To Our Clients and Friends

Memorandum

SEC Proposes to Modernize and Streamline Exempt Offerings

On March 4, 2020, the Securities and Exchange Commission (the "SEC") proposed amendments to certain rules under the Securities Act of 1933, as amended ("Securities Act")[1] that are intended to, among other things, address gaps and complexities in the exempt offering framework that may impede access to investment opportunities for investors and capital for issuers. The proposed amendments would impact numerous types of exempt offerings, including offerings conducted under Regulation D and Regulation S. We highlight below the amendments that may be of particular interest to our clients that regularly conduct offerings under those exemptions. Comments to the proposal are due within 60 days of publication of the Proposing Release in the Federal Register.

Background

Regulation D is a series of rules that provides three exemptions from the registration requirements of the Securities Act. Rule 506(b) of Regulation D is a non-exclusive safe harbor under Section 4(a)(2) of the Securities Act pursuant to which an issuer may offer and sell an unlimited amount of securities, provided that offers are made without the use of general solicitation or general advertising and sales are made only to accredited investors and up to 35 non-accredited investors who meet an investment sophistication standard. A second non-exclusive safe harbor, Rule 506(c) of Regulation D, is substantially the same as Rule 506(b) except that (1) offers may be made through general solicitation or general advertising and (2) all purchasers in the offering must be accredited investors and the issuer must take reasonable steps to verify their accredited investor status. Rule 506(c) provides a principles-based method for verification of accredited investor status, as well as 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 persons. Offerings under both Rule 506(b) and Rule 506(c) must satisfy a number of other terms and conditions set forth in Regulation D, including the requirements in Rule 502(a) regarding integration (discussed below).

Regulation S provides a safe harbor from Securities Act registration for offers and sales that occur outside of the United States. Rule 903 of Regulation S requires, among other things, that (i) the offer or sale is made in an "offshore transaction," and (ii) no "directed selling efforts" are made in the United States by the issuer, a distributor, any of their respective affiliates, or any person acting on behalf of any

[1] Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, Release Nos. 33-10763; 34-88321 (Mar. 4, 2019) ("Proposing Release").

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of the foregoing. "Directed selling efforts" is generally defined to mean any activity undertaken for the purpose of, or that could reasonably be expected to have the effect of, conditioning the market in the United States for any of the securities being offered in reliance on Regulation S.[2]

Rule 502(a) provides that "offers and sales that are made more than six months before the start of a Regulation D offering or are made more than six months after completion of a Regulation D offering will not be considered part of that Regulation D offering, so long as during those six month periods there are no offers or sales of securities by or for the issuer that are of the same or a similar class as those offered or sold under Regulation D…." Rule 502(a) states that the following factors should be considered in determining whether offers and sales should be integrated for purposes of the exemptions under Regulation D: (1) the sales are part of a single plan of financing, (2) the sales involve issuance of the same class of security, (3) the sales have been made at or about the same time, (4) the same type of consideration is to be received, and (5) the sales are made for the same general purpose. In addition, in adopting Regulation S, the SEC stated that ''[o]ffshore 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."[3] As described above, offerings exempt from Securities Act registration under Rule 506(b), Rule 506(c) and Regulation S must satisfy a number of terms and conditions, which differ depending on the exemption relied upon. If two offerings relying on different exemptions were to be integrated, the integrated offering may no longer be eligible for either exemption because the integrated offering may not satisfy the terms and conditions of either exemption.

Proposed Amendments to the Integration Framework

The SEC proposes to modernize and simplify the integration framework for securities offerings with Proposed Rule 152, which would replace current Rules 152 and 155 concerning the integration of private and public offerings.[4] Proposed Rule 152(a) would set forth a general principle of integration, and proposed Rule 152(b) would provide four new safe harbors from integration.

1. Integration Principles

The general principle of integration under proposed Rule 152(a) would apply to all offers and sales of securities not covered by the four safe harbors set forth in proposed Rule 152(b). It would provide that 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 that an exemption from registration is available for the particular offering.[5] This proposed facts and circumstances analysis would be a codification of the SEC's prior guidance first provided in 2007 in the

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2 Securities Act Rule 902(c).

3 See Offshore Offers and Sales, 55 Fed. Reg. 18306 (May 2, 1990), at Section III.C.1. In addition, the Note to Rule 502(a) states that, "generally, transactions otherwise meeting the requirements of an exemption will not be integrated with simultaneous offerings being made outside the United States in compliance with Regulation S." Rule 502(a).

