SEC Simplifies Private Offering Rules

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This week, the Securities and Exchange Commission **adopted** broad changes to the current framework. Recognizing the growing availability and appeal of private investments, this is the latest in a series of recent actions by the SEC (including **expanding** "testing the waters" communications and **adding** new categories of accredited investors) intended to broaden access to capital markets for issuers and to the exempt offering market for investors. The new rules are substantially similar to those proposed in March 2020 and incorporate a number of comments received by the SEC from Davis Polk and others, such as the inclusion of bright-line rules. We believe the new rules are a step in the right direction.

The new rules 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.

Highlights

The new rules aim to both streamline the current regime governing exempt offerings and to broaden the availability of such offerings. Highlights of the new rules include:

- Streamlining the rules governing "integration" of private and public offerings by establishing four new safe harbors that, for the first time, expressly permit concurrent private and public offerings;
- Expanding communications exemptions, including for "demo days" and general solicitations of interest; and
- Increasing the size of offering exemptions available to issuers in Rule 504, Regulation A and Regulation Crowdfunding offerings.

Simplified Integration Rules

The SEC adopted new Rule 152 in order to simplify the rules for determining when an issuer's private and public offerings might be "integrated," or considered part of the same offering, thereby requiring registration of the private offering. The rules regarding integration currently include a patchwork of SEC rules, staff guidance and market practice that has evolved over decades. New Rule 152 offers both a number of specified safe harbors from integration and, where no safe harbor is available, a principles-based approach to determine whether an exemption from registration is available for a particular offering. As a result, the new rules will make it easier for an issuer to commence a private offering after a public one (or vice versa); this will be especially true where the issuer has a substantive pre-existing relationship with the purchasers.

Safe Harbors

New Rule 152 includes four non-exclusive safe harbors from integration:

Safe Harbor 1	Offerings made more than 30 calendar days before or after any other offering would not be integrated with that offering, as long as the issuer reasonably believes that for each purchaser in the exempt offering, the issuer either: • did not solicit such purchaser through a general solicitation, or • had previously established a substantive relationship with such purchaser prior to the exempt offering.

Safe Harbor 2	Offers and sales made in compliance with Rule 701 (pursuant to an employee benefit plan) or in compliance with Regulation S (for offshore offerings) would not be integrated with other offerings.
Safe Harbor 3	An offering for which a registration statement has been filed would not be integrated with an earlier private offering if the registered offering is made subsequent to: • a terminated or completed private offering for which general solicitation is not permitted; • a terminated or completed private offering for which general solicitation is permitted (i.e., a Rule 506(c) or Rule 144A offering) that was made only to qualified institutional buyers and institutional accredited investors; or • a private offering that was terminated or completed more than 30 calendar days prior to the commencement of the registered offering.
Safe Harbor 4	Offers and sales made in reliance on an exemption for which general solicitation is permitted would not be integrated with a prior private offering that has been terminated or completed.

General Integration Principles

If no safe harbor is available for an offering, new Rule 152 codifies existing SEC guidance on integration by requiring an issuer to consider the particular facts and circumstances of each offering pursuant to general principles of integration.

Under the general principle of Rule 152(a), offers and sales will not be integrated if the offering either complies with registration requirements under the Securities Act or is an exempt private offering. In making this determination, the rule specifies that:

- for a private offering for which general solicitation is prohibited (i.e., Rule 506(b)), the issuer must reasonably believe that each purchaser either:
  - was not solicited through a general solicitation; or
  - had a substantive relationship with the issuer prior to the commencement of the private offering.
- for a two or more concurrent private offering permitting general solicitation (i.e., Rule 506(c) or Rule 144A), if the general solicitation materials for one private offering includes material information about the concurrent private offering, the general solicitation materials may constitute an offer of securities in the concurrent offering. Therefore, the offering must comply with all of the requirements for the concurrent offering, including any legend and communication requirements.

Thus, under the new rules, which generally codify existing SEC guidance, an issuer may conduct simultaneous public and private offerings, or concurrent private offerings, as long as the provisions of the rule are satisfied.

Determining "Commencement" and "Termination" of an Offering

The new rules list non-exclusive factors to be considered when determining whether an offering has been "commenced" and "terminated or completed" for purposes of the integration analysis.

Rule 152 contains a non-exclusive list of factors that should be considered in determining whether an offering has commenced. This list includes, among others:

- the date on which the issuer first makes a generic offer soliciting interest in a contemplated offering pursuant to "testing the waters" under new Rule 241 (discussed below);
- the date on which the issuer first makes an offer of securities in reliance on certain private placement exemptions, such as Section 4(a)(2) and Regulation D; and
- the date on which the issuer first files a shelf registration statement for an offering that will commence on the date of the registration statement's effectiveness, or, for a "delayed" offering, the first date on which the issuer commences public efforts to offer and sell the securities (which could be evidenced by the first filing of a prospectus supplement describing the offering, or the issuance of a press release, announcing the commencement of the offering).

Likewise, Rule 152 includes a non-exclusive list of factors to consider in determining when an offering is deemed to be terminated or completed, including, among others:

- for most private placements, the later of: (1) the date the issuer entered into a binding commitment to sell the securities in the offering (subject only to conditions outside of the issuer's control); or (2) the date the issuer and its agents ceased efforts to make further offers to sell the securities in the offering; and
- for cases where a registration statement has been filed, upon: (1) the withdrawal of the registration statement; (2) the filing of a prospectus supplement or amendment to the registration statement indicating that the offering has been terminated or completed; (3) entry of an order by the SEC declaring that the registration statement has been abandoned; (4) after the third anniversary of the effective date of a shelf registration statement, the date on which the issuer is prohibited from continuing to sell securities using the registration statement, or any earlier date on which the offering terminates by its terms; or (5) any other factors that indicate that the issuer has abandoned or ceased its public selling efforts in furtherance of the offering.

