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Approaching the Tipping Point for "Public-Private Offerings:" The Current Trajectory of Rule 506(c)

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ABSTRACT

Rule 506(b) of Regulation D of the Securities Act of 1933 is, without question, the most utilized exemption from registration by securities practitioners in private offerings of equity securities to date by a wide margin. So to say that Rule 506(b) may soon be overtaken in popularity by another exemption would seemingly amount to heresy among securities law practitioners, who almost exclusively rely on this safe harbor in private placements and other corporate transactions. Rule 506(c) has many similarities to Rule 506(b) and affords use of general solicitation (which Rule 506(b) prohibits), but also has a number of weaknesses that limit its use by issuers and practitioners. However, the SEC's recent enactment of the updated integration framework in Rule 502 in November 2020, viewed in light of the SEC's recent guidance concerning the use of Rule 506(c), raises the question of whether Rule 506(c) will eventually subsume, or at least overtake, Rule 506(b) as the exemption of choice for securities practitioners.

Part I of this article will review the current state of securities law practice concerning the use of exemptions from registration and analyze the underlying drivers that steer practitioners toward consistent use of Rule 506(b) as the preferred exemption from registration. Part II of this article will then review recently enacted legislation, rules, and guidance, including the newly enacted integration framework in Rule 502, and consider its potential impact on usage of Rule 506(c). Finally, Part III of this article will consider whether the actions discussed in Part II represent a trajectory toward the SEC's eventual conflation of Rule 506(b) into Rule 506(c), whether explicitly or implicitly, thereby making Rule 506(c) the rational ex-emption of choice for securities law practitioners. Ultimately, this

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article concludes that recent rulemaking will not materially change the current usage of Rules 506(b) and 506(c) by issuers and securities practitioners, but that the continued addition of accredited investor verification method safe harbors to Rule 506(c), such as self-certification, would eventually cause Rule 506(c) to merge with or surpass Rule 506(b) as the exemption of choice for issuers and securities practitioners.

Introduction

In most private offerings, no other registration is even considered. Rule 506(b) of Regulation D ("Rule 506(b)") under the Securities Act of 1933 (the "1933 Act") is the industry standard exemption utilized in private offerings.[1] According to a recent report from the Office of the Advocate for Small Business Capital Formation of the Securities and Exchange Commission ("SEC"), Rule 506(b) accounted for approximately $1.4 trillion of capital raised in private offerings conducted from July 1, 2019 to June 30, 2020, which is more than 20 times the next largest exemption commonly used for equity financings, Rule 506(c) of Regulation D under the 1933 Act ("Rule 506(c)"), accounting for a mere $69 billion.[2] Capital raised under Rule 506(b) alone also rivals the capital raised in all United States public offerings, including both initial public offerings (IPOs) and other registered offerings.[3] It also outpaces the capital raised pursuant to exempt secondary transactions among qualified institutional buyers under Rule 144A.[4] Furthermore, when comparing the number of transactions (rather than the capital raised) utilizing Rule 506(b) versus public offerings and 144A transactions, the gap widens even further.[5] According to a separate study performed by the SEC's Division of Economic and Risk Analysis, Rule 506(b) was utilized in 22,120 new offerings in 2017, compared to a combined total of 4,921 public offerings and

1. See Off. Advoc. for Small Bus. Cap. Formation, SEC, Ann. Rep. for Fiscal Year 2020 17 (2020), https://www.sec.gov/files/2020-oasb-annual-report.pdf.

2. *Id.*

3. *Id.*

4. *Id.*; See Scott Bauguess et al., Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017, at 8 (SEC Div. Econ. and Risk Analysis 2018), https://www.sec.gov/files/DERA%20white%20paper_Regulation%20D_082018.pdf. The category of "Other Exempt Offerings" is likely comprised of mostly Rule 144A offerings, where securities (typically debt securities) are issued to an investment bank or other intermediary using the exemption in Section 4(a)(2) and then resold to qualified institutional buyers in accordance with Rule 144A. The Division of Economic and Risk Analysis of the Securities and Exchange Commission provided a detail of Rule 144A offerings and other private offerings from 2017, which showed Rule 144A offerings accounting for more than $1 trillion raised, while other private offerings, such as Regulation S and Section 4(a)(2) offerings collectively accounting for less than $200 billion raised.

5. Bauguess, supra note 4, at 9.

144A transactions.[6] Thus, it is clear that Rule 506(b) is by far the most utilized exemption in terms of both capital raised and number of transactions in the United States, particularly with respect to equity offerings, given that most Rule 144A offerings pertain to debt securities.[7]

The dominance of Rule 506(b) is nothing new and is obvious to most practitioners and scholars in this area.[8] Indeed, this has been the case for more than a decade.[9] So what, if anything, could possibly change the status quo? In 2012, pursuant to Section 201(a)(1) of the Jumpstart Our Business Startups Act (the "JOBS Act"), Congress directed the SEC to include an exemption under Rule 506 of Regulation D that would allow for general solicitation in connection with offers or sales of securities, provided that all purchasers are accredited investors and that the issuer take reasonable steps to verify that the purchasers are accredited investors, using such methods as provided by the SEC.[10] The SEC then promptly adopted Rule 506(c) in compliance with this mandate.[11] While politicians heralded the JOBS Act as a tectonic shift in the capital raise landscape with promise to channel untold amounts of capital into growing businesses, issuers and practitioners largely yawned and continued using Rule 506(b).[12] Since the passage of the JOBS Act, the SEC has further amended Rule 506(c) and

6. *Id.* at 9, 16.

7. *Id.* at 13 ("In addition, a larger fraction of non-financial issuers rely on Regulation D for raising capital compared to the Rule 144A market, where the vast majority of issuers are financial institutions and over 99% of securities are debt securities.").

8. Paige M. Lager, Note, The Route to Capitalization: The Transcendent Registration Exemptions for Securities Offerings as a Means to Small Business Capital Formation, 94 Tex. L. Rev. 567, 595 (2016) ("Given this past predominance of Rule 506, it is likely that issuers will continue to take advantage of it. Familiarity with the rule's use makes it certain and efficient. And not only is it naturally easiest to maintain the status quo, using Rule 506 is also the least expensive, most flexible, and least restrictive method.").

9. Vladimir Ivanov & Scott Bauguess, SEC, Capital Raising in the U.S.: An Analysis of Unregistered Offerings Using the Regulation D Exemption, 2009-2012, at 7 (2013), https://www.sec.gov/divisions/riskfin/whitepapers/dera-unregistered-offerings-reg-d.pdf.

10. Jumpstart Our Business Startups (JOBS) Act, Pub. L. No. 112-106, § 201(a)(1), 126 Stat. 306, 313–14 (2012) (codified at note following 15 U.S.C. 77d).

11. 17 C.F.R. § 230.506(c) (2020).

12. Barack Obama, U.S. President, Remarks on Signing the Jumpstart Our Business Startups Act (Apr. 5, 2012) (transcript available at https://www.presidency.ucsb.edu/documents/remarks-signing-the-jumpstart-our-business-startups-act) ("And for startups and small businesses, this bill is a potential game changer. Right now you can only turn to a limited group of investors, including banks and wealthy individuals, to get funding. Laws that are nearly eight decades old make it impossible for others to invest. But a lot's changed in 80 years, and it's time our laws did as well. Because of this bill, startups and small business will now have access to a big new pool of potential investors, namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in."); Manning Gilbert Warren III, The False Promise of Publicly Offered Private Placements, 68 SMU L. REV. 899, 901 (2015); see also Off. Advoc. for Small Bus. Cap. Formation, supra note 1 at 4; see also Ivanov & Bauguess, supra note 9 at 7 – 8.

released guidance concerning its use to resolve concerns surrounding this new exemption and to expand its use in the market.[13] While there has been an increase in the use of Rule 506(c) since its adoption, the exemption's usage has largely plateaued at approximately 8% of offerings under Rule 506 generally, with the amount raised under such offerings consisting even less at 4% of the total amount raised under Rule 506.[14] For now, Rule 506(b) is still the predominant exemption.

This article will review the reasons why Rule 506(b) offerings currently predominate other offerings, including Rule 506(c) offerings, and what factors, whether current or prospective, may cause practitioners to change their historical practices in this regard. Ultimately, this article concludes that Rule 506(c) may unseat Rule 506(b) as the exemption of choice for issuers and securities practitioners or, if the SEC expands listed accredited investor verification methods under Rule 506(c) to include self-certification, combine with Rule 506(b) into a single highly utilized safe harbor.

I. WHY RULE 506(B) PREDOMINATES OTHER EXEMPTIONS

Rule 506(b) has been a reliable and well-tested private offering exemption for more than 30 years and has significant advantages over the other comparable exemptions in most offerings.[15] The combination of the ability to raise unlimited capital from unlimited accredited investors with comparatively minimal disclosure requirements and federal preemption over state blue sky laws[16] provides a straightforward path to compliance in most offerings with minimal regulatory risk.[17] In contrast, let us briefly consider the alternatives to Rule 506(b).[18]

13. 17 C.F.R. § 230.506(c); see, e.g., Question 260.07, Question on Securities Act Rules, SEC, (Nov. 13, 2013) https://www.sec.gov/corpfin/securities-act-rules.

