each purchaser, that the issuer (or any person acting on the issuer'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 private placement prohibiting general solicitation.

[4] See also SEC Release at page 16, summarizing the integration harbors.

b. Rule 701, Employee Benefit Plans and Regulation S (New 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. New Rule 152(b)(2) also codifies the SEC's long-standing position 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 an exemption from registration under the Securities Act," including a concurrent 144A offering.[5]

c. Subsequent Registered Offerings (New 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 and institutional accredited investors; or
- an offering for which general solicitation is permitted that terminated or was completed more than 30 calendar days prior to the commencement of the registered offering.

The SEC staff made clear in the SEC Release that the new Rule 152(b)(3) is intended to allow issuers to conduct private offerings shortly before a registered offering. The SEC Release notes the importance of capital raising around the time of a public offering, including immediately before the filing of a registration statement for an initial public offering, for issuers to have access to sources of funds to continue their operations during the pendency of the public offering. Moreover, for exempt offerings permitting general solicitation that are followed by registered offerings, the SEC Release notes that a 30-day period is "sufficient to mitigate concerns that an exempt offering may condition the market for a subsequent registered offering."[6] These changes will be particularly important for late-stage private capital raising prior to a public offering; however, issuers should remain mindful of the information provided to private investors shortly before a registered offering.

d. Offers or Sales Preceding Exempt Offerings Permitting General Solicitation (New Rule 152(b)(4)): Offers and sales made in reliance on an exemption where general

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5 See SEC Release at page 51.

6 See SEC Release at pages 56-57.

solicitation is permitted will not be integrated if made subsequent to any terminated or completed offering.

General Integration Principle (New Rule 152(a))[7]

Under the general integration principle, offerings not covered by one of the safe harbors in new Rule 152(b) will not be integrated if the issuer can establish that each offering either complies with the registration requirements of the Securities Act or that an exemption from registration is available for each offering.

In addition, for any exempt offering prohibiting general solicitation, the issuer must have a reasonable belief, with respect to each purchaser, that the issuer (or any person acting on the issuer's behalf) either:

- did not solicit such purchaser through the use of general solicitation; or
- established a substantive relationship with such purchaser (a "pre-existing" relationship) prior to the commencement of the exempt offering where general solicitation is prohibited.

A relationship is generally viewed as "pre-existing" if the issuer has formed the relationship with the offeree before the commencement of the offering, or if the relationship was established through another person prior to that person's participation in the offering, *e.g.*, through a registered broker-dealer or investment advisor. For a relationship to be "substantive," the issuer, or a person acting on its behalf, should have sufficient information to evaluate (and does in fact evaluate) the offeree's financial circumstances and sophistication in determining the offeree's status as an accredited or sophisticated investor.[8]

In the case of concurrent exempt offerings that each allow general solicitation, in addition to meeting 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 the concurrent offering. Such offer must comply with all the requirements under the exemption for the concurrent offering, including any legend requirements and communications restrictions.

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[7] See generally SEC Release at pages 26-34.

[8] See SEC Release at page 31.

Other Considerations

In connection with the integration safe harbors and general integration principle, the amended rules also outline factors to consider in determining when an offering has commenced and when an offering is terminated or completed, including factors to consider in the context of offerings made in reliance on Section 4(a)(2) and Regulation D.[9] In addition, in response to concerns raised during the comment process for the proposed rule, the number of non-accredited investors purchasing in Rule 506(b) offerings will be limited to no more than 35 within a 90-calendar day period.

As a result of the adoption of the new Rule 152, the current Rule 155, which provides safe harbors for the integration of abandoned offerings, will be removed. The new Rule 152 safe harbors will apply when determining whether abandoned offerings will be integrated with subsequent offerings.

Other Notable Amendments

"Testing the Waters" Communications[10]

New Rule 241 permits an issuer or any person authorized to act on behalf of an issuer to communicate orally or in writing to gauge interest in a contemplated exempt offering ("testing the waters" communications) before determining which exemption it will use for the sale of the securities. The rule provides an exemption from registration only with respect to the generic solicitation of interest; an issuer would need to comply with an applicable exemption for a subsequent exempt offering. Certain other requirements must also be met under new Rule 241, including that the solicitation materials notify potential investors about the limitations of the generic solicitation. In addition, if an issuer sells securities under Rule 506(b) within 30 days of the generic solicitation to any purchaser that is not an accredited investor, the issuer must provide such purchaser with the written generic solicitations of interest used under new Rule 241.

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[9] Under new Rule 152(c), an offering of securities will be deemed to be commenced at the time of the first offer of securities in the offering by the issuer or its agents. For offerings made in reliance on Section 4(a)(2) and Regulation D, an issuer or its agents may commence the offering on the date the issuer first made an offer of its securities in reliance on such exemptions. Under new Rule 152(d), the termination or completion of an offering is deemed to have occurred when the issuer and its agents cease efforts to make further offers to sell the issuer's securities under such offering. For offerings made in reliance on Section 4(a)(2) and Regulation D, the factors that should be considered to determine when an offering is terminated or completed include the later of: (i) the date the issuer entered into a binding commitment to sell all securities to be sold under the offering (subject only to conditions outside of the investor's control); or (ii) the date the issuer and its agents ceased efforts to make further offers to sell the issuer's securities under such offering. See SEC Release at pages 346-347.

[10] See generally SEC Release at pages 90-96.

Rule 506(c) "Accredited Investors" Verification[11]

Under the current Rule 506(c), issuers are required, among other conditions, to take reasonable steps to verify that purchasers are accredited investors prior to conducting a Rule 506(c) offering. Under the amended Rule 506(c), if an issuer previously took reasonable steps to verify an investor was an accredited investor in accordance with Rule 506(c)(2)(ii), the issuer is permitted to establish that the investor remains an accredited investor 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. A written representation of this type will satisfy the issuer's verification obligation for a period of five years from the date the investor was previously verified as an accredited investor.

Further, the SEC release reaffirmed prior guidance on the principle-based method for verification and what may be considered "reasonable steps" to verify an investor's accredited investor status, noting that an issuer should include consideration of the following factors:

- the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
- the amount and type of information that the issuer has about the purchaser; and
- the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount.

Harmonization of Disclosure Requirements

The amendments to Rule 502(b) align the disclosure requirements for Regulation D offerings with the less burdensome requirements of Regulation A, particularly with respect to the financial information that must be provided to non-accredited investors participating in Regulation D offerings.

Additional Changes

In addition to the above-discussed changes, the amendments outlined in the SEC Release also:

- change rules related to Regulation Crowdfunding offering communications;

[11] See generally SEC Release at pages 108-112.

- increase offering and investment limits allowed under Regulation A, Regulation Crowdfunding and Regulation D;
- modify Regulation Crowdfunding and Regulation A disclosure and eligibility requirements;
- harmonize disqualification provisions in Regulation A, Regulation Crowdfunding and Regulation D; and
- expand exemptions for "demo day" communications.

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

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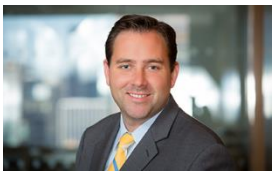
Please do not hesitate to contact us with any questions.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