LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
TUESDAY, DECEMBER 1, 2020

PERSPECTIVE

SEC adopts final rules to improve access to capital

By Sara L. Terheggen

It is the most fundamental premise of the Securities Act that all securities offerings must be registered unless a valid offering exemption exists. Throughout the years, the offering exemption framework has evolved and expanded in an effort to facilitate capital raising but that same evolution has created complexity and uncertainty. This has made it difficult for private companies and investors to navigate the murky waters. On Nov. 2, the SEC adopted final rules to reduce the complexity and "promote capital formation and expand investment opportunities while preserving or improving important investor protections." Among the amendments, the most critical for improving access to capital raising opportunities include: (i) revising the integration framework, (ii) increasing the offering limits and revising certain individual investment limits and (iii) expanding rules governing offering communications.

Integration

Different offering exemptions have different limitations, conditions, etc., and offerings conducted in close proximity to another offering for companies who have frequent capital needs can encounter integration issues. Integration is the framework used to determine whether the two offerings should be considered "integrated" into one offering to ensure a valid securities exemption exists. Historically, issuers had to look to a five-factor test to analyze whether two exempt offerings must be integrated. This five-factor test was difficult to apply because of the years of interpretive guidance provided by the SEC leaving issuers at risk of tripping up the integration doctrine. This served as an impediment for companies who needed to frequently access the private markets. New Rule 152 will help to overcome this impediment by establishing a revised integration framework that is more facts and circumstances oriented and provides four important non-exclusive safe harbors. These include:

• *30-Day Safe Harbor:* Any offering completed or terminated more than 30 calendar days before the commencement of a new offering will not be integrated. However, in those instances when an offering that prohibits general solicitation is followed by an offering that allows it, the issuer must have a reasonable belief that each purchaser in the offering that prohibits general solicitation was not solicited through general solicitation or that a substantive relationship was established prior to commencement of the offering prohibiting general solicitation. The 30- day window is a significant departure from the previous 6-month safe harbor and will provide companies with significantly more opportunity to access capital without fearing an integration issue.

• *Specialized Offerings:* Rule 701, employee benefit plans and Regulation S offerings will not be integrated with other offerings. This safe harbor codifies previous SEC interpretative guidance that already provided that Regulation S will not be integrated with registered or exempt domestic offerings.

• *Registered Offerings:* Any offering for which a registration statement has been filed will not be integrated if it was made subsequent to a terminated or completed offering where general solicitation is not permitted. This is also true where general solicitation is permitted but made only to qualified institutional buyers and institutional accredited investors or an offering that allows general solicitation but was terminated or completed more than 30 days prior to the commencement of the registered offering. This will make it easier for a company to pursue a smaller private offering in preparation for a larger public offering without concern of integration.

• *General Solicitation Offerings:* Any offering made in reliance on an exemption where general solicitation is permitted will not be integrated if made subsequent to a terminated or completed offering.

Offering and Investment Limits

In an effort to increase issuer and investor access to different types of private placements, the SEC increased the offering and investment limits for certain offerings, including:

• *Regulation A:* Tier 2 primary offering maximum increased to $75 million (up from $50 million) and secondary sales increased to $22.5 million (up from $15 million).

• *Crowdfunding:* Increased offering maximum to $5 million (up from $1.07 million), removed limitations on investment amounts by accredited investors and allowed non-accredited investors to use the greater of their annual income or net worth when calculating their investment limits.

• *Rule 504:* Increased offering maximum to $10 million (up from $5 million). Given the expense associated with conducting any type of offering, increasing these limits will likely make these offerings more palatable for issuers.

Offering Communications

As part of their amendments, the SEC expanded permissible communications in the context of private offerings. Offering communications are always a difficult terrain to navigate but these amendments help to clarify some critical aspects that will ease the offering process for issuers.

• *Rule 241:* New Rule 241 will

now allow issuers to effectively test the waters by gauging interest in an offering without first determining under which private offering exemption they plan to rely. Issuers must ensure an exemption is determined prior to solicitation or acceptance of commitments, appropriate legends are used on the materials and no part of the purchase price is received until the exemption is determined. However, it is important to remember that Rule 241 provides an exemption for the general solicitation and not for the offering. As such, issuers must be careful about general solicitation. Because general solicitation is still prohibited for many exempt offerings, an issuer who engages in such could preclude them from relying on certain exemptions for the offering itself. Despite this limitation, Rule 241 is an important amendment as it allows more companies to gauge interest before committing to an offering and be able to garner true insight into the "type" of transaction that is likely to yield the most success which is critical in the private offering context.

• *Crowdfunding:* The SEC will also allow issuers relying on crowdfunding to test the waters prior to filing an offering document with the SEC (similar to Regulation A). Further, issuers will be able to orally communicate with prospective investors after a Form C is filed.

• *Demo Days:* New Rule 148 provides that demo day communications will not be deemed to be general solicitation or general advertising. To ensure an issuer meets this exemption, a number of conditions must be met, including that more than one issuer must be participating in the event; sponsor is not allowed to make investment recommendations or receive any compensation in connection with the demo day; no investment advice is allowed to be conveyed during the demo day; virtual participation must be limited; and advertising for the demo day may not reference a specific offering of securities. Demo days are an important aspect for companies with innovative technology and the ability to participate is not only important for future capital raising efforts but also provides other benefits outside the exempt offering framework, such as identification of strategic partners and general business development.

Improving Capital Access

Clarifying integration issues, including shortening the 6-month safe harbor to 30-days, increasing offering amount limitations and improving the offering communication regime are all critical SEC amendments to smooth the path to capital for many companies while maintaining important investor protections. Especially in turbulent times, access to capital when and as needed can mean the difference between a company that cannot survive and one that thrives. ■

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