Committee on Securities Law
of the Business Law Section of the
Maryland State Bar Association

June 1, 2020

VIA EMAIL TO RULE-COMMENTS@SEC.GOV

Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File No. S7-05-20; Proposing Release "Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets"

Ladies and Gentlemen:

This letter expresses the views of the Committee on Securities Laws (the "Committee") of the Business Law Section of the Maryland State Bar Association ("MSBA"), with respect to the above-referenced proposing release, Securities and Exchange Commission (the "Commission") Release Nos. 33-10763; 34-88321; File No. S7-05-20 (the "Release") relating to the Commission's proposed amendments "to facilitate capital formation and increase opportunities for investors by expanding access to capital for entrepreneurs across the United States," as set forth in the Release. The membership of the Committee consists of securities practitioners who are members of the MSBA and includes lawyers in private practice, business, and government, including Commission alumni. The Business Law Section and the Board of Governors of the MSBA have not taken a position on the matters discussed herein, and individual members of the MSBA and the Committee, and their associated firms or companies, may not necessarily concur with the views expressed in this letter.

To begin with, the Committee wishes to express its agreement with, as noted in the Release, the "consistent theme" in the comment letters received on the Commission's related June 2019 concept release soliciting comment on ways to simplify, harmonize, and improve the exempt offering framework, "that many elements of the current structure work effectively and a major restructuring is not needed." While we understand that the "complex patchwork of exemptions

from registration"[1] can seem overly and unnecessarily complex, the varying exemptions generally serve different purposes and are aimed at accommodating a variety of issuers and types of securities offerings. As a result, we believe that it would be difficult to simplify the exemption regime by collapsing or reducing the various exemptions while retaining the flexibility inherent in the current system that allows issuers to choose exemptions that work for them and their intended securities offerings. We do, however, agree that the requirements of these exemptions should be harmonized to the extent possible, which we believe will reduce confusion and increase compliance. As an example, there is no logical reason why the substantive "bad actor" disqualification provisions should vary among the different exemptions that include such provisions. Therefore, we support the proposed amendments to harmonize the bad actor provisions of Regulation D, Regulation A, and Regulation Crowdfunding as proposed in the Release.

The Committee's comments on specific provisions of the proposed amendments are set forth below.

<u>Proposed Integration Framework</u>

Our primary concerns with respect to the proposals set forth in the Release relate to the proposed amendments to the integration framework, which would be set forth in amended Rule 152. As proposed, the current five-factor integration test set forth in Rule 502(a) of Regulation D and various other rules promulgated under the Securities Act of 1933 ("Securities Act") would be replaced by a general principle of integration that includes a facts and circumstances analysis, two provisions applying the general principle to specific fact patterns, and four non-exclusive safe harbors. In general, as discussed below, we found several elements of the proposed integration framework to be confusing, internally inconsistent, and, with respect to certain provisions, illogical. Further, we question the need for such a tremendous overhaul of the current integration framework, as we are not aware of significant problems in applying the current five-factor test to determine if purportedly separate offerings should be integrated and considered one offering. We discuss a number of these specific concerns below.

<u>General Principle of Integration</u>

The proposed general principle of integration would provide that, for

[1] Commissioner Allison Herren Lee, *Statement on Proposed Amendments to the Exempt Offering Framework*, March 4, 2020.

offerings not covered by a safe harbor, "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."

We don't believe that it makes sense to provide, as the language of the general principle appears to do, that purportedly separate offerings will not be integrated if each offering standing alone complies with registration or exemption provisions of the Securities Act. To our understanding, at least one purpose of the concept of integration is so that an issuer cannot do indirectly (i.e. have non-accredited/sophisticated investors invest in a Rule 506 offering that has no dollar limit or exceed the 35 non-accredited but sophisticated investors limit in a Rule 506(b) offering) what it cannot do directly, a concept that permeates much of federal securities law. The plain language of the general principle, however, would apparently codify the permissibility of doing exactly that – doing something indirectly that you could not do directly. For example, it appears that under the general principle an issuer would be permitted to conduct side-by-side Rule 504 and Rule 506 offerings that are in essence the same offering (same time, same security, same price, etc.), allowing (as a practical matter) non-accredited investors to invest in a Rule 506 offering without receiving any prescribed disclosure and without any other investor protections (save those required by the applicable exemptions the issuer is complying with under applicable state laws).

Again, we simply cannot understand the logic of the general principle that purportedly separate offerings will not be integrated *solely* because each offering, standing on its own, would comply with an exemption to registration. We believe that whether purportedly separate offerings should be integrated should be based on the facts and circumstances as to whether they are so similar as to functionally be one offering. We cannot understand how whether each purportedly separate offering complied with the requirements of an exemption should possibly impact a determination of whether they should be integrated. Whether two offerings should be integrated should be based on the particular facts and circumstances of the *offerings*, not on whether the purportedly separate offerings each comply with an exemption. These should be entirely separate determinations, with the question of whether the offerings were functionally the same offering being determined first, followed by, if they were not functionally separate offerings, whether the "integrated" offering satisfied the requirements of an exemption. Intermingling these two separate questions confuses the issues and, to us, does not make any sense given the purpose of the concept of

integration.