14. Bauguess, SEC, DERA, supra note 4, at 2, 16. ("Since the effectiveness of Rule 506(c) that eliminated the ban on general solicitation, only a small proportion (4%; $255 billion) of the capital raised in Regulation D offerings was raised in offerings conducted pursuant to Rule 506(c).").

15. 17 C.F.R. § 230.506(b).

16. 15 U.S.C. § 77r (2018). "Blue sky laws" refer to state securities laws that, among other things, require that securities be registered at the state level absent either a state level exemption from registration or federal preemption over such state securities laws. *See generally* Rutheford B. Campbell, Jr., *The Role of Blue Sky Laws After NSMIA and the JOBS Act*, 66 Duke L.J. 605, 606 (2016) (discussing the role of blue sky laws following the JOBS Act).

17. 17 C.F.R. § 230.506(b).

18. Appendix A hereto contains a detailed chart of exemptions that has been updated to reflect the SEC's November 2020 rule amendments.

A. Lesser Utilized Exemptions

Rule 504 has a $10 million offering cap and does not preempt state blue sky laws.[19]It does allow unlimited unaccredited investors at the federal level,[20] but state blue sky laws will often limit or eliminate the perceived federal-level advantage.[21] Particularly in a multi-state offering, Rule 504 quickly becomes inconvenient and risky due to required compliance with the securities laws of multiple states, with which securities practitioners are mostly unfamiliar and which may impose significant registration and disclosure requirements, leading to increased cost for a relatively small offering.[22] Thus, lack of federal preemption is a non-starter in most securities offerings, even if such offering would fit within Rule 504's $10 million cap.[23]

Reliance on Section 4(a)(2) without a Regulation D safe harbor raises similar problems as Rule 504 in that it also does not provide federal preemption over state blue sky laws.[24] But perhaps the even larger issue here is that, even at the

19. 17 C.F.R. § 230.504 (2020); 15 U.S.C. § 77r.

20. 17 C.F.R. § 230.504.

21. *See Rule 504 of Regulation D: A Small Entity Compliance Guide for Issuers*, SEC, (Jan. 20, 2017), https://www.sec.gov/divisions/corpfin/guidance/rule504-issuer-small-entity-compliance.html ("Issuers must comply with state securities laws and regulations in the states in which securities are offered or sold. Each state's securities laws have their own registration requirements and exemptions to registration requirements."); *See also* Denise Voigt Crawford, *Limited and Private Offering Exemptions under Texas Securities Law*, 2005 U. Tex. Conf. on Secs. Regul. & Bus. L. Probs. 5–19, http://docshare01.docshare.tips/files/27638/276381809.pdf ; *What are Florida's Regulation D and Rule 506 Offering Requirements?*, Question on *Division of Securities Frequently Asked Questions*, Fla. Off. Fin. Regul., https://flofr.gov/sitePages/DivisionOfSecuritiesFAQ.htm (last visited Jul. 14, 2021) ("Rule 504 Public Offerings: Sales must be made pursuant to the registration by Qualification (Intra-state or Merit Review) requirements of Chapter 517.081, Florida Statutes, and Rule 69W-700.001, Florida Administrative Code, and the dealer registration requirements of Chapter 517.12, Florida Statutes.").

22. *See Rule 504 of Regulation D: A Small Entity Compliance Guide for Issuers*, SEC, (Jan. 20, 2017), https://www.sec.gov/divisions/corpfin/guidance/rule504-issuer-small-entity-compliance.html ("Issuers must comply with state securities laws and regulations in the states in which securities are offered or sold. Each state's securities laws have their own registration requirements and exemptions to registration requirements."); *See also* Denise Voigt Crawford, *Limited and Private Offering Exemptions under Texas Securities Law*, 2005 U. Tex. Conf. on Secs. Regul. & Bus. L. Probs. 5–19, http://docshare01.docshare.tips/files/27638/276381809.pdf ; *What are Florida's Regulation D and Rule 506 Offering Requirements?*, Question on *Division of Securities Frequently Asked Questions*, Fla. Off. Fin. Regul., https://flofr.gov/sitePages/DivisionOfSecuritiesFAQ.htm (last visited Jul. 14, 2021) ("Rule 504 Public Offerings: Sales must be made pursuant to the registration by Qualification (Intra-state or Merit Review) requirements of Chapter 517.081, Florida Statutes, and Rule 69W-700.001, Florida Administrative Code, and the dealer registration requirements of Chapter 517.12, Florida Statutes.").

23. *Id.*; 17 C.F.R. § 230.504.

24. 15 U.S.C. § 77r. Note that Section 18(b)(4)(F) of the Securities Act only provides preemption over state law to "*rules or regulations* issued under section 4(a)(2)" (emphasis added) and not to section 4(a)(2) itself. *Id.*

federal level, compliance with Section 4(a)(2) involves navigating a sea of case law and SEC guidance concerning adequate disclosure and investor sophistication with factors that turn heavily on the facts and circumstances of the offering and investor qualifications, as opposed to the more bright-line safe harbors in Rule 506 that afford a clearer path to compliance.[25] Indeed, Regulation D was originally enacted to address this very issue.[26] Because of this concern, most practitioners would only consider a naked Section 4(a)(2) exemption for their clients in instances where a safe harbor is unavailable, such as an issuance involving unaccredited investors or "bad actors".[27] In fact, in those circumstances, some practitioners may advise against such offerings altogether. In sum, except in the clearest of cases,[28] issuers and their counsel are rightly wary of relying upon this traditional exemption when a perfectly sound safe harbor to such exemption is typically available under Regulation D.[29]

There are three intrastate exemptions available for use by issuers provided in Section 3(a)(11), Rule 147 and Rule 147A, although Rule 147A is the only one that continues to make sense in practice.[30] Rule 147A fully encompasses the benefits of the other two intrastate exemptions and provides the additional advantage of allowing issuers incorporated in another state, such as Delaware, to conduct an intrastate offering in the state of the issuer's primary place of

25. John C. Coffee, Jr. et. al., Securities Regulation Cases and Materials, 376 (Robert C. Clark et al. eds., 14th ed. 2021) ("Initially, the §4(a)(2) exemption embodied a very vague and imprecise concept: a nonpublic offering. What defined such an offering was not self-evident, and the resulting uncertainty likely impeded capital formation. With the adoption of Regulation D in 1982…, [the] new 'bright-line' standards facilitated substantial offerings of securities without 1933 Act registration, because they eliminated most legal uncertainty."); *SEC v. Ralston Purina Co.*, 346 U.S. 119, 125 (1953) ("An offering to those who are shown to be able to fend for themselves is a transaction 'not involving any public offering.'" (quoting Securities Act of 1933, Pub. L. No. 73-22, § 4(1), 48 Stat. 74, 77 (codified as amended at 15 U.S.C. 77d))); *Doran v. Petroleum Mgmt. Corp.*, 545 F.2d 893, 909 (5th Cir. 1977) ("We are conscious of the difficulty of formulating black letter law in this area in light of the multiplicity of security transactions and their multifarious natures. Securities regulation is often a matter of the hound chasing the hare as issuers devise new ways to issue their securities and the definition of a security itself expands."); *See also* Citizen VC, Inc., SEC Staff No-Action Letter, 2015 WL 4699193 (Aug. 6, 2015); 17 C.F.R. § 230.506 (2020).

26. *See* Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11,251, 11,251 (Mar. 16, 1982).

27. 17 C.F.R. § 230.506(d).

28. Despite the risks typically associated with using Section 4(a)(2) without a safe harbor, practitioners do routinely use Section 4(a)(2) in the first step of a Rule 144A offering. *See* 17 C.F.R. § 230.144A(e) (2020) (providing that resales under this exemption will not integrate with any prior or subsequent offering, thus allowing issuances exempt under section 4(a)(2) or Rule 506(b) to investment banks or other intermediaries to immediately precede a resale by such intermediary under Rule 144A to qualified institutional buyers).

29. *See* Coffee, Jr. et. al., *supra* note 25.