4 See Securities Act Rules 152 and 155.

5 Proposing Release at 30-31.

context of a simultaneous registered and private offering and would extend it to other contexts.[6] Proposed Rule 152 would replace the traditional five factor test that appears in current Rule 502(a) (described above), which would be amended to cross reference the revised Rule 152.[7] Proposed Rule 152(a)(1) provides that for an exempt offering for which general solicitation is not permitted, offers and sales will not be integrated with other offerings if the issuer has a reasonable belief, based on the facts and circumstances, that the purchasers in each exempt offering (i) were not solicited using general solicitation or (ii) established a substantive relationship with the issuer (or person acting on the issuer's behalf) prior to the commencement of such offering.[8] The Proposing Release indicates that proposed Rule 152(a) would permit an issuer to conduct concurrent offerings under Rule 506(b) and Rule 506(c) without integration concerns; provided that for the Rule 506(b) offering, the issuer has a reasonable belief, based on the facts and circumstances, that the purchasers were not solicited through the use of general solicitation or that they established a substantive relationship with the issuer (or person acting on the issuer's behalf) prior to the commencement of the Rule 506(c) offering.[9] In addition to such concurrent offerings, the Proposing Release states that under proposed Rule 152(a), an offering conducted in reliance on Rule 506(c) and a *subsequent* offering conducted in reliance on Rule 506(b) would not be integrated if the investors in the Rule 506(b) offering were not solicited through the use of general solicitation in connection with the Rule 506(c) offering, or if the investors established a substantive relationship with the issuer (or person acting on the issuer's behalf) prior to the commencement of the Rule 506(b) offering.[10]

2. Integration Safe Harbors

The SEC proposes the following four non-exclusive safe harbors from integration, which are set forth in proposed Rule 152(b): (i) 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, would not be integrated; provided that, for an exempt offering for which general solicitation is not permitted, the purchasers either were not solicited through the use of general solicitation, or established a substantive relationship with the issuer prior to the commencement of the offering for which general solicitation is not permitted, (ii) offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan, or Regulation S under the Securities Act, would not be integrated with other offerings, (iii) registered offerings made following terminated or completed offerings for which general solicitation is not permitted (or following certain terminated or completed offerings for which general solicitation is permitted) will not be integrated, and (iv) offers and sales made in reliance on an exemption for which general solicitation is permitted will not be integrated if made subsequent to any prior terminated

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6 Id. at 31-32.

7 Id. at 31; see also proposed Rule 502(a).

8 In addition, for an exempt offering permitting general solicitation that includes information about the material terms of a concurrent offering under another exemption also permitting general solicitation, the offering materials must include the necessary legends for, and otherwise comply with, the requirements of each exemption.

9 Id. at 32-33.

10 Id. at 33-34.

or completed offering.[11] We highlight certain aspects of the first two safe harbors and the fourth safe harbor below.[12]

- 30-Day Safe Harbor. As mentioned above, existing Rule 502(a) provides a safe harbor from integration for offerings made outside of a six-month time period. In light of changes in technology, the markets, and the securities laws, the SEC proposes Rule 152(b)(1), which would provide that 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, provided that for an exempt offering for which general solicitation is not permitted, the purchasers either (i) were not solicited through the use of general solicitation or (ii) established a substantive relationship with the issuer prior to the commencement of the offering for which general solicitation is not permitted.[13] The SEC states in the Proposing Release that waiting less than 30 days between offerings would not necessarily result in integration, but would require an analysis of the facts and circumstances surrounding the offerings.[14]

- Regulation S Safe Harbor. The Proposing Release states that Proposed Rule 152(b)(2) would codify the SEC's current position, mentioned above, that offshore offerings that are conducted in compliance with Regulation S will not be integrated with concurrent registered domestic offerings or domestic offerings that are conducted in compliance with any exemption.[15] The Proposing Release also states that when determining the availability of this safe harbor, it would still be necessary to assess each transaction for compliance with Regulation S and the conditions of the other exemption.[16] In addition, the SEC proposes amendments to Regulation S that would permit an issuer that is conducting an exempt offering that allows general solicitation, such as an offering under Rule 506(c), and uses widely accessible internet or similar communications, to continue to be able to rely on Regulation S for a concurrent offshore offering even though the general solicitation activity would likely be deemed "directed selling efforts" under current Rule 902(c) under Regulation S.[17] The SEC proposes to amend Rule 902(c) such that an issuer that engages in general solicitation activity under an exemption that allows general solicitation (e.g.,

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11 Proposed Rule 152(b). See Proposing Release at 29.

12 The third safe harbor described above is not the focus of this client memorandum and discussion of that safe harbor, and the conditions and requirements related thereto, has been omitted.

13 Proposed Rule 152(b)(1). See Proposing Release at 36-37, 38.

14 Id. at 42. The SEC also states in the Proposing Release that although recent data may suggest that shortening the safe harbor to 30 days is not likely to result in a large increase in the number of non-accredited investors participating in Rule 506(b) offerings, it is mindful that issuers may seek to undertake serial Rule 506(b) offerings each month, selling to up to 35 unique non-accredited investors in each offering, potentially resulting in unregistered sales of securities to hundreds of non-accredited investors in a year. To address this concern, the SEC proposes to amend Rule 506(b) so that where an issuer conducts more than one offering under Rule 506(b), the number of non-accredited investors purchasing in all such offerings within 90 calendar days of each other would be limited to 35. Id. at 42-43.