The proposed general principle seems to turn the entire concept of integration on its head by providing that integration only applies if it would result in a violation. We believe that, as is currently the case, an integration analysis should first determine whether purportedly separate offerings should be integrated and then determine if together they would be in violation. The proposed general principle seems to have no purpose other than to make a purportedly separate offering be in violation of the registration provisions of the Securities Act but only if another purportedly separate offering with which it could be integrated, standing alone, was also in violation. To us, it seems the proposed framework guts the whole concept of integration and calls into question the integrity of the integration framework with little attendant benefit with respect to investor protection or the securities regulation framework in general. We also believe that the proposed rule's focus on when offerings will *not* be integrated unintentionally illustrates that the Commission does not actually believe that integration will survive the changes proposed for the new integration framework as set forth in proposed Rule 152 (other than when there is a registration violation). In this regard, we note that the proposed rule provides a number of instructions and scenarios governing when two purportedly separate offerings will <u>not</u> be integrated. Unlike current Rule 502(a), however, the proposed rule does not address <u>at all</u> how issuers are to determine whether offers and sales that are part of purportedly separate offerings <u>should</u> be integrated if none of the safe harbors apply and the general principle does not result in a determination that such offers and sales will not be integrated. In other words, let's assume one walks through the analysis set forth in the Rule for two concurrent exempt offerings where none of the safe harbors apply and one of the offerings violated the terms of its exemption. Under proposed Rule 152(a) there is no basis upon which the issuer can be comfortable that the offerings would not be integrated. That does not mean, however, that the two offerings should be integrated; it would make no sense whatsoever to assert that the two offerings should be integrated simply because one of them did not comply with its exemption - the two offerings could be as different as night and day. Yet proposed Rule 152 does not address how to determine, under these circumstances, whether the two offerings should be integrated. The complete lack of guidance as to how an integration analysis would be conducted in such circumstances is not only a deficiency of the proposed rule itself, but it also reveals the Commission's unstated intention and expected outcome as well.

Further, we find the reference to "based on the particular facts and

circumstances" in the general principle of integration set forth in proposed Rule 152(a) confusing and unnecessary. We believe an analysis based on "facts and circumstances" makes sense when, as under the current integration framework, there are no bright lines or hard and fast requirements that govern the outcome. That is not the case here, where whether an offering complies with the requirements of an exemption is generally not based on a "facts and circumstances" analysis. We fail to understand what the reference to "facts and circumstances" means in this context or what it adds to the general principle; in other words, if that language were removed, it does not appear that it would change anything as far as the meaning of the general principle – so why is it needed? If this language is retained, we suggest that the Commission provide an explanation and examples, if not in any final rule that may be adopted then at least in the adopting release, as to what relevant facts and circumstances might be in this context and how they would be analyzed for purposes of the general principle.

Application of the General Principle of Integration

The first provision applying the general principle of integration, as set forth in proposed paragraph (a)(1) of amended Rule 152, would provide that, with respect to "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: (i) The purchasers in each exempt offering were not solicited through the use of general solicitation; or (ii) The purchasers in each exempt offering established a substantive relationship with the issuer (or person acting on the issuer's behalf) prior to the commencement of the offering not permitting general solicitation." We have a number of concerns regarding this part of the proposal.

First, we find this application of the general principle confusing, as it seems to contradict the general principle itself. The general principle states that in determining whether two or more offerings will be treated as one, offers and sales will not be integrated if an exemption is available for each offering. We read this to mean that each purportedly separate offering should be analyzed individually to determine if an exemption is available for each such offering. But proposed Rule 152(a)(1) provides that an exempt offering that does not permit general solicitation will not be integrated if the purchasers in each exempt offering (i.e., all the offerings) were not solicited through general solicitation or had a pre-existing substantive relationship with the issuer or a person acting on the issuer's behalf. This, apparently, would mean that each offering is not analyzed separately to determine if such offering complied with an exemption, at

least with respect to the no general solicitation prong of an exempt offering. For example, if an issuer conducted simultaneous Rule 506(b) and Rule 506(c) exempt offerings, then under the application of the general principle each offering should be analyzed separately to determine if it complied with its exemption. As paragraph (a)(1) of the proposed rule requires that "the purchasers in each exempt offering" (emphasis ours) must satisfy the no general solicitation requirements, then the Rule 506(b) and 506(c) offerings would be integrated under the application of the general principal set forth in proposed Rule 152(a)(1). Therefore, the integrated offerings would not be in compliance with a registration exemption, even though it appears that based on the language of the general principle that should not be the outcome because it states that offerings will not be integrated if each such offering complies with an available exemption.