30. 15 U.S.C. § 77c(a)(11); 17 C.F.R. §§ 230.147–.147A (2020).

business.[31] Still, Rule 147A falls short of facilitating a broad spectrum of offerings given that all offerees must be in-state residents[32] and issuers must comply with a separate exemption under state blue sky laws due to lack of federal preemption.[33] There is no reason for an issuer to subject itself to these restrictions when either exemption in Rule 506 can deliver the same result with fewer restrictions, particularly when all investors are accredited investors.[34]

Regulation A is a rather niche exemption for those rare issuers that desire (or perhaps need) to conduct a small public offering to raise capital, and , will comply with extensive registration and ongoing reporting requirements (though less arduous than a registered offering) for the ability to do so.[35] From a registration and ongoing disclosure standpoint, Regulation A is more comparable to a registered offering under Section 5 than a private placement to accredited investors under Rule 506(b).[36] Furthermore, a Tier 2 offering under Regulation A has an offering cap of $75 million (and a Tier 1 offering cap at only $20 million), while both registered offerings and the Rule 506 exemptions are uncapped.[37] In essence, Regulation A stands crowded between the Rule 506 exemptions that allow for unlimited sales of restricted securities to accredited investors with few disclosure requirements, and registered offerings under Section 5 of the 1933 Act that allow for unlimited sales of unrestricted securities to any investor, but with greater disclosure requirements.[38] The space for an exemption like Regulation A becomes perhaps even more constrained when considering that Rule 506(c) allows for general solicitation in a private offering,[39] which was historically an advantage of Regulation A prior to enactment of Rule 506(c); and Section 5 of the 1933 Act now affords reduced disclosure requirements for registered offerings to smaller reporting companies and emerging growth companies on Form S-1.[40] Indeed, the small space between the Rule 506 exemptions and a registered

31. *Id*.

32. *Id*.

33. 15 U.S.C. § 77r.

34. Both exemptions in Rule 506 are afforded federal preemption and are not subject to the substantial disclosure requirements provided in Rule 502(b) when all investors in the officering are accredited investors. 15 U.S.C. § 77r.; 17 C.F.R. §§ 230.502(b), .506(b)–(c).

35. 17 C.F.R. §§ 230.251–.263 (2020).

36. 15 U.S.C. § 77e; 17 C.F.R. § 230.506.

37. *Compare* 17 C.F.R. §§ 230.251(a)(1)–(2), *with* 17 C.F.R. §§ 230.502(b), .506(b)–(c).

38. *Compare* 17 C.F.R. §§ 230.251(a)(1)–(2), *with* 17 C.F.R. §§ 230.502(b), .506(b)–(c), *and* 15 U.S.C. § 77e.

39. 17 C.F.R. §§ 230.502(c), .506(c).

40. 17 C.F.R. § 229.10(f) (2020); Jumpstart Our Business Startups (JOBS) Act, Pub. L. No. 112-106, § 102(c), 126 Stat. 306, 310 (codified at note following 15 U.S.C. 77g).

offering on Form S-1 leaves little room for a rational Regulation A offering in most cases.[41]

Regulation Crowdfunding is another niche exemption primarily crafted to source relatively small amounts of capital, mostly from unaccredited investors.[42] If nothing else, its offering limit of $5 million in a 12-month period takes it out of the running as a serious contender for mainstream financings.[43] Furthermore, the issuer must (i) utilize a broker or funding portal to complete the transaction, (ii) monitor investment amount limits for unaccredited investors and (iii) provide annual certified financial statements to investors on an ongoing basis.[44] Thus, issuers may rationally find Regulation Crowdfunding to be a rather heavy lift for relatively small amounts of capital, which perhaps limits its popularity relative to the exemptions in Rule 506.

B. A Worthy Competitor in Rule 506(c)?

As discussed above, some of the primary benefits of Rule 506(b) include the ability to raise unlimited capital from unlimited accredited investors with comparatively minimal disclosure requirements and federal preemption over state blue-sky laws.[45] Rule 506(c) provides these exact same benefits and also allows for general solicitation in connection with the offering.[46] So why does Rule 506(c) remain rarely utilized as compared to Rule 506(b)?[47] Even if most offerings to accredited investors do not involve general solicitation, why not reduce the risk of that issue ever being asserted by securities litigators or the SEC? Are securities practitioners simply stuck in a Rule 506(b) rut without duly considering Rule 506(c)'s benefits? Not at all. As discussed below, Rule 506(b) remains the dominant exemption for good reason. Rule 506(c) requires that an issuer take reasonable steps to verify that the purchasers are accredited investors, using such methods as determined by the SEC, while Rule 506(b) is not constrained by this requirement.[48] Importantly, these reasonable steps must be taken for all investors

41. *Compare* 17 C.F.R. §§ 230.251(a)(1)–(2), *with* 17 C.F.R. §§ 230.502(b), .506(b)–(c), *and* 15 U.S.C. § 77e.

42. 17 C.F.R. §§ 227.100–.503 (2020); Darian M. Ibrahim, Equity Crowdfunding: A Market for Lemons?, 100 MINN. L. REV. 561, 562–63 (2015) ("Crowdfunding is thought to fill a funding gap for startups that cannot attract other financing, or are too early in their life cycles to attract angels and VCs.")

43. Ibrahim, *supra* note 42; 17 C.F.R. § 227.100(a)(1).

44. 17 C.F.R. §§ 227.100(a)(2)–(3), .201.

45. *See supra* notes 15–16 and accompanying text.

46. 17 C.F.R. § 230.506(c) (2020).

47. *See* Bauguess et al., *supra* note 4, at 9.

48. *Compare* 17 C.F.R. § 230.506(c), *with* 17 C.F.R. § 230.506(b). Also, note that the definition of "accredited investor" in Rule 501(a) requires that an issuer "reasonably believes" that an investor is an accredited investor in order for such investor to fall within such definition. 17 C.F.R. § 230.501(a) (2020). Accordingly, this "reasonable belief" requirement applies to offers and sales of securities to accredited investors under the exemptions in both Rule 506(b) and Rule 506(c).

in a Rule 506(c) offering because the integration rules still prohibit a contemporaneous Rule 506(b) and Rule 506(c) offering.[49] Because of this, securities practitioners weigh the risks and cost of compliance with long-standing well-defined general solicitation restrictions under Rule 506(b) against the risks and cost of compliance with relatively new verification requirements for accredited investors.[50] When weighing these factors, Rule 506(b) is simply less costly, more convenient and less risky to utilize in most offerings than Rule 506(c), particularly when issuers have pre-existing relationships with accredited investors.[51]

In a Rule 506(b) offering, issuers typically have each investor provide self-certification of its accredited investor status in a relatively simple but detailed accredited investor questionnaire and also provide a representation as to such status to help the issuer develop a pre-existing substantive relationship with the investor[52] to meet the "reasonable belief" requirement under the definition of "accredited investor" in Rule 501(a).[53] Customarily, practitioners carefully draft these representations and questionnaires and then replicate their use in future offerings to streamline the investment process.[54] In contrast, Rule 506(c) adds an inconvenient and potentially risky step of having to take reasonable steps to verify

49. 17 C.F.R. § 230.152 (2020).

50. *See* Warren, *supra* note 12, at 908 (In a survey of attorneys concerning use of the exemption in Rule 506(c) "[a]pproximately 65% of respondents indicated concerns over compliance with the verification requirement."). Furthermore, the survey indicated that practitioners anticipated reluctance by investors to provide confidential information for purposes of meeting the verification requirement. *Id.* at 908–09.

51. *Id.* at 908 (In a survey of attorneys concerning use of the exemption in Rule 506(c), "[a]pproximately 80% of respondents affirmed that their issuer clients had access to adequate capital from accredited investors without any resort to general solicitation.").

52. *See* Bateman Eichler, Hill Richards, Inc., SEC Staff No-Action Letter, 1985 WL 55679 (Dec. 3, 1985). ("A substantive relationship may be established with a person who has provided a satisfactory response to a questionnaire that enables [the issuer] with sufficient information to evaluate the prospective offeree's sophistication and financial circumstances.").

53. 17 C.F.R. § 230.501(a) (requiring that an issuer "reasonably believes" that an investor is an accredited investor to fall under such definition); *see supra* note 48 and accompanying text.

54. Note that while the SEC has stated that a form accredited investor questionnaire may help form a pre-existing substantive relationship, the SEC may still scrutinize an issuer distributing questionnaires broadly to solicit new investors, even if such questionnaire does not mention the offering. See Agristar Global Networks, Ltd., SEC Staff No-Action Letter, 2004 WL 299067 (Feb. 9, 2004). Furthermore, the SEC warns against forming a substantive relationship solely on the basis of "checking a box" in a questionnaire. See Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 86 Fed. Reg. 3,496, 3,505 n.79 (Jan. 14, 2021) [hereinafter November 2020 Amendments] ("We do not believe that self-certification alone (by checking a box) without any other knowledge of a person's financial circumstances or sophistication would be sufficient to form a 'substantive' relationship for these purposes.").

that investors in an offering are accredited investors.[55] The list of authorized verification methods provided by the SEC in Rule 506(c) includes reviewing tax returns, bank statements and consumer reports, or receiving confirmation from an attorney, certified public accountant or investment adviser that has used such methods to confirm the investor's status.[56] Anyone who has served as a junior associate attempting to collect signature pages and accredited investor questionnaires from investors and to timely close a financing knows the inconvenience, or even the impracticality, of also obtaining the investor's bank statements and tax returns. Furthermore, should corporate attorneys be willing to undertake the responsibility of accurately assessing the income or net worth of investors by analyzing their tax returns and bank statements under the shadow of uncertain verification requirements?[57] Also, retaining appropriate documentation to later prove to the SEC or others that these sensitive personal documents were reviewed as part of a verification process adds ongoing administrative burdens and potential data privacy concerns.[58] Thus, the listed verification methods inevitably result in longer lead times to close a financing and create additional risk of non-compliance with the exemption.[59] The risk of non-compliance under Rule 506(c) is exacerbated by the fact that if an issuer does not clear the verification hurdle, no failsafe argument for compliance under Rule 506(c) exists, unlike under Rule 506(b) with the accidental inclusion of an unaccredited investor in the offering.[60]

Some may quickly point out that Rule 506(c) states that the above verification methods are not exclusive.[61] However, that is cold comfort for issuers

55. 17 C.F.R. § 230.506(c)(2)(ii) (2020); *see supra* note 50 and accompanying text.