15 Proposed Rule 152(b)(2). See Proposing Release at 47.

16 Id.

17 Id. at 48.

Rule 506(c)) would not be considered to have engaged in "directed selling efforts" in connection with an offering under Regulation S if the general solicitation activity is not undertaken for the purpose of conditioning the market in the United States for any of the securities being offered in reliance on Regulation S.[18] However, because the SEC is mindful that, regardless of the issuer's intent, such activities may increase the risk of flowback of Regulation S securities to the United States when there is a concurrent exempt offering of the securities in the United States using general solicitation (e.g., Rule 506(c)), the SEC proposes new Rule 906 of Regulation S.[19] Proposed Rule 906 would apply to securities offered and sold in a transaction subject to the conditions of Rule 901 or Rule 903, and would require an issuer that engages in general solicitation activity covered by the proposed exclusion from the definition of "directed selling efforts" described above to prohibit resales to U.S. persons (or for the account or benefit of a U.S. person) of the Regulation S securities for six months from the date of sale, except to qualified institutional buyers or institutional accredited investors.[20] This six-month limitation would apply regardless of the Regulation S category applicable to the securities, and notwithstanding, and in addition to, any applicable distribution compliance period.[21]

- Safe Harbor for Offers or Sales Preceding Exempt Offerings Permitting General Solicitation. Proposed Rule 152(b)(4) would provide a safe harbor for offers and sales made in reliance on an exemption for which general solicitation is permitted if such offers and sales are made subsequent to any prior terminated or completed offering.[22] The Proposing Release indicates that this safe harbor would apply to offerings conducted under Rule 506(c) that are subsequent to the completion or termination of an offering conducted under Rule 506(b).[23] The SEC further proposes to clarify that offerings under Regulation D would be considered "terminated or completed" on the later of the date (i) the issuer entered into a binding commitment to sell securities under the offering (subject only to conditions outside of the investor's control); or (ii) the issuer and its agents ceased efforts to make further offers to sell the issuer's securities.[24] The Proposing Release states that for purposes of exemptions permitting the use of general solicitation, the cessation of selling efforts would require the removal of any publicly available general solicitation materials, to the extent possible.[25]

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18 Id. See also proposed Rule 902(c)(3)(ix). As noted above, the current definition of "directed selling" efforts includes not only activity undertaken for the purpose of conditioning the market in the United States for any of the securities being offered in reliance on Regulation S, but also any activity undertaken that could reasonably be expected to have that effect.

19 Id. at 49.

20 Proposed Rule 906. See Proposing Release at 49. "Institutional accredited investors" are those accredited investors who qualify as such under Rule 501(a)(1), (2), (3), (7) and (8).

21 Proposing Release at 49.

22 Proposed Rule 152(b)(4).

23 Proposing Release at 52-53. The Proposing Release also states that such offerings would not be integrated on the basis of proposed Rule 152(a)(1). See Proposing Release at pages 33-34.

24 Proposed Rule 152(c)(1). See Proposing Release at 45.

25 Id. at 45 n. 102.

Proposed Accredited Investor Verification Method

As discussed above, Rule 506(c) permits issuers to engage in general solicitation and advertisement provided that (i) all purchasers in the offering are accredited investors, (ii) the issuer takes reasonable steps to verify that purchasers are accredited investors, and (iii) certain other conditions in Regulation D are satisfied.[26] Rule 506(c) provides a principles-based method for verification of accredited investor status as well as a non-exclusive list of verification methods that issuers may use when seeking to satisfy the verification requirement with respect to natural persons.[27] The SEC proposes a new verification safe harbor that would allow an issuer to establish that an investor for which the issuer previously took reasonable steps to verify as an accredited investor remains an accredited investor as of the time of a subsequent sale if the investor provides a written representation to that effect and the issuer is not aware of information to the contrary.[28] As with the existing safe harbors in Rule 506(c), the new safe harbor would only apply with respect to natural persons.

In the Proposing Release, the SEC also reaffirms and updates its prior guidance with respect to the principles-based method for accredited investor verification, seeking to "lessen concerns that an issuer's method of verification may be second guessed by regulators" and to "encourage more issuers to rely on additional verification methods tailored to their specific facts and circumstances."[29] Notably, the SEC states that it is of the view that in some circumstances, the "reasonable steps" determination may not be substantially different from an issuer's development of a "reasonable belief" for Rule 506(b) purposes.[30] As an example, the Proposing Release states that an issuer's receipt of a representation from an investor as to his or her accredited status could meet the reasonable steps requirement if the issuer reasonably takes into consideration a prior substantive relationship with the investor or other facts that make apparent the accredited status of the investor.[31] The Proposing Release also states that the same representation may not meet the reasonable steps requirement if the issuer has no other information available to it about the investor or has information that does not support the view that the investor was an accredited investors.[32] The SEC also cautions issuers that it continues to believe that an issuer will not be considered to have taken reasonable steps to verify accredited investor status if it, or those acting on its behalf, require only that a person check a box in a questionnaire or sign a form, absent other information about the purchaser indicating accredited investor status.[33]

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[26] See id. at 86; see also Rule 506(c).

[27] Rule 506(c)(ii).

[28] Proposed Rule 506(c)(2)(ii)(E).

[29] Proposing Release at 89.

[30] Id. at 90.

[31] Id.

[32] Id. at 90-91.

[33] Id. at 91 n. 175.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its contents. If you have any questions about the contents of this memorandum, please call your regular Fried Frank contact or an attorney listed below:

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