Second, as currently proposed Rule 152(a)(1) would not be consistent with Rule 502(c), which provides that, except as provided in Rules 504(b)(1) and 506(c), "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising."

Proposed Rule 152(a)(1), on the other hand, provides that an offering for which general solicitation is not permitted will not be integrated with other offerings if the issuer reasonably believes that the purchasers in each offering were not solicited through the use of general solicitation or had a pre-existing substantive relationship with the issuer or a person acting on the issuer's behalf.

Taking an example of two simultaneous exempt offerings conducted under Regulation D, one under Rule 506(b) and one under Rule 504 (not subject to the exception permitting general solicitation), then under the proposal if (i) the issuer offered the securities in the offerings by means of a general solicitation, but (ii) all of the purchasers were not solicited through such general solicitation or had a pre-existing substantive relationship with the issuer or someone acting on the issuer's behalf, then (y) the offerings would not be integrated as per proposed Rule 152(a)(1), but (z) each offering would be in violation of the registration provisions of the Securities Act because Rule 502(c) prohibits general solicitation in connection with the offer or sale of securities in these offerings, while proposed Rule 152(a)(1) focuses solely on the purchasers – i.e., the means by which the securities were sold.

We surmise that this is not the intended outcome of the proposed amendments – there does not seem to be much point in broadening the permissible use of general solicitation to allow issuers to avoid integration when,

in the end, they will have violated the registration provisions of the Securities Act anyway. In this regard, Commissioner Lee states in her public statement on the proposed amendments, *supra* note 1, that "[p]resently, an issuer conducting an exempt offering that prohibits general solicitation generally cannot rely on the exemption if investors in the offering were identified or contacted through general solicitation. Under the new proposed integration framework, however, it does not matter if the investor was in fact identified through general solicitation. The issuer can still rely on an exemption that purports to prohibit general solicitation as long as the issuer has a reasonable belief of a pre-existing substantive relationship with the purchaser. Even if that relationship was developed pursuant to a general solicitation." For that to be true, however, we believe that an amendment to Rule 502(c) would be necessary, since otherwise Rule 502(c) would still prohibit the offer (as well as the sale) of securities through general solicitation. The Commission is not, however, proposing to amend Rule 502(c); in fact, the only reference to potentially amending Rule 502(c) is the Commission's question in the Release as to whether the similar language in the proposed 30-day integration safe harbor set forth in proposed Rule 152(b)(1)(i) would be more appropriate in Rule 502(c).

In addition, assuming this expansion of the permissible use of general solicitation is in fact the Commission's intention, such a huge expansion of the permissible use of general solicitation in exempt offerings should be proposed, analyzed, and discussed on its own, not simply implied as part of revisions to the rules governing integration. We note, for example, that the idea that an issuer can engage in general solicitation as long as all purchasers have a substantive pre-existing relationship with the issuer (or someone acting on its behalf) is not discussed in the section of the Release entitled "General Solicitation and Offering Communication." We believe that such a significant and unprecedented expansion of the permissible use of general solicitation requires a robust discussion and analysis, including a straightforward statement that this is what is in fact being proposed so that interested parties have the ability to comment on such proposal directly. Until forced by Congress pursuant to the Jumpstart Our Business Startups Act to adopt Rule 506(c) in 2013, general solicitation was prohibited in exempt offerings conducted pursuant to Regulation D (the substantial majority of exempt offerings), other than the narrow exemption in Rule 504(b)(1). In this regard, the Rule 506(c) adopting release[2] stated that "public advertising is incompatible with a claim of exemption under Section 4(a)(2)" and that "an issuer relying on Section 4(a)(2) outside of the Rule 506(c)

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[2] Commission Release No. 33-9415; No. 34-69959; No. IA-3624, *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings* (July 10, 2013).

exemption will be restricted in its ability to make public communications to solicit investors for its offering because public advertising will continue to be incompatible with a claim of exemption under Section 4(a)(2)." The Commission "amend[ed] Rule 500(c) of Regulation D accordingly to make this clear." In that regard, Rule 500(c) currently provides that "[f]or instance, an issuer's failure to satisfy all the terms and conditions of rule 506(b) (§ 230.506(b)) shall not raise any presumption that the exemption provided by section 4(a)(2) of the [Securities] Act (15 U.S.C. 77d(2)) is not available." The language was amended to add the "(b)" after "Rule 506" so that it was clear that an offering conducted under Rule 506(c), which permits an issuer to offer and sell securities by means of general solicitation, would not be in compliance with Section 4(a)(2) or eligible for the registration exemption provided thereunder. We note that the Commission is not proposing to amend Rule 500(c) as part of the amendments proposed in the Release and that none of such proposed amendments would provide that Rule 506(b) is no longer a registration safe harbor pursuant to Section 4(a)(2) of the Securities Act.