56. 17 C.F.R. § 230.506(c)(2)(ii).

57. *See* Warren, *supra* note 12, at 908 .

58. *See id.* ("The reluctance factors related to the new Rule 506(c) accredited investor verification requirements and their investor privacy implications were viewed by securities lawyers as obstacles to the utilization of the new exemption.").

59. *See supra* notes 57–58 and accompanying text.

60. Rule 506(b) allows for inclusion of up to 35 unaccredited investors in the offering, meaning that if an issuer accidentally includes an unaccredited investor in its offering, compliance is nonetheless possible if the issuer happened to meet the disclosure requirements provided in Rule 502(b). See 17 C.F.R. §§ 230.502(b), 506(b) (2020); Furthermore, even if the terms of Rule 506(b) were not met, an issuer could then claim compliance with Section 4(a)(2), though it would be subject to federal case law interpretations and state blue sky laws concerning purchaser sophistication and disclosure requirements that pose a heightened risk of non-compliance. *See* discussion *supra* Section I.A. No reasonable failsafe argument exists for non-compliance with Rule 506(c) because neither Rule 506(b) nor Section 4(a)(2) afford use of general solicitation. *See* 17 C.F.R. § 230.506(c). Other federal exemptions affording use of general solicitation, such as Regulation A, Regulation Crowdfunding or Rule 147A, have additional requirements that an issuer would not likely meet when conducting a Rule 506(c) offering. *See* discussion supra Section I.A.

61. 17 C.F.R. § 230.506(c)(2)(ii).

and practitioners who value certainty of compliance.[62] Since Rule 506(c)'s enactment in 2012, the SEC has repeatedly worked to assuage concerns of issuers and their counsel as to the use of this exemption, even suggesting that its requirements may be the same as Rule 506(b) in some cases.[63] However, the SEC has also been clear in its guidance and in enforcement actions that mere representations and self-certification concerning accredited investor status are insufficient for verification purposes under Rule 506(c).[64] The SEC also acknowledges the fuzzy nature of compliance with the verification requirements by stating that "requiring issuers to consider their particular facts and circumstances in establishing a reasonable basis for their determination of accredited investor status…provides issuers with appropriate flexibility for making the determination."[65] Unfortunately, the SEC's statement is a disingenuous to issuers and securities practitioners. Issuers and practitioners desire certainty when complying with securities laws, not "flexibility" that can later be challenged by the SEC as being too flexible.[66] To be clear, the SEC is not providing flexibility to the issuer; it is providing itself flexibility to institute enforcement actions.[67] The SEC made this intent quite clear when enacting Rule 506(c) in August 2012 when it stated that "a flexible standard applicable to all issuers better accomplishes the goal of investor protection that this requirement is intended to serve."[68] History reveals that the traditional "facts and circumstances" approach concerning

62. *See* Warren, *supra* note 50.

63. November 2020 Amendments, *supra* note 54, at 3,527 ("We are 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. 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.").

64. November 2020 Amendments, *supra* note 54, at 3,527 n.299; *see also* CoinAlpha Advisors LLC, Securities Act Release No. 10,582, 2018 WL 6433070 (Dec. 7, 2018) (in which the SEC imposed a civil monetary penalty against an issuer that collected self- certifications and representations from its investors concerning their accredited investor status but did not take reasonable steps to verify such status for some of the investors).

65. November 2020 Amendments, supra note 54, at 3,527; *see also* Question 260.07, Question on Securities Act Rules, SEC, (Nov. 13, 2013) https://www.sec.gov/corpfin/securities-act-rules (stating that "the determination of what constitutes reasonable steps to verify is an objective determination based on the particular facts and circumstances of each purchaser and transaction.").

66. *See* Warren, supra note 50.

67. *See infra* note 68.

68. Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, 78 Fed. Reg. 44,771, 44,803 (July 24, 2013) (emphasis added) ("As the verification requirement is intended to protect investors by limiting participation in unregistered offerings to those who are most able to bear the risk, we are of the view that a flexible standard applicable to all issuers better accomplishes the goal of investor protection that this requirement is intended to serve.").

investor sophistication and disclosure requirements in case law interpreting Section 4(a)(2)[69]eventually led to Regulation D, which provided a clear definition of "accredited investor" and detailed disclosure requirements in Rule 502, when applicable.[70] With Rule 506(c)'s verification requirements, the SEC is reverting back to an antiquated principles-based approach to securities law with limited, inconvenient safe harbors, so that it can preserve optionality for enforcement in offerings using general solicitation.[71]

For these reasons, use of general solicitation under Rule 506(c) remains precarious in many cases, providing the SEC great discretion in its determination of whether an issuer has done enough to verify that an investor is accredited. Failure by issuers to meet the mark in this regard results in strict non-compliance with no reasonable failsafe under an alternate exemption.[72] Accordingly, gaining the right to generally solicit investors under Rule 506(c) in an offering has a price tag that most issuers are unwilling to pay.[73] Therefore, Rule 506(b) remains dominant.

II. Recent Trends to Diminish the Role of General Solicitation Restrictions in Finanacings

While Rule 506(c) remains an inferior exemption to Rule 506(b) for most offerings, its enactment in 2012 and subsequent rule amendments and guidance concerning its use are nonetheless emblematic of a trend to diminish general solicitation restrictions in securities offerings.[74] In general, the historical hallmark of the SEC's mandate has been to protect investors from predatory issuers, brokers and dealers.[75] Recently, however, the SEC has increasingly embraced counterbalancing interests concerning access to capital for issuers and access to investment opportunities for a broader set of investors.[76] Analyzing these trends may prove predictive of future rules and guidance from the SEC concerning the increased use of general solicitation.

69. *See supra* note 25 and accompanying text.

70. *See* Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11,251, 11,254-57 (Mar. 16, 1982).

71. *See supra* notes 25, 70 and accompanying text.

72. *See supra* note 60 and accompanying text.

73. *See* BAUGUESS ET AL., *supra* note 4, at 2, 16.

74. 17 C.F.R. § 230.506(c) (2020); *see infra* note 76 and accompanying text.

75. *See infra* note 81 and accompanying text.

76. *See* November 2020 Amendments, *supra* note 54, at 3,496 ("We are adopting amendments to facilitate capital formation and increase opportunities for investors by expanding access to capital for small and medium-sized businesses and entrepreneurs across the United States.").

A. The JOBS Act: A New Legislative Mandate to the SEC

On the surface, the JOBS Act had the appearance of watershed legislation for securities law that would unencumber issuers from general solicitation restrictions that the SEC had enforced in private offerings for decades in the name of investor protection.[77] However, upon deeper inspection, many securities practitioners quickly discovered that the JOBS Act did little for most of their clients who were conducting private offerings.[78] With the addition of Rule 506(c) and Regulation Crowdfunding and the expansion of Regulation A, one would expect a large influx of private offerings utilizing general solicitation, but as discussed earlier in this article,[79] the price of using general solicitation simply remains too high in most offerings, while Rule 506(b) has worked just fine for decades.[80]

Despite the lackluster market response to the SEC's shiny new exemptions, the JOBS Act marked a notable shift in the SEC's mandate from Congress. Since its inception in 1934, the SEC's primary mandate from Congress has been to protect investors from fraud, largely due to concerns emanating from the shockwaves of the 1929 market crash.[81] In 1980, Congress showed its propensity to support securities reform that supported capital investment by passing the Omnibus Small Business Capital Formation Act of 1980,[82] which was soon followed by the enactment of Regulation D.[83] While this legislation and rulemaking certainly benefited capital formation by providing clarity for compliance and uniformity between Federal and state exemptions, investor protection appeared to remain the SEC's dominant role.[84] However, Congress's mandate in the JOBS Act is quite different from the mandate in the reforms of the 1980s. The JOBS Act states that it is an act "[t]o increase American job creation and economic growth by

77. *See* David B. H. Martin, Jr. & L. Keith Parsons, *The Preexisting Relationship Doctrine Under Regulation D: A Rule Without Reason?,* 45 WASH. & LEE L. REV. 1031, 1033–34 (1988); Use of Electronic Media, Securities Act Release No. 7856, Exchange Act Release No. 42,728, Investment Company Act Release No. 24,426, 65 Fed. Reg. 25,843, 25,851–52 (proposed May 4, 2000); KCD Fin. Inc., Exchange Act Release No. 80,340, 116 SEC Docket 1954, 1954 (Mar. 29, 2017); CoinAlpha Advisors LLC, Securities Act Release No. 10,582, 2018 WL 6433070 (Dec. 7, 2018).

