POST-JOBS ACT INTEGRATION ISSUES FOR SMALL BUSINESS FINANCING

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A. JOBS Act Changes Affecting Integration

1. The two key concepts underlying the SEC's position that an offering must be both commenced and completed either privately or publicly are (i) general solicitation from a public offering that would prevent completing it privately and (ii) gun-jumping that would prevent converting a private offering into a public offering. The JOBS Act created exceptions to these two concepts by directing the SEC to amend Rule 506 to permit general solicitation if sales are made solely to verified accredited investors, which the SEC has done, and authorizes (without SEC rulemaking) test-the-waters activity by "emerging growth companies" with QIBs and institutional accredited investors before or after the filing of a registration statement. These changes affect the integration analysis when they apply. For example, if there is widespread general advertising in connection with a completed Rule 506(c) offering sold only to appropriately verified accredited investors, will Rule 152 apply to permit a subsequent registered public offering or will the general advertising be considered gun-jumping? In my view, the answer should be that Rule 152 does apply and compliant general solicitation should not be treated as impermissible gun-jumping.

2. In addition, these permitted activities can create integration issues for related offerings under traditional integration concepts and reduce the flexibility companies otherwise would have. For example, general solicitation activity in a Rule 506(c) offering could prevent completing the offering to non-accredited investors and may foreclose use of other exemptions outside Rule 506(c), such as the statutory 4(a)(2) private offering exemption or Rule 506(b), in which general solicitation is not permitted. Similarly, test-the-waters activity could constitute general solicitation that would foreclose some exempt offerings.

3. In addition to raising issues under § 5 of the Securities Act, integration concepts can raise issues under the antifraud provisions. For example, in the situation described in paragraph 1 above, even if the general advertising is not gun-jumping, will it be considered a written offer in connection with the registered offering for which there can be antifraud liability? Similarly, can test-the-waters communication be the basis for antifraud liability in a subsequent registered offering in which the institutional investors purchase or in a Rule 506(c) offering to them?

4. In implementing the JOBS Act, the SEC has chosen to limit its actions to those required by the JOBS Act and has not gotten into the broader integration issues involving private and other exempt offerings, except for providing transition guidance in the Rule 506 Adopting Release at p. 19. *See also* C&DI §§ 260.05, 260.11, 260.12, 260.33 and 260.34.

5. The Commission has addressed integration issues in the releases proposing and adopting several discrete exemptions. In connection with the revision of Regulation A, the Commission stated in the proposing release at p. 57 that "… we believe that an offering made in reliance on Regulation A should not be integrated with another exempt offering made by the issuer, provided that each offering complies with the requirements of the exemption that is being relied upon for the particular offering" (see Release No. 33-9497, *"Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act"* (Dec. 18, 2013), at pp. 55-60). It then gave examples of a concurrent offering for which general solicitation is not permitted (citing the Reg. D Proposing Release interpretation) and one for which it is. This was confirmed in the Regulation A adopting release at §II.B.5. The Commission followed a similar approach on crowdfunding (see proposing Release No. 33-9470, *"Crowdfunding"* (October 23, 2013), text accompanying fn. 33-34, and the Regulation Crowdfunding adopting release at p. 19). It also followed this approach in the proposing release to amend Rule 147 at §II.B.4.d. and in the release (No. 33-10238, *"Exemptions to Facilitate Intrastate and Regional Securities Offerings"* (October 26, 2016)) amending Rule 147 and adopting Rule 147A at §II.B.5. This approach could be useful for further SEC clarification on integration following the JOBS Act changes, with its emphasis on identifying when offerings relying on separate exemptions can be viewed as separate offerings and the question being whether each offering complied with the requirements for its exemption as opposed to combining the offerings and testing them together to determine if the exemption requirements were met.