If the Commission were proposing to expand the use of general solicitation in the manner implied as per our discussion above, we believe (in addition to stating so outright), that at the very least a discussion of what has changed since 2013 such that "public advertising" is no longer "incompatible with a claim of exemption under Section 4(a)(2)" is imperative. If the Commission were proposing such an expansion of the permissible use of general solicitation for Rule 506(b) offerings, an explanation of why Rule 506(b) offerings were still covered by the statutory Section 4(a)(2) exemption while Rule 506(c) offerings were not would also be crucial. In any case, such a proposed expansion of the use of general solicitation in Rule 506(b), as well as in Rule 504, offerings, should be specifically and clearly proposed, not implemented as part of a revision to the integration rules. If such an expansion is not intended, however, then to avoid confusion that should be made clear in the adopting release, and an explanation of the utility of proposed Rule 152(a)(1) would be in order as well.

Third, we believe that, if adopted, proposed Rule 152(a)(1) should be revised to clarify that the offerings would not be integrated if the provisions addressed therein with respect to general solicitation were complied with <u>and</u> the offering otherwise complied with the terms of the claimed exemption. Paragraphs (a)(1) of the proposed rule provides that "offers and sales will not be integrated with other offerings" if the general solicitation provisions addressed therein are complied with. This contradicts the provision in the general statement that offerings will not be integrated if "the issuer can establish that … an

exemption from registration is available for the particular offering," which we understand to mean that each offering in question must be in compliance with all the requirements of such an exemption.

Fourth, the safe harbor in paragraph (b)(1) of proposed amended Rule 152 would similarly provide that the 30-day safe harbor will apply with respect to an exempt offering for which general solicitation is not permitted if the purchasers in the offering were not solicited through general solicitation or had a pre-existing substantive relationship with the issuer. Paragraphs (a)(1) and (b)(1) of the proposed rule therefore use an almost identical standard, but paragraph (b)(1) omits the "reasonable belief" standard as well as the provision that the purchaser's pre-existing relationship could be with a "person acting on the issuer's behalf." We find these inconsistencies confusing and question how they should be applied in practice. For example, what should an issuer do differently to satisfy the higher standard of the safe harbor that is not subject to the issuer's "reasonable belief?" Further, why is a pre-existing substantive relationship with a person acting on the issuer's behalf acceptable under the general principle but not under the safe harbor? If the proposed amendments to Rule 152 are adopted, we would suggest that the Commission either harmonize these provisions or provide an explanation of how they differ as well as guidance addressing what these provisions would mean for issuers in the context of structuring and conducting their private placements to ensure compliance.

Finally, given the Commission's statement in the Release that "[p]roposed Rule 152(a)(1) would codify Commission guidance first issued in 2007 in the context of setting forth a framework for analyzing how an issuer can conduct simultaneous registered and private offerings," which addresses a situation involving one offering where general solicitation is permitted (the registered offering) and one offering, the private offering, where it is not (at least in 2007), we fail to understand why the proposed rule does not address an application of the general principle for simultaneous exempt offerings where general solicitation is permitted for one or more, but not all, such offerings. We suggest that the Commission consider specifically addressing such a situation if it adopts the proposed amendments to Rule 152. While we note that the Release states that "[p]roposed Rule 152(a)(1) would also apply to an offering made under an exemption from registration for which general solicitation is prohibited that follows a registered offering or an offering that permits general solicitation," the requirement set forth therein that "[t]he purchasers in *each* exempt offering were not solicited through the use of general solicitation; or … established a [pre-existing] substantive relationship with the issuer (or person acting on the

issuer's behalf" (emphasis ours) appears to belie that assertion.

The second provision applying the general principle of integration, as set forth in proposed paragraph (a)(2) of amended Rule 152, would provide that, with respect to concurrent exempt offerings conducted under different exemptions that each permit general solicitation, if the offering materials for one offering "includes information about the material terms of" the concurrent offering, "the offering materials must include the necessary legends for, and otherwise comply with, the requirements of each exemption." Again, we believe this portion of the proposed rule is confusing. First, it is not entirely clear whether the statement requiring compliance with "the requirements of each exemption" refers to solely the offering materials or to the offering in general. If this provision of proposed Rule 152 is adopted, we suggest that it be revised to make this clarification. Second, this application of the general principle appears to potentially contradict the general principle because it states that the requirements of each exemption must be complied with (at the least, with respect to offering materials), whereas the general principle appears to provide that each exempt offering should be analyzed individually for compliance only with its claimed exemption.

Integration Safe Harbors

Paragraph (b) of proposed amended Rule 152 would provide four non-exclusive integration safe harbors. We address each proposed safe harbor below.