78. See Warren, supra note 12, at 908.

79. *See* discussion *supra* Part I.

80. *See supra* note 9 and accompanying text.

81. *See* Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74, 74 (codified as amended at 15 U.S.C. §§ 77a–77aa) (The Securities Act of 1933 is labeled as an act "[t]o provide full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails, and to prevent frauds in the sale thereof . . . .").

82. Omnibus Small Business Capital Formation Act of 1980, Pub. L. No. 96-477, title V, 94 Stat. 2291, (1980) (codified as amended at 15 U.S.C. §§ 80c to 80c-3).

83. *See* Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11,251 (Mar. 16, 1982).

84. *Id.*; *see supra* note 25 and accompanying text.

improving access to the public capital markets for emerging growth companies."[85] Whereas Regulation D and other reforms of the 1980s benefited the capital markets by providing clarity and consistency to securities laws (thereby , reducing compliance costs and encouraging expanded use), the JOBS Act focused on providing companies greater access to capital from the public (whether accredited or unaccredited), which naturally runs contrary to the SEC's original mandate to protect investors.[86] Ever since the enactment of the JOBS Act, the SEC has been working to balance these dueling mandates from Congress: protecting investors from fraud without unduly stifling a growing business's access to capital.[87]

B. Finding Balance: The SEC's Slide Toward Access to Capital

Following the JOBS Act, the SEC has taken a measured approach to providing guidance and enacting rules to better facilitate access to capital, which naturally comes at the expense of its mandate to protect investors.[88] As noted above, the enactment of Rule 506(c) itself did not sufficiently incentivize issuers to take advantage of the new exemption,[89] and thus did not fully achieve the legislative objective of the JOBS Act to increase access to capital in this regard.[90] Accordingly, the SEC has since been moving forward slowly on a metaphorical see-saw away from the investor-protection mandate on one end and toward the access-to-capital mandate to find a balanced center between these two competing interests.[91]

1. Early Signs of Movement in SEC Guidance

One of the earliest signs that the SEC was willing to move beyond the original enactment of Rule 506(c) itself and further toward the access-to-capital mandate was its release of Compliance and Disclosure Interpretation ("C&DI")

85. Jumpstart Our Business Startups (JOBS) Act, Pub. L. No. 112-106, 126 Stat. 306, 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

86. *See supra* note 81 and accompanying text.

87. November 2020 Amendments, *supra* note 54, at 3,577 ("After considering these alternatives and public comment, we continue to believe that the amended offering limits are most likely to provide meaningful capital formation benefits and increased access to investment opportunities to investors while representing a balanced approach to expansion of the respective offering exemptions.").

88. *Id*.

89. *See* Bauguess et al., *supra* note 4, at 2, 16.

90. *See supra* note 87 and accompanying text.

91. *See supra* note 87 and accompanying text.

Question 256.34 on November 17, 2016.[92] In answering this question, the SEC provided that a Rule 506(c) offering would not be integrated with a prior Rule 506(b) offering because a Rule 506(c) offering constituted a "public offering" under Rule 152.[93] This meant that a Rule 506(c) offering could now immediately follow a Rule 506(b) offering, even if both offerings sold the same type of securities.[94] At least in theory, this change reduced a material barrier to using Rule 506(c), as an issuer could now begin an offering to its current equity holders or other preexisting relationships under Rule 506(b), and after closing with such investors, move immediately into a "private public offering" under Rule 506(c) to complete the capital raise.[95] This guidance was quite curious given that Rule 506(a) clearly states that Rule 506(c) shall be deemed to be a transaction *not* involving any public offering within the meaning of Section 4(a)(2), and, at the time, Rule 502(a) clearly set forth a six-month safe harbor for offerings under Regulation D.[96] The release of this C&DI question was also curious in that it was the only question released on this date that related to Regulation D or private exemptions generally.[97] It seemed as if the SEC was interposing guidance between issuing formal rule amendments to alleviate restrictions on the use of Rule 506(c). Despite the SEC's somewhat unorthodox efforts to favor wider usage of Rule 506(c), its guidance did not immediately translate into greater usage of Rule 506(c) offerings; as compared to Rule 506(b).[98] Thus, while not substantive from a market standpoint, C&DI Question 256.34 is interesting from a policy perspective in that the SEC was seemingly willing to strain its interpretive guidance to promote usage of Rule 506(c). Indeed, this was a sign of things to come, as the substance of this change, along with other changes, was officially captured in the latest amendment to Rule 152, effective March 15, 2021, as discussed further below.[99]

92. Question 256.34, Question on Securities Act Rules, SEC, (Nov. 17, 2016) https://www.sec.gov/corpfin/securities-act-rules.

93. *Id*.

94. *Id*.

95. *Id*.

96. 17 C.F.R. § 230.506(a) (2020); 17 C.F.R. § 230.502(a) (2020) (amended by Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 86 Fed. Reg. 3,496, 3,598 (Jan. 14, 2021) (to be codified at 17 C.F.R. pt. 230)).

97. Question 256.34, Question on Securities Act Rules, SEC, (Nov. 17, 2016) https://www.sec.gov/corpfin/securities-act-rules.

98. Bauguess et al., *supra* note 4, at 16 (showing Rule 506(c) offerings in 2017 remaining consistent at approximately 7%, consistent with prior years since enactment).

99. *See* discussion *infra* Section II.B.3.

2. *Indirectly Expanding General Solicitation in the "Accredited Investor" Definition*

On August 26, 2020, the SEC indirectly created a construct to expand use of general solicitation under Rule 506(c) by adopting amendments to the definition of "accredited investor" set forth in Rule 501(a).[100] While a number of the additions were clarifying in nature, such as including limited liability companies in the $5 million assets test for entities,[101] the SEC also added a new category of accredited investor that has the potential to reduce general solicitation restrictions over time.[102] The new category includes "[a]ny natural person holding in good standing one or more professional certifications or designations or credentials from an accredited educational institution that the Commission has designated as qualifying an individual for accredited investor status."[103] While the SEC took a conservative approach upon adoption of this amendment by only designating natural persons holding a Series 7, Series 82 or Series 65 license as accredited investors, the construct has potential to apply to much broader groups, based on the four factors that the SEC will consider when designating future certifications, designations, or credentials.[104] For example, certified public accountants, attorneys and certain bachelor's and masters' degrees were considered for designation in connection with the rules amendment, which would have substantially expanded the number of natural persons covered by this new category of accredited investors.[105] Importantly for Rule 506(c), these certifications, designations and credentials are easily verifiable without obtaining sensitive financial information, making compliance with Rule 506(c) verification requirements straightforward for this type of accredited investor.[106] In fact, some organizations, like FINRA and certain state bar associations, make licensing information searchable on their websites.[107] However, while the SEC's addition of verifiable certifications, designations and credentials to the definition of "accredited investor" may cause Rule 506(c) to become marginally more palatable

100. Accredited Investor Definition, 85 Fed. Reg. 64,234 (Oct. 9, 2020) (to be codified at 17 C.F.R. pt. 230, 240).

101. *Id*. at 64,247.

102. *See infra* note 103 and accompanying text.

103. 17 C.F.R. § 230.501(a)(10) (2020).

104. Accredited Investor Definition, 85 Fed. Reg. at 64,237.

105. *Id*. at 64,239.

106. *See* 17 C.F.R. § 230.506(c)(2)(ii) (2020).

107. *See, e.g.*, *BrokerCheck*, FINRA, https://brokercheck.finra.org (last visited Oct. 12, 2021); Find a Lawyer, STATE BAR TEXAS, https://www.texasbar.com/AM/Template.cfm?Section=Find_A_Lawyer&Template=/CustomSource/MemberDirectory/Search_Form_Client_Main.cfm (last visited Oct. 12, 2021).

to issuers in certain offerings, it is unlikely to meaningfully increase usage of Rule 506(c) on its own. Most private financings will not focus solely on these readily verifiable classes, even if expanded, meaning that some accredited investors would still need to provide bank statements, tax returns, etc. to complete a safe harbor method of verification, a process which most issuers currently avoid when using Rule 506(b).[108]

3. *Big Changes Likely Leading to Little Change*

Most recently, on November 2, 2020, the SEC made its most direct attempt to expand access to capital since the adoption of Rule 506(c), and thereby reduce general solicitation restrictions, by adopting multiple rule amendments that, among other things, slightly expanded the listed verification methods under Rule 506(c) and wholistically overhauled the integration framework in Rule 152.[109] Despite the notable time and effort expended to make these changes, issuers are still unlikely to conduct significantly more offerings using general solicitation under Rule 506(c).