B. Application to Specific Integration Situations

1. Consider the case of a company that recently completed an exempt offering under § 4(a)(2) or Rule 506(b) (or another exemption for which general solicitation is not permitted) and now wants to do a Rule 506(c) offering solely to verified accredited investors using general solicitation. If applying the five-factor test the offerings would be integrated under traditional integration principles, the general solicitation in the subsequent offering might relate back and defeat the exemption for the prior offering, and the presence of non-accredited investors in the subsequent offering might defeat the Rule 506(c) offering exemption. In view of Congress' intent to facilitate capital formation, it would be helpful for the SEC to take action, whether through rulemaking or guidance, to separate these offerings by confirming that a completed exempt offering is not affected by a subsequent Rule 506(c) offering solely to accredited investors (akin to Rule 152 or Rule 251(c)) or by reducing the integration safe harbors from 6 months to 90 days as previously proposed or even less. Although § 4(b) of the Securities Act provides that a Rule 506 offering is not a public offering as a result of general solicitation, that section has a specific different focus and the offering has attributes of a public offering, namely the general solicitation, that are relevant to the purpose of Rule 152 and therefore one possibility might be to apply Rule 152 to this situation. The SEC did indicate in the Rule 506 Adopting Release at p. 19 as transitional guidance that general solicitation under Rule 506(c)

after the effective date will not affect the exempt status of offers and sales made prior to the effective date in reliance on Rule 506 as it then existed (and now is Rule 506(b)). Chairman White also indicated in a letter dated August 8, 2013 to Congressman McHenry, *avail. http://www.wowlw.com/White%20Response%20to%20McHenry%20Letter.pdf*, that any proposed revision of Rule 506 would not apply to offerings prior to the effective date of such revision and so issuers could comfortably rely on Rule 506(c) as currently adopted. On January 23, 2014, the staff issued C&DI §§ 260.33 and 260.34 providing further transitional guidance. If an issuer began a Rule 506 offering before the September 23, 2013 effective date and after that date continued the offering under Rule 506(c), it must only have taken reasonable verification steps for investors who purchased after the effective date in the Rule 506(c) offering and not those who purchased before. If the issuer sold to non-accredited investors before or after September 23, 2013 in reliance on Rule 506 or Rule 506(b), it could continue the offering in reliance on Rule 506(c) without impairing the exemption for the prior sales so long as subsequent sales are limited to accredited investors for which the issuer has taken reasonable verification steps. In my view, this same approach should apply to an offering commenced pursuant to Rule 506(b) (as well as other exemptions that do not permit general solicitation) after September 23, 2013. It would be helpful if the SEC confirmed this.

2. Alternatively, a company might begin an exempt offering without general solicitation but before any sales are made decide to convert to a Rule 506(c) offering. This should be permissible. See C&DI § 260.12. See also by analogy Rule 155(b), although it is not obvious that all its conditions are necessary.

3. Consider the reverse situation, with a company that completes a Rule 506(c) offering using general solicitation and within 6 months wants to do an exempt offering under § 4(a)(2) or Rule 506(b) with sales to non-accredited investors. Again, traditional integration principles could prevent the subsequent offering from being exempt because of the general solicitation. Here, too, it would be helpful for the SEC to provide relief, for example, by making clear that a facts and circumstances analysis can be used under the guidance in the 2007 Regulation D Proposing Release. In addition, a safe harbor like Rule 251(c) might be considered.

4. Alternatively, what if, rather than completing the Rule 506(c) offering, the company abandons it after engaging in general solicitation but now wants to raise funds from non-accredited investors apart from the general solicitation. Again, it would be helpful if the SEC clarified that a facts and circumstances analysis can be applied to demonstrate that the non-accredited investors were not found through the general solicitation. In addition, the Commission could consider a safe harbor along the lines of Rule 155(c).

5. Another situation is a company that undertakes a Rule 506(c) offering using general solicitation and decides to convert to a registered offering or to do a side-by-side or follow-on registered offering. It would be helpful for the SEC to provide guidance for these

situations. For example, if a Rule 506(c) offering is completed, Rule 152 should be applicable to permit a follow-on registered offering for the reasons identified above. Similarly, if the Rule 506(c) offering is abandoned, a registered offering should be possible if the company can conclude that there was no impermissible gunjumping. Rule 163A, for example, might be available in such a situation to avoid gunjumping.