Thirty-Day Integration Safe Harbor

Proposed Rule 152(b)(1) would shorten the current six-month integration safe harbor set forth in Rule 502(a) to 30 days. According to the Release, this would "harmonize current Securities Act exemptions by providing the same 30-day safe harbor time period throughout their integration provisions." The Release also notes that other integration provisions include a 30-day waiting period between offerings, including: (i) Rule 155 addressing an abandoned private offering followed by a subsequent registered offering, and vice-versa; and (ii) Rules 255(e), 147, and 147A addressing an abandoned Regulation A offering or an exempt intrastate offering conducted under Rules 147 or 147A, in each case followed by a subsequent registered offering.

We disagree that, in this case, harmonization is appropriate justification for shortening the six-month safe harbor to 30 days. The 30-day safe harbors set forth in the rules referenced above deal with specific situations where the

characteristics of the two non-integrated offerings are likely to be significantly different given that one of the offerings in question was private and the other was a registered, public offering. Further, in the case of Rule 255(e), one of the non-integrated offerings in question has been abandoned, with no sales of securities thereunder. This is quite different than two Regulation D offerings conducted 30 days apart, which based on our experience in many cases would amount to no more than a pause in what as a practical matter is a single offering. Given these differences, we do not believe that the fact that some integration safe harbors are 30 days justifies decreasing all integration safe harbors to 30 days.

We do note that, to address the risk that issuers may undertake serial Rule 506(b) offerings, Rule 506(b)(2)(i) would provide that if an issuer conducts more than one offering under Rule 506(b), the number of non-accredited investors purchasing in all such offerings would be limited to 35 in any 90-day period. While this addresses some of our concerns, we believe that a 90-day (or three-month) safe harbor would be more effective than the currently-proposed 30-day period in in accomplishing the goal of "imped[ing] what integration seeks to prevent: improperly avoiding registration by artificially dividing a single offering into multiple offerings."

The Release justifies the decrease in the safe harbor to a 30-day period by asserting, among other things, that "[g]iven the accelerating speed and consumption of electronically disseminated information in today's financial marketplace, we believe a 30-day time frame is sufficient to mitigate concerns that an exempt offering may condition the market for a subsequent registered offering or undermine the protections of a subsequent exempt offering. In this regard, we think it likely that the effects of any offers made more than 30 days prior to or after commencement of another offering would be sufficiently diluted by intervening market developments so as to render an integration analysis unnecessary." We do not believe that these statements are accurate, at least with respect to the offerings with which members of our committee have been involved. In our experience, exempt offerings can go on for many months (with updates or supplements to the offering materials for material developments as necessary), and as a practical matter, a 30-day period of no offers and sales would, as we stated above, effectively constitute a pause in what in reality is a single offering as opposed to really being two separate offerings. Admittedly, the bulk of our experience is with private and smaller public companies, and the referenced Release statements may very well be true with respect to the largest public companies with broad analyst followings; but we do not believe they are applicable to the majority of companies and would not be accurate with respect

to the majority of private offerings. Given these apparent differences, we believe a 90-day safe harbor period would be an appropriate compromise between the current six-month period and the proposed 30-day period.

We also wanted to note the guidance in the Release aimed at "provid[ing] greater certainty to issuers as to the availability of all of our proposed safe harbors that require the prior offering to be 'terminated or completed.'" The Committee believes that the guidance set forth in the Release is helpful and wishes to extend its appreciation to the Commission for including it.

Rule 701, Employee Benefit Plans, and Regulation S

Proposed Rule 152(b)(2) would provide that offers and sales made in compliance with Rule 701, pursuant to an employee benefit plan, or in compliance with Regulation S, would not be integrated with other offerings.

We note that Rule 701 currently provides that offers and sales thereunder and are not subject to integration with any other offers or sales of securities. The rationale for exempting offers and sales under Rule 701 from integration with other offers and sales is applicable to offers and sales under employee benefit plans generally. We therefore support this provision of proposed Rule 152(b)(2).

Similarly, as the proposal to exempt offers and sales under Regulation S would simply codify the integration exemption set forth in the Regulation S adopting release, particularly given the provisions of proposed new Rule 906 to prevent "flowback" of such securities into the United States, we support this part of the proposed amendment to Rule 152 as well.

Subsequent Registered Offerings

Proposed Rule 152(b)(3) addresses integration of registered offerings with certain terminated or completed prior exempt offerings. This proposed safe harbor appears to be generally consistent with existing Rule 152, updated mainly to account for the fact that general solicitation is now permitted for offerings conducted under Rule 506(c). We believe this part of the proposal is consistent with the general purpose of the integration analysis and have no objections to this proposed safe harbor.

Offers or Sales Preceding Exempt Offerings Permitting General Solicitation

Proposed Rule 152(b)(4) would provide an integration safe harbor "for all offers and sales made in reliance on an exemption for which general solicitation is permitted that follow any other terminated or completed offering."