The additional verification method provided by the SEC did little practically to provide certainty in the market concerning compliance with its "principles-based method for verification of accredited investor status."[110] The additional method simply provides that if an issuer successfully clears the hurdle of taking reasonable steps to verify that an investor is an accredited investor in an initial offering, the issuer need not clear such a hurdle again for a five-year period.[111] The problem, of course, is that the SEC's "principals-based method of verification"[112] may not provide the issuer reasonable assurance that it actually took the necessary steps to verify an investor in the initial offering, meaning that the risk of non-compliance persists in subsequent offerings during the five-year period.[113] This risk could be mitigated by an issuer utilizing the non-exclusive verification methods listed in Rule 506(c),[114] but the inconvenience of such methods likely outweighs the utility of using these methods in the initial offering simply to gain the benefit of the aforementioned five-year look-back.[115] Furthermore, subsequent offerings during the five-year period may involve both

108. *Compare* 17 C.F.R. § 230.506(b), *with* 17 C.F.R. § 230.506(c)(2)(ii).
109. November 2020 Amendments, *supra* note 54, at 3,496.
110. *Id.* at 3,525.
111. 17 C.F.R. § 230.506(c)(ii)(E).
112. November 2020 Amendments, *supra* note 54, at 3,525.
113. *See* 17 C.F.R. § 230.506(c)(ii)(E).
114. *See* 17 C.F.R. § 230.506(c)(2)(ii).
115. *See* 17 C.F.R. § 230.506(c)(ii)(E).

existing and new investors, thus requiring the issuer to use enhanced verification requirements for new investors to obtain the benefits of the five-year look-back for previously verified investors.[116] Finally, this new method requires an administrative effort to start and track a five-year clock following the initial verification of each applicable investor and retain documentation of such verification for that period to ensure the issuer can prove ongoing compliance.[117] Intuitively, increased costs and risk of perceived non-compliance may result if records are not well maintained. Thus, while the additional verification method under Rule 506(c) provided by the November 2020 amendments may prove marginally helpful to issuers that have undertaken, or are willing to undertake, the onus of initially verifying accredited investors, this change is unlikely to drive significant new adoption of Rule 506(c), because most issuers will be reluctant to undergo the initial time and expense required to access the benefit of this method.

The SEC's most noteworthy action encouraging the use of general solicitation under Rule 506(c) since the adoption of the JOBS Act was to significantly weaken the integration doctrine in the November 2020 amendments.[118] The integration doctrine historically stood as a strong barrier between multiple offerings utilizing different exemptions.[119] The integration doctrine's origins extend back to the 1930s in the intrastate offering context, where the SEC considered sales of securities within one state and subsequent resales of such securities outside of such state to be part of the same "issue," meaning that all such sales were integrated together for determining whether the intrastate exemption applied under Section 5(c) (predecessor to Section 3(a)(11)).[120] In 1939, the court in *Unity Gold* extended the "issue" concept outside of the intrastate exemption context to other exemptions, providing in part that:

116. *Id.*

117. *Id.*

118. November 2020 Amendments, *supra* note 54, at 3,499–517; 17 C.F.R. § 230.152 (2020).

119. Unity Gold Corp., Securities Act Release No. 1,776, 3 S.E.C. 618 (July 19, 1938) ("Securities of the same class, offered on the same general terms to the public in an uninterrupted program of distribution, cannot be segregated into separate 'issues,' within the meaning of Section 3(b) of the Securities Act of 1933, as amended, merely by claiming an exemption for a limited portion of such shares under one of the rules adopted by the Commission under that section and registering the remainder, or by the mere formality of filing successive prospectuses under one or more of such rules.").

120. Securities Act of 1933, Pub. L. No. 73-22, § 5(c), 48 Stat. 74, 77–78 (1933) ("The provisions of this section relating to the use of the mails shall not apply to the sale of any security where the issue of which it is a part is sold only to persons resident within a single State or Territory, where the issuer of such securities is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."); See also Securities Act Release No. 97 (Dec. 28, 1933) ("The Securities Act will not permit you to use the mails inside the state of X for the sale of your securities until a registration statement is effective unless, in accordance with the provisions of section 5(c) the entire issue is to be sold to residents of

> *[s]ecurities of the same class, offered on the same general terms to the public in an uninterrupted program of distribution, cannot be segregated into separate 'issues,'…merely by claiming an exemption for a limited portion of such shares under one of the rules adopted by the Commission under that section and registering the remainder, or by the mere formality of filing successive prospectuses under one or more of such rules.*[121]

Unity Gold also provided a list of factors for determining whether two offerings would be integrated, forming the basis of the five-factor test applied in the 1960s and thereafter to determine whether to integrate successive private offerings.[122] While the five-factor test provided some guidance to issuers attempting to avoid integration, this test did not provide a bright-line rule and required subjective application by securities practitioners to achieve compliance.[123] The SEC then alleviated this concern in part by providing multiple safe harbors to avoid integration in multiple rule amendments, which most notably included the six-month safe harbor for the exemptions contained in

that state. It is understood that you plan to sell part of the issue to nonresidents of X as soon as the registration statement becomes effective. If this is done, the conditions of section 5(c) will not be met, and any use of the mails for sales within the state pending an effective registration will be a violation of the Act.").

121. Unity Gold Corp., Securities Act Release No. 1,776, 3 S.E.C. 618, 625 (July 19, 1938) ("The determination whether securities are being offered as part of a single 'issue' will depend upon a consideration of various factors concerning the methods of sale and distribution employed to effect the offerings and the disposition of the proceeds. If the offerings may be segregated into separate blocks, as evidenced by material differences in the use of the proceeds, in the manner and terms of distribution, and in similar related details, each offering will be a separate 'issue.' In the main, of course, each case must be determined upon the basis of its own facts.").

122. *Compare id.* ("The determination whether securities are being offered as part of a single 'issue' will depend upon a consideration of various factors concerning the methods of sale and distribution employed to effect the offerings and the disposition of the proceeds. If the offerings may be segregated into separate blocks, as evidenced by material differences in the use of the proceeds, in the manner and terms of distribution, and in similar related details, each offering will be a separate 'issue'. In the main, of course, each case must be determined upon the basis of its own facts."), *with* Non-Public Offering Exemption, Securities Act Release No. 4,552, 27 Fed. Reg. 11,317 (Nov. 16, 1962) ("The following factors are relevant to such question of integration: whether (1) the different offerings are part of a single plan of financing, (2) the offerings involve issuance of the same class of security, (3) the offerings are made at or about the same time, (4) the same type of consideration is to be received, (5) the offerings are made for the same general purpose.").

123. Exemption for Local Offerings from Registration, Securities Act Release No. 4,434, 26 Fed. Reg. 11,896 (Dec. 13, 1961) ("Any one or more of the following factors may be determinative of the question of integration") (emphasis added); Non-public Offering Exemption, 27 Fed. Reg. 11,317 (Nov. 16, 1962) ("The following factors are relevant to such question of integration") (emphasis added).

Regulation D, including Rule 506(b).[124] While the six-month safe harbor provided greater certainty for compliance with the integration rules, the length of the period proved artificial and impractical for developing issuers actively raising capital.[125] This point became especially clear following the passing of the JOBS Act in 2012, which initially appeared to prevent successive Rule 506(b) and Rule 506(c) offerings, where the only material difference in the offering is whether general solicitation is utilized to source investment.[126] As discussed above, the SEC released C&DI Question 256.34 on November 17, 2016, which provided that a Rule 506(c) offering would be treated as a "public offering" under Rule 152, and thus, not be integrated with a prior private offering.[127] In retrospect, this

124. *See* Definitions and Clarification of Certain Conditions Regarding Intrastate Offering Exemption, 39 Fed. Reg. 2,353 (Jan. 21, 1974) (codified at 17 C.F.R. pt. 230) (adopting the Rule 147 safe harbor to the intrastate exemption in Section 3(a)(11) of the Securities Act and included a six month integration safe harbor applying to securities sold by the issuer only (and not prior or subsequent secondary sales by issuer equityholders)); Notice of Adoption of Rule 146 Under the Securities Act of 1933— "Transactions By An Issuer Deemed Not To Involve Any Public Offering", Securities Act Release No. 5487, 1974 SEC LEXIS 3297 (Apr. 23, 1974) (adopting Rule 146, the predecessor to Regulation D, and including the initial version of the six-month safe harbor that was later included in Regulation D); Notice of Adoption of Rule 240, Securities Act Release No. 5560, 1975 SEC LEXIS 2372 (Jan. 24, 1975); Exemption of Limited Offers and Sales by Qualified Issuers, Securities Act Release No. 6180, 1980 SEC LEXIS 2234 (Jan. 17, 1980); Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11,251 (Mar. 16, 1982) (codified at 17 C.F.R. pts. 230, 239) (adopting Regulation D, replacing prior Rules 146, 240 and 242, and including an updated version of the six-month safe harbor in Rule 502(a) of Regulation D, which has now been further amended to refer to current Rule 152 concerning integration); *compare* 17 C.F.R. § 230.502(a) (2013) (amended by Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 86 Fed. Reg. 3,598 (Jan. 14, 2021) (to be codified at 17 C.F.R. pt. 230)), *with* 17 C.F.R. § 230.502(a) (2013) *and* 17 C.F.R. § 230.152(2021).