6. The changes to Regulation D adopted by the Commission require checking a box on Form D to indicate whether the offering is under Rule 506(b) or Rule 506(c). Aside from the question of what are the consequences of checking the wrong box, the question exists whether checking the 506(c) box is itself general solicitation. The answer should be that checking the box in a filed Form D should not itself be general solicitation absent other solicitation activity. See C&DI § 260.11.

7. A company does a crowdfunding offering under § 4(a)(6) and complies with the limitations on the offering process required by § 301 of the JOBS Act. It may have done a Rule 506(c) offering with general solicitation before commencing the crowdfunding offering, it may want to do a side-by-side Rule 506 offering or it may want to raise additional capital with a follow-on Rule 506 offering, with or without general solicitation. Alternatively, the company could be doing a Regulation A offering as revised in accordance with the JOBS Act or an intrastate offering under revised Rule 147 or new Rule 147A. It would be helpful if the SEC clarified when a prior or contemporaneous Rule 506 (or other exempt) offering could take place. See paragraph A.4 above.

8. An emerging growth company, following filing of a registration statement, has test-the-waters communications with several institutional accredited investors to determine their interest in investing in the company and finds that these investors want to invest before the public offering occurs. Since these communications are not gun-jumping, the company should be able to complete a Rule 506 offering solely with these investors, either as a Rule 506(b) offering or a Rule 506(c) offering depending on the circumstances. This should be the case even if marketing activity has occurred, especially if Rule 506(c) is used. Even before amendment of Rule 506, it was possible to complete the private offering applying a facts and circumstances analysis as permitted by the 2007 Regulation D Proposing Release guidance. It would be helpful if the SEC made clear that testing-the-waters by an emerging growth company under § 5(d) of the Securities Act, whether before or during the pendency of a registration statement, will not prevent a company from engaging in an exempt offering so long as the requirements for testing-the-waters are met and the requirements for the exempt offering are otherwise met. Furthermore, because the permissible test-the-waters communication is not gun-jumping, an institutional accredited investor's participation in an exempt private offering should not prevent it from buying in the public offering.

9. As a result of the amendment of Rule 144A, a company can conduct a Rule 144A offering using general solicitation following a private offering under § 4(a)(2) to the

initial purchasers. As recognized in the Rule 506 Proposing and Adopting Releases, the general solicitation in the 144A offering would not affect the exemption for the offering to the initial purchasers because of Rule 144A(e). Furthermore, so long as the initial offering was done under Rule 506(c) and the initial purchasers were accredited investors, as they typically would be, there should no longer be any hesitation to provide a copy of a prospectus used in a contemporaneous registered public offering to investors in a 144A offering.

10. A company that does a side-by-side Regulation S offering abroad can do a Rule 506(c) or 144A offering in the United States using general solicitation. The Commission has addressed the issue of the potential integration of these offerings in Section IV of both the Rule 506 Proposing and Adopting Releases. The Commission has confirmed that the existing position reflected in Rule 500(g) and the note to Rule 502(a) that offshore sales under Regulation S will generally not be integrated with a domestic offering will continue to apply notwithstanding the use of general solicitation for the domestic offering and that the general solicitation should not be considered impermissible U.S. directed selling efforts under Regulation S so long as the offerings are conducted in compliance with their applicable exemptions.

11. A company's use of 506(c) with general solicitation can raise issues regarding exempt resales by selling shareholders, including resales of securities purchased in the 506(c) offering. Unlike an issuer, Rule 506(c) is not available for a selling shareholder, who will need to find its own exemption. Typically, if Rule 144 is not available or used, that exemption, like the "4 (1 ½)" exemption, will not be available if there is general solicitation. The issue is the extent to which the issuer's general solicitation will be attributable to the selling shareholder's resale. The answer may depend upon the particular facts and circumstances.

12. The Commission's proposals to further revise Regulation D remain pending. Adoption of those proposals would create even greater challenges in dealing with integration issues. For example, the proposals to require advance filings and additional information if general solicitation is used can make it harder to know what exemption is available if general solicitation is unplanned. Moreover, the disqualification provision if the Form D filing requirement is not satisfied means that every prior offering during the lookback period would need to be examined to determine if Rule 506 is available to exempt the current offering.