Again, we do not believe that it is appropriate to extend the safe harbor for Regulation A and intrastate offerings to, for example, Regulation D offerings. We believe that, as proposed, this safe harbor would permit a Rule 506(c) offering to commence immediately following the completion of a Rule 506(b) offering for the same securities at the same price, etc. As a practical matter, we believe that this is no different than permitting general solicitation in a Rule 506(b) offering, with the caveat that the offering would be conducted in two phases, first in compliance with Rule 506(b), and then with general solicitation (and verification of accredited investor status) commencing after subscription agreements are signed with the investors in the first phase. Pursuant to the guidance regarding when an offering is "terminated or completed," these "separate" offerings could even be closed (i.e. subscription price paid and securities issued to investors) on the same date and still not be integrated.

<u>"Plan or Scheme to Evade"</u>

As proposed, the lead-in paragraph of Rule 152 would provide that the "safe harbors are not available to any issuer for any transaction or series of transactions that, although in technical compliance with the rule, is part of a plan or scheme to evade the registration requirements of the [Securities] Act." We have two concerns with this part of the proposal.

First, as written the proposed rule would make <u>only the safe harbors</u> unavailable for transactions designed to evade the registration requirements of the Securities Act - meaning that the general principle to avoid integration *would* be available to an issuer for transactions that *are part of a plan or scheme to evade such registration requirements*. It does not appear that the language in the proposed rule limiting this exclusion to the safe harbors was unintentional, as the Release states several times that the "safe harbors" in proposed Rule 152 would be unavailable in such circumstances. The Release states that the proposed language is "[c]onsistent with current Rule 155," but this language makes sense in Rule 155 because Rule 155 is itself solely an integration safe harbor. Proposed amended Rule 152, on the other hand, sets forth the entire proposed new integration framework in addition to safe harbors. As a result, use of the same or similar language is not necessarily appropriate because, as noted above, it results in the proposed rule providing that, other than the safe harbors, the rule is

available for transactions designed to evade the registration requirements of the Securities Act.

In addition, and we beg the Commission's forgiveness for our bluntness here, but this language in the proposed rule seems, to say the least, disingenuous and misleading given that many parts of the proposed rule seemed *designed*, at the least, to permit, if not actually encourage, such very evasion of the registration requirements of the Securities Act. In addition to the discussion immediately above, see also the example we discuss under "*Offers or Sales Preceding Exempt Offerings Permitting General Solicitation*" with respect to Rule 506(c) offerings that immediately follow a completed Rule 506(b) offering. As a group, the Committee is unsure how we would be able to counsel clients on complying with the proposed integration framework given this language, since it would appear to make impermissible many of the transactions the rule seems otherwise designed to permit.

General Solicitation and Offering Communications

Exemption from General Solicitation for "Demo Days" and Similar Events

Proposed new Rule 148 would provide that certain communications made in connection with "demo days" and similar seminars and meetings "would not be deemed to constitute general solicitation or general advertising" if the event and the communication in question comply with the requirements of the proposed rule.

We understand that there have been calls for the Commission to clarify whether communications at "demo day" and similar events constitute general solicitation since at least 2013, when Rule 506(c), permitting general solicitation in Regulation D offerings for the first time, was adopted and, given the attendant focus on the meaning of "general solicitation" following such adoption, certain elements of the issuer community became concerned that their communications at such events could be considered general solicitation such that they would be required to comply with the accredited investor verification requirements of Rule 506(c).

We understand that the Commission has been put in a difficult position with respect to communications at these events. On the one hand, these communications seem to, at a minimum, skirt close to the line of what would usually constitute a general solicitation, and we are aware that there are securities fraud issues that have emerged in private offerings conducted by

issuers presenting at these events. On the other hand, we believe that the limitations set forth in the proposed rule, particularly those that limit the types of entities that can sponsor these events and limit the fees and compensation the sponsors can receive in connection therewith, mitigate this risk. Further, we believe that the reality that these events have been happening for years and have become an established part of the private placement process, as a practical matter, somewhat limits the actions the Commission can take here. In other words, it is too late to simply "close the barn door." As declaring communications at these events to be prohibited general solicitations would, as a practical matter, be unworkable, we believe the limitations that proposed Rule 148 would put in place adequately strikes a proper balance between investor protection and providing issuers, "particularly small and emerging issuers, and investors, the opportunity to more efficiently expand and grow their networks." We therefore support proposed Rule 148.

Rule 506(c) Verification Requirements

Rule 506(c)(2)(ii) provides four non-exclusive methods by which issuers are deemed to have taken "reasonable steps to verify" the accredited investor status of natural person purchasers in a private placement conducted under Rule 506(c), assuming that the issuer does not have knowledge that the purchaser is not an accredited investor.