125. *See* Stuart R. Cohn, *Keep Securities Reform Moving: Eliminate the SEC's Integration Doctrine*, 44 Hofstra L. Rev. 3, 25-26 (2015) ("The six-month safe harbors applicable to Rule 147, Regulation A, and Regulation D exemptions have the virtue of creating a clear cut-off for the integration doctrine. However, the safe harbors are not a panacea, especially for small and developing companies. Six months is an arbitrary time frame that, for many smaller companies, may be too long a period to wait before safely raising additional capital.") (*citing* footnote 135, Revisions of Limited Offering Exemptions in Regulation D, Securities Act Release No. 8828, 91 SEC Docket 685 (Aug. 3, 2007))(the SEC noted that "[t]he current six-month time frame of the safe harbor in Rule 502(a) provides a substantial time period that has worked well to clearly differentiate two similar offerings and provide time for the market to assimilate the effects of the prior offering. The Advisory Committee has expressed concern, however, that such a long delay could inhibit companies, particularly smaller companies, from meeting their capital needs. We recognize that increased volatility in the capital markets and advances in information technology have changed the landscape of private offerings.").

126. 7 C.F.R. § 230.502(a) (2013) *amended by* Facilitating Capital Formation and Expanding Investment Opportunities by Improving Access to Capital in Private Markets, 86 Fed. Reg. 3,598 (Jan. 14, 2021) (to be codified at 17 C.F.R. pt. 230)).

127. SEC Securities Act Rules Compliance and Disclosure Interpretations, Question 256.34 (Nov. 17, 2016); *see supra* Part II.B.1.

guidance appears to have been regulatory patchwork preceding more substantial changes enacted a few years later in November 2020.

The November 2020 amendments significantly overhauled the integration doctrine in many respects and the impact on general solicitation restrictions was significant.[128] As an initial matter, revised Rule 152 codified, clarified and broadened the guidance provided earlier in C&DI Question 256.34 by stating that "[o]ffers and sales made in reliance on an exemption for which general solicitation is permitted will not be integrated if made subsequent to any terminated or completed offering."[129] The practical material impact of this change is to officially eliminate the integration doctrine for a Rule 506(c) offering that follows a Rule 506(b) offering.[130] Furthermore, revised Rule 152 also nearly eliminates the inverse of this offering sequence (a Rule 506(c) offering followed by a Rule 506(b) offering) by reducing the prior Regulation D six-month integration safe harbor to only 30 days.[131] Therefore, conducting a Rule 506(c) offering no longer precludes an issuer from conducting a subsequent Rule 506(b) offering with purchasers with whom they have a preexisting substantive relationship for a material period of time.[132] However, one nagging aspect of this construct is that in an offering of the same securities, an issuer will actually need to close its Rule 506(c) offering and wait 30 days before commencing its Rule 506(b) offering.[133] Thus, to avoid the risk associated with investor verification requirements in Rule 506(c) for an issuer's investors with whom it has preexisting relationships, an issuer would need to close with its newly solicited investors first and ask its preexisting relationships to wait for a subsequent closing more than 30 days later. Anomalies like this have caused some scholars to advocate for the elimination of the integration doctrine altogether, and merely require compliance with an issuer's chosen exemption, perhaps with a narrow exception for numerically based exemptions (such as exemptions with a maximum number of investors[134] or maximum dollar thresholds[135]).[136] A different approach would be to combine, rather than attempt

128. November 2020 Amendments, *supra* note 54, at 3,499–517.

129. 17 C.F.R. § 230.152(b)(4) (2021).

130. *Id.*

131. 17 C.F.R. § 230.152(b)(1) (2021).

132. *Id.*

133. 17 C.F.R. § 230.152(b)(4) (2021).

134. *See, e.g.,* 17 C.F.R. § 230.506(b) (2021) (providing that a maximum of 35 unaccredited investors may participate in an offering under this exemption).

135. *See, e.g.,* 17 C.F.R. § 230.504 (2021) (providing that the aggregate price in an offering under such exemption shall not exceed $10 million).

136. *See, e.g.,* Cohn, *supra* note 125.

to harmonize (as the SEC has done),[137] the patchwork of exemptions provided by the SEC into only a few exemptions that would be heavily utilized in practice. Instead of eliminating or minimizing the integration doctrine, the SEC could simply eliminate largely underutilized exemptions and combine the benefits of such exemptions into a more useful exemption, similar to its approach when it merged former Rule 505 of Regulation D into Rule 504.[138] Might Rule 506(b) and Rule 506(c) eventually be good candidates for such a merger?

III. How Rule 506(c) Could Overtake or Combine with Rule 506(b)

Despite ongoing measured efforts by the SEC to increase access to capital through additional exemptions that reduce general solicitation restrictions, the market largely remains reticent to reach beyond Rule 506(b) to new exemptions that were supposed to give life to the congressional intent to expand access to capital.[139] As Rule 506(c) is the most popular (though underutilized) exemption arising from the JOBS Act,[140] it is quite likely that the path to meeting the policy goals of access to capital and investor opportunity lie within an expanded version of this exemption. So, the question arises: what would the SEC need to do to shift issuers and practitioners toward widespread use of general solicitation under Rule 506(c)?

As discussed above, Rule 506(b) and Rule 506(c) share many of the same benefits with one major difference: the cost of using general solicitation under Rule 506(c) requires issuers to use inconvenient or amorphous reasonable verification methods to help ensure all investors in an offering are indeed accredited investors.[141] Furthermore, the updated integration rules continue to prohibit a contemporaneous Rule 506(b) and Rule 506(c) offering, meaning that issuers desiring to raise capital from existing relationships under Rule 506(c) must traverse the rigmarole of verifying those investors objectively (through tax returns, bank statements, etc.), or else rely on and document subjective factors concerning their preexisting substantive relationship with the investor to meet the threshold of using reasonable verification methods.[142]

137. November 2020 Amendments, *supra* note 54, at 3,496 (“Specifically, the amendments simplify, harmonize, and improve certain aspects of the exempt offering framework to promote capital formation while preserving or enhancing important investor protections.”).

138. *See* Exemptions to Facilitate Intrastate and Regional Securities Offerings, 81 Fed. Reg. 83,494, 83,513–23 (Nov. 21, 2016).

139. *See supra* Part I.B.

140. *See supra* note 1, at 11.

141. *See supra* Part I.B.

142. *See supra* Part II.B.3.

To afford regulatory certainty to the market concerning the use of Rule 506(c), the SEC would need to provide a convenient and objective safe harbor to verify accredited investors. The current practice in a Rule 506(b) offering, though not technically required by rule, is to have accredited investors complete an accredited investor questionnaire and make representations concerning their accredited investor status as part of forming a substantive relationship with the issuer.[143] Unfortunately, in the November 2020 amendments, the SEC specifically declined to add self-certification as a listed verification method in Rule 506(c), explaining that such verification method "could significantly increase risks to non-accredited investors" who may complete the certification incorrectly and participate in the offering.[144] This justification by the SEC lacks merit. While investor questionnaires could be structured as a simple "check-the-box" form, as criticized by the SEC,[145] such questionnaires could alternatively prompt a deeper inquisition of the investor, having them certify that they meet one or more particular definitions of "accredited investor." Indeed, in the latter instance, an unaccredited investor would either be knowingly dishonest or intentionally indifferent if it mischaracterized itself as accredited when completing one of these more detailed questionnaires. In fact, both Regulation A and Regulation Crowdfunding allow for general solicitation and also explicitly allow issuers to rely upon self-certification as to an unaccredited investor's annual income and net worth requirements.[146] Additionally, neither Regulation A nor Regulation Crowdfunding require an issuer to use reasonable verification methods when determining an investor's status as an accredited investor.[147] Indeed, the SEC has perpetuated an anomaly in Rule 506(c) by not affording self-certification as a

143. *See supra* Part I.B.

144. November 2020 Amendments, *supra* note 54, at 3,564–65. ("As another alternative, we could adopt additional means of verification of accredited investor status (such as investment amounts or self-certification as suggested by some commenters. Compared to the final amendments, these alternatives would further reduce the costs of accredited investor status verification for issuers. However, they would result in a significantly higher likelihood of non-accredited investors becoming purchasers in an offering involving general solicitation under Rule 506(c). In particular, self-certification would be a significantly less rigorous means of verification that, in conjunction with general solicitation, could significantly increase risks to non-accredited investors.").