Expanded Testing the Waters Exemptions

Exemption for "Demo Days"

Under new Rule 148, "demo days" and similar events will be exempt from the definition of general solicitation. While Rule 506(c) of Regulation D includes exemptions that allow issuers to use general solicitation for exempt offerings, in order to qualify the issuers must take reasonable steps to verify that the purchasers are accredited investors. The exemption under new Rule 148 is a reflection of current market practice in which startup companies often meet with larger groups of angel investors and others to present their businesses. Recognizing this, new Rule 148 deems communications made by an issuer not to involve a general solicitation if made in connection with a seminar or meeting in which more than one issuer participates and that is sponsored by a college, university, or other institution of higher education, a state or local government, a nonprofit organization, or an angel investor group, incubator, or accelerator sponsoring the seminar or meeting. Under the rule, an "angel investor group" is defined as a group of accredited investors that holds regular meetings and has defined processes and procedures for making investment decisions, and is not associated with brokers, dealers, or investment advisers.

In order to avail itself of the exemption, the issuer will not be permitted among other things to make investment recommendations, engage in investment negotiations or charge fees to attend the event. In addition, advertising for the event will not be allowed to reference an offering and information conveyed at the event regarding an offering will be limited to:

- notification of the planned offering;
- the type and amount of securities being offered;
- the intended use of proceeds; and

- the unsubscribed amount of the offering.

In addition, if the event is online rather than in person, participation would be limited to:

- individuals who are associated with the sponsor organization;
- individuals reasonably believed by the sponsor to be accredited investors; and
- individuals invited by the sponsor based on industry or investment-related experience reasonably selected by the sponsor in good faith and disclosed in public communications about the event.

While the "demo days" rule is new, we note that it substantially codifies existing practice.

General Solicitation of Interest Exemption

When the SEC expanded the "testing the waters" flexibility to all issuers in September 2019, it provided that companies would not be precluded from conducting a private placement in lieu of a registered offering after testing the waters. New Rule 241 goes further by including an exemption that permits an issuer to use generic solicitation of interest materials for an offer of securities prior to making a determination as to the exemption under which the offering may be conducted. Certain conditions need to be met under new Rule 241, including legending the materials used. No solicitation or acceptance of consideration or commitments is permitted until the issuer makes a determination as to which exemption it will rely on and the offering is commenced in compliance with that exemption. The anti-fraud provisions of the federal securities laws will apply to these general solicitations of interest.

Depending on the method of dissemination of the information, such communications could be considered a general solicitation. New Rule 241 provides an exemption from registration only with respect to the general solicitation of interest, not for the private offering. In the event that the communication was deemed a general solicitation, the issuer would need to rely on a private offering exemption, such as the new safe harbor permitting the commencement of a private placement 30 days following the termination of the solicitation.

The new rules require that where the issuer sells securities pursuant to one of the safe harbors within 30 days of a generic solicitation of interest, it is required to provide any purchaser who is not an accredited investor with any written generic solicitations of interest used prior to the sale. If the subsequent offering is made pursuant to Regulation A or Regulation Crowdfunding, the generic solicitation materials are required to be filed with the SEC.

Expanded Method of Verification

The new rules expand the methods by which an issuer may verify accredited investor status. If the issuer has reasonably established an investor's accredited status in the past five years, as long as the issuer is not aware of information to the contrary, it need not seek additional documentation or third-party verification and may instead rely on confirmation from the investor that he or she remains accredited.

While the new rules do not mandate what would be considered "reasonable steps" to verify an accredited investor's status, the release notes that the following factors are among those an issuer should consider when making its verification:

- 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.

Increased Offering and Investment Exemptions

The proposal would increase the offering and investment limits allowed under Regulation A, Regulation Crowdfunding and Rule 504 of Regulation D. The following chart summarizes the current and amended offering and investment limits.

	Offering Limits		Investment Limits	
	Current Rules	**New Rules**	**Current Rules**	**New Rules**
Regulation A: Tier 1	$20 Million	$20 Million	None	None
Regulation A: Tier 2	$50 Million	$75 Million	*Accredited investors:* no limits *Non-Accredited Investors:* limits based on the greater of an income or net worth standard	*Accredited investors:* no limits *Non-Accredited Investors:* limits based on the greater of an income or net worth standard
Regulation Crowdfunding	$1.07 Million	$5 Million	*All investors:* limits based on the lesser of an income or net worth standard	*Accredited investors:* no limits *Non-Accredited Investors:* limits based on the greater of an income or net worth standard
Rule 504 of Regulation D	$5 Million	$10 Million	None	None

Harmonization of Disclosure Requirements

For Regulation D offerings by non-reporting companies that include non-accredited investors, the amended Rule 502(b) aligns the disclosure requirement with the less burdensome disclosure requirements of Regulation A. Amended Rule 502(b) also simplifies Regulation A by aligning it with the rules for registered offerings regarding the redaction of confidential information in material contracts, permitting draft offering statements to be made public on EDGAR, permitting incorporation by reference on Form 1-A, and permitting the declaration of a post-qualification amendment as abandoned. The new rules also clarify that concurrent offshore Regulation S offerings will not be integrated with any registered or exempt domestic offerings.

Davis Polk

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