Proposed new paragraph (c)(2)(ii)(E) to Rule 506 would add a fifth such verification method, such that with respect to an investor for whom the issuer previously took reasonable steps to verify their status as accredited, the verification requirement will be satisfied if the issuer obtains from the investor at the time of sale a written representation that he or she qualifies as an accredited investor and the issuer is not aware of information to the contrary. The Committee believes that this proposed amendment is eminently reasonable, as it would save issuers unnecessary time and expense with negligible investor protection risk, if any, and therefore we strongly support this proposal. We do, however, have two suggestions we would ask the Commission to consider. First, we suggest that the Commission consider expanding the proposed verification method beyond the particular issuer in question where reasonable and appropriate. For example, investment advisers to private funds will often form and manage multiple successive investment funds, and often a number of investors in the earlier funds will also invest in one or more of the later-formed funds. While each such fund is a separate issuer, and may be managed by affiliated investment adviser entities, the individuals employed by the investment adviser(s) and managing the funds are often the same, which means

that, basically, the same personnel would be responsible for performing the verification of the accredited investor status of those natural persons who invest across multiple funds in the "fund family." In this circumstance, limiting the use of this proposed verification method to a single "issuer" serves no legitimate purpose and is inconsistent with the spirit of the proposed amendment.

We also suggest that the Commission consider including a reasonable time limit after which use of the proposed verification method alone would no longer be acceptable. To take an extreme example, it may not be reasonable to do no more than obtain a written representation as to accredited investor status with respect to an investor who participated in a Rule 506(c) offering conducted by the issuer 20 years ago. The investor may not still qualify as accredited after all those years, and the individuals who would have any knowledge related to the prospective investor may be long gone. To the extent in such circumstances that the issuer has a reasonable basis to believe that the investor is still accredited even after such 20-year period, such as recent personal contact with current management, then obtaining the written representation from the investor could still satisfy the "reasonable steps to verify" standard based on the overall principles-based approach set forth in Rule 506(c)(2)(ii); in this regard, we note the Commission's statement in the Release 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. For example, 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." Having the period between the prior investment and the current proposed investment be unlimited, however, could call into question the appropriateness of the proposed new method to satisfy the "reasonable steps to verify" standard and may make issuers wary of using it despite its status as a non-exclusive "safe harbor."

Offering and Investment Limits

Regulation Crowdfunding

The proposed amendments would raise the offering limit for crowdfunded offerings from $1.07 million to $5 million. We believe the Commission should defer taking action on this part of the proposal at this time and reconsider such an increase when there is sufficient information available to determine whether such increase is appropriate.

We note that Regulation Crowdfunding has been effective for approximately four years and, until very recently, in place only during what had been the longest economic expansion in U.S. history. Without data regarding investor outcomes over a longer-term and during periods that include economic retractions, increasing the offering limit for crowdfunding offerings seems unjustified at best, especially given, as noted in the Release, that the amount raised in such offerings is typically below the current offering limit.

We are aware that the Commission received a significant number of very similar comments during the final few days of March 2020 urging an immediate increase in the Regulation Crowdfunding offering limit to $5 million as start-ups and small businesses were becoming desperate for cash amid the economic shutdown implemented by states to contain the rapid spread of COVID-19. These comments, predictably, did not address investor protection concerns or the advisability of “mom and pop” investors putting their money into such businesses as other sources of capital dried up and the country entered what many economists predict will be a deep recession. But some of the letters are telling as to how the current economic environment and market turmoil shows why it is inappropriate to increase the crowdfunding offering limit at this time. One of the commenters in particular noted that amid the pandemic the “private” investors (we assume this was a reference to “accredited” investors) he had lined up backed off and he therefore urged an increase in the Regulation Crowdfunding offering limit to help restore access to capital.

Reading between the lines, and based on our collective decades of experience in the securities industry, the story this letter tells is that amid the economic shutdown and chaos wrought by the pandemic, the experienced and/or sophisticated investors that had intended to invest in this business had determined that it was not a good investment in the current environment. The commenter’s assertion that it would be appropriate to allow a larger number of unsophisticated investors with limited financial resources to invest larger amounts in his business instead, while understandable from the viewpoint of a small business owner desperate for cash, is clearly the wrong answer to the lack of access to capital with which small businesses are currently dealing, as an investment in the types of businesses that would raise capital through crowdfunding has become much riskier than it would have been just a few months ago. The shutdown’s impact on the securities markets and our economy has unintentionally presented the Commission with the perfect opportunity to study how investors in crowdfunding offerings during the last few years fare under the more challenging conditions we are currently experiencing, an

opportunity that was not available during the 2019 Regulation Crowdfunding Report discussed in the Release nor while the Commission was formulating its proposals set forth therein. These commenters' disregard of investor protection issues in supporting the proposed increase is, again, understandable, but the Commission must balance investor protection considerations with its mission to facilitate access to capital, and the current environment will give it that opportunity instead of simply relying on the investor protections already in place to justify an approximately five-fold increase in the Regulation Crowdfunding offering limit. The situation we are all dealing with in the wake of the Coronavirus has been devastating for many and frustrating for almost all, but there have also been unintended gifts, such as time with family and an adequate night's sleep, for those willing to acknowledge them. For the Commission, the gift is the opportunity to base its decision about the advisability of the proposed increase in the crowdfunding offering limit on more balanced information than would have been possible when proposing such increase just a short three months ago (albeit by being willing to defer this proposal in order to gather the data).