145. *See supra* note 54 and accompanying text.

146. 17 C.F.R. § 230.251(d)(2)(D) (2021); 17 C.F.R. pt. 227 (2021).

147. 17 C.F.R. § 230.251(d)(2)(D) (2021); 17 C.F.R. §§ 227.100-227.504 (2021). The SEC also admits that verification of accredited investor status "may serve as a significant barrier to accepting accredited investors in a Regulation Crowdfunding offering," but then justifies its use in a Rule 506(c) offering. *See* November 2020 Amendments, *supra* note 54, at 3580 ("While such additional costs would be smaller for issuers with a prior or concurrent Rule 506(c) offering, for the typical Regulation Crowdfunding issuer that is small, with limited internal cash flows and no prior offering experience, such costs may serve as a significant barrier to accepting accredited investors in a Regulation Crowdfunding offering.").

verification method. If the SEC is comfortable with issuers relying on self-certification for investors under other exemptions that allow for general solicitation, would it not make sense to also allow issuers to rely upon self-certification under Rule 506(c)?

Given that self-certification is routinely utilized in Rule 506(b) offerings[148] and specifically authorized by the SEC in Regulation A and Regulation Crowdfunding offerings,[149] the SEC could reasonably change its position to provide certainty to issuers in Rule 506(c) offerings while still mitigating concerns about "check-the-box" questionnaires by creating an authorized form accredited investor questionnaire to serve as a reasonable verification method under Rule 506(c).[150] While this questionnaire should be fairly detailed and unmistakably clear, the form should *not* require the investor to submit additional documents that evidence their status, as that requirement would undermine the utility of the verification method. To the SEC's point, there will undoubtedly be dishonest or negligent unaccredited investors that choose to improperly certify and represent themselves as accredited investors in a Rule 506(c) offering. But as a policy matter, it makes little sense to limit an issuer's access to capital on account of dishonest or negligent unaccredited investors.[151] While securities laws are formulated to protect investors, the SEC cannot reasonably be expected to protect those that knowingly or negligently refuse protection.If the SEC adds self-certification as an objective and convenient verification method as suggested above, it is reasonable to assume that many more issuers and practitioners would utilize this SEC-approved method when raising capital from accredited investors under Rule 506(c), given that it conforms to current practice in other offering types, including Rule 506(b).[152] In fact, one likely implication of affording this additional verification method under Rule 506(c) would be the eventual conflation of Rules 506(b) and 506(c). If the SEC ultimately permits Rule 506(c) to conform to the customary practice of investor self-certification and representation in Rule 506(b) offerings, little difference would remain in practice between the two exemptions, except that Rule 506(c) would afford use of general solicitation.[153] Even if general solicitation is not anticipated in an offering, use of Rule 506(c) would nonetheless reduce the risk of non-compliance with general solicitation

148. *See supra* notes 52–53 and accompanying text.

149. *See* 17 C.F.R. § 230.251(d)(2)(D) (2021); 17 C.F.R. §§ 227.100–227.504 (2021).

150. *See supra* notes 52–54.

151. *See supra* notes 52–54.

152. *See supra* notes 52–54.

153. *Compare* 17 C.F.R. § 230.506(b) (2021) (Providing an exemption to both accredited and unaccredited investors, while limiting to thirty-five purchasers within a ninety-day period), *with* 17 C.F.R. § 230.506(c) (2021) (Providing a similar exemption without the thirty-five purchaser limit, but requiring that purchasers be accredited investors).

restrictions under Rule 506(b), making Rule 506(c) the less risky exemption.[154] While Rule 506(b) would still afford up to 35 unaccredited investors as a relative advantage to Rule 506(c),[155] that difference is not heavily utilized in practice, because most issuers will not undertake the burdensome disclosure required by Rule 506(b) to include unaccredited investors in the round.[156] In fact, the SEC recently harmonized Rule 506(b)'s disclosure requirements with the disclosure requirements of Regulation A, which allows for general solicitation of unaccredited investors.[157] Accordingly, it may become more logical for issuers raising capital from unaccredited investors to gain the benefits of Regulation A than to tack such investors on to a Rule 506(b) offering, though the filing and ongoing reporting requirements under Regulation A would remain meaningfully different from Rule 506(b).[158] Furthermore, the SEC could account for this relatively small number of offerings by revising Rule 506(c) to allow inclusion of unaccredited investors, similar to its Rule 506(b) counterpart, by utilizing its general exemption authority under Section 28 of the 1933 Act.[159] Therefore, for all practical purposes, Rule 506(b) would have little utility once Rule 506(c) allows for self-certification of investors as a listed verification method, meaning that Rule 506(b) could logically be merged into Rule 506(c), similar to Rule 505's merger into Rule 504.[160]

A slightly different approach that would achieve nearly the same result as adding self-certification as an approved verification method under Rule 506(c) would be for the SEC to simply allow general solicitation under Rule 506(b) by eliminating the application of Rule 502(c) to such exemption, thus practically eliminating the utility of Rule 506(c) and prompting its conflation into Rule 506(b).[161] However, because Rule 506(c) was created pursuant to a legislative mandate under the JOBS Act,[162] the SEC would be more likely to merge Rule

154. *Compare* 17 C.F.R. § 230.506(b) (2021) (Providing an exemption to both accredited and unaccredited investors, while limiting to thirty-five purchasers within a ninety-day period), *with* 17 C.F.R. § 230.506(c) (2021) (Providing a similar exemption without the thirty-five purchaser limit, but requiring that purchasers be accredited investors).

155. *Compare* 17 C.F.R. § 230.506(b)(2)(i) (allowing up to 35 unaccredited investors in the offering), *with* 17 C.F.R. § 230.506(c)(2)(i) (allowing only accredited investors in the offering).

156. *See* Ivanov & Bauguess, *supra* note 9, at 15 ("Although Rule 506 allows for the participation of non-accredited investors, they only participated in 11% of the Rule 506 offerings conducted between 2009 and 2012."); Bauguess et. al., *supra* note 4, at 2. ("Nonaccredited investors were present in only 9% of Regulation D offerings.").

157. *See* 17 C.F.R. § 230.502(b) (2021); November 2020 Amendments, *supra* note 54, at 3527–30.

158. *See* 17 C.F.R. §§ 230.252–230.257 (2020).

159. 15 U.S.C. § 78mm (2018).

160. *See supra* Part II.B.3.

161. *Compare* 17 C.F.R. § 230.502(c), *and* 17 C.F.R. § 230.506(b), *with* 17 C.F.R. § 230.506(c).

162. *See supra* Part II.A.

506(b) into Rule 506(c) to more cleanly comply with the JOBS Act, and message fulfillment of its congressional mandate to craft an exemption that affords greater access to capital, rather than abandon its new exemption in favor of the old guard of Rule 506(b).[163]

IV. Conclusion

While the JOBS Act has had relatively little impact on how private offerings are conducted to date,[164] this legislation ushered in a new era of securities regulation in which the SEC will balance the investor-protection mandate of the 1933 Act with the expanded access-to-capital mandate of the JOBS Act.[165] In meeting this latter mandate, the SEC has, in recent years, taken a measured approach to weaken general solicitation restrictions in private offerings that once stood as the hallmark of private offering exemptions.[166] The new "public-private exemption" of Rule 506(c) largely embodies this new era, yet remains underutilized by practitioners[167] due to inadequate safe harbors to amorphous factor-based restrictions related to verification of accredited investors.[168] Similar factor-based restrictions once plagued other areas of securities law, such as the general private placement exemption in Section 4(a)(2)[169] and the integration doctrine,[170] but in each of those cases, the SEC ultimately implemented convenient and clear safe harbors to provide greater ease and certainty of compliance to issuers and practitioners.[171] As the safe harbor methods expand under Rule 506(c) for verification of accredited investors (especially if self-certification is added as a method), there may eventually be little difference in practice between Rule 506(c) and the highly utilized Rule 506(b), other than 506(b)'s restriction on general solicitation. At that point, Rule 506(b) loses its utility, logically leading to higher utilization of, or conflation with, Rule 506(c). Until such time, Rule 506(b) will continue as the predominant exemption from registration in private offerings.

163. *See supra* notes 82–85 and accompanying text.

164. *See* Bauguess et. al., *supra* note 4.

165. *See supra* notes 82–85 and accompanying text.

166. *See supra* Part II.B.

167. *See* Bauguess et. al., *supra* note 4.

168. *See supra* Part I.B.

169. *See supra* notes 24–25 and accompanying text.

170. *See supra* notes 123–124 and accompanying text.

171. *See supra* notes 123–124 and accompanying text; *see* Revision of Certain Exemptions From Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11251, 11264-66 (Apr. 15, 1982).