Regulation A

We also question the advisability of raising the Regulation A Tier 2 offering limit from $50 million to $75 million. Regulation A was significantly revised, including a ten-fold increase in its offering limit, just a few years ago. Similar to our above discussion on raising the offering limit under Regulation Crowdfunding, any analysis of Regulation A since the 2015 amendments has relied on data gathered solely during an economic expansion, and is therefore likely to be unbalanced and impede the consideration of investor protection considerations. Further, the justifications for this increase, as set forth in the Release, are rather limited; "a higher offering limit" with respect to *any* exemption that includes such a limit could "enhance capital formation for those … issuers that have exhausted existing offering limits." Stating that raising the offering limit for a particular offering exemption would allow issuers using that exemption to raise more money hardly seems like a viable argument for increasing the Regulation A offering limit just a few years after it was already significantly increased. Further, the Committee believes that the fact, as stated in the Release, that only approximately 10% of issuers conducting Regulation A Tier 2 offerings have reached the $50 million offering limit belies the Release's position that the proposed increase is called for; nor does the "build it and they will come" arguments to the effect that the increase "*may* help attract a larger and potentially more seasoned pool of issuers and intermediaries or institutional

investors to the Regulation A market" and "*may* make regulation A offerings more attractive to Exchange Act reporting companies" (in each case, emphasis ours), without any proffer of evidence to that effect, provide strong support for the notion that the proposed increase in the offering limit is appropriate.

The Release notes that the rules under Regulation A (among other exemptions) "were developed with smaller issuers in mind." The Committee cannot believe that the "smaller issuers" the Regulation A exemption is intended to assist would need to raise more than $50 million in capital more than once every 12 months. Even in 2020, $50 million is still a huge amount of money; companies that are large enough to be able to put such large amounts of capital to good use or that are the smaller issuers the rules are intended to benefit but still capable of burning through $50 million every 12 months *should*, in our opinion, be raising capital in the public markets with the full disclosure required by, and investor protections provided in, the Securities Act.

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Finally, the Committee would like to reiterate the concerns we expressed in our March 16, 2020 comment letter on the proposed amendments to the "Accredited Investor" definition (File No. S7-25-19) with respect to the Commission's increasing focus on expanding registration exemptions and ordinary investors' access to the risky private markets; in this regard we note that the first substantive line of the release states that "[t]he Securities and Exchange Commission is proposing amendments to facilitate capital formation and increase opportunities for investors by expanding access to capital for entrepreneurs across the United States." We will not reiterate those comments here, but did want to express our growing dismay at the Commission's increasing deregulatory focus and increasing partisan atmosphere. Many of the proposals in the Release, including the all-but-complete gutting of integration, clearly reflect this bias towards increasing access at the expense of investor protection. We believe the Commission did a reasonable job of balancing access to capital with investor protection in connection with the proposals to revise the accredited investor definition; it did not, unfortunately, do so here.

In this vein, certain members of the Commission continue to express dismay that ordinary investors are "locked out" of the private markets, thereby missing out on the most lucrative returns because companies experience the bulk of their growth and increase in value before they go public, while simultaneously lamenting the decrease in public markets and public companies. The increase in the private securities markets such that a majority of capital raised in the United

States is currently raised in the private markets is, however, largely a result of the expansion of available offering exemptions and the increasing burdens placed on public companies during the last approximately two decades. So the argument here, in essence, is that because the expansion of the private placement markets has resulted in a decrease in companies going public and those that do go public waiting longer to do so, we need to expand the private placement markets even more! This is of course, circular and irrational.

We believe that it is disingenuous to argue that because the private securities markets have become so much more attractive as a result of tinkering with the federal securities laws and the rules thereunder such that the majority of capital has moved from the public market with its attendant investor protections to the largely-unregulated private market, that we now have to open up the private markets to ordinary investors because it is unfair that they are missing out on these opportunities. This path eventually leads right back to the situation that resulted in the need for the Securities Act and the Securities Exchange Act in the first place. Such deregulation hurts everyone, including issuers, as it undermines investors' trust in our capital markets, making it more difficult for all issuers to raise capital and for investors to make good investment decisions.

We appreciate the Commission's consideration of the foregoing comments.

Very truly yours,

Committee on Securities Law of the Business Law Section of the Maryland State Bar Association

Penny Somer-Greif, Chair

Gregory T. Lawrence, Vice-Chair