Securities Offerings and Communications: Is the Integration Bogeyman Dead?

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In our Practising Law Institute treatise *Exempt and Hybrid Securities Offerings*, we refer to the concept of "integration" under the securities law as a bogeyman of sorts for practitioners. In this day and age of tweets and posts, and where public and "private" offerings are hard to distinguish from one another, is the concept of integration antiquated? Or is it perhaps due for a comprehensive re-examination by the Securities and Exchange Commission? As we discuss below, many of the fundamental principles of integration of offerings, aggregation of offerings for purposes of securities exchange rules, and communications issues like "gun-jumping" and "quiet periods" may have been so eroded as to no longer be meaningful.

Integration Principles and the "Five-Factor Test"

It is well understood that an issuer should not be able to circumvent the registration requirements arising under section 5 of the Securities Act of 1933 by conducting a series of smaller offerings separately and thereby evading registration. An issuer must consider each proposed financing and assess whether such financing meets all of the requirements for an exemption from the registration requirements. Also, an issuer must assess whether a series of financings conducted in close proximity to one another form part of the same plan of financing and ought to be integrated and considered as a single offering that either is exempt from registration or subject to the registration requirements. It is, of course, possible that even if a series of separate exempt offerings was considered part of a plan of financing, or "integrated," that there may still be a valid exemption for the offering as a whole. Offerings occurring in close proximity to one another may not be required to be integrated or considered together if each such offering meets the applicable conditions for its exemption and is a separate offering. Related to these questions, practitioners often consider as part of the same inquiry whether communications made in connection with one proposed offering may vitiate the exemption sought to be relied upon in connection with a subsequent offering. For example, would communications that are considered a "general solicitation" made in connection with a proposed public offering render unavailable the section 4(a)(2) statutory private placement exemption under the Securities Act. Or would discussions relating to a potential private placement be viewed as "jumping the gun" in connection with a subsequent, but not-yet-launched, public offering? While not necessarily central to the fundamental integration question, communications issues seem inextricably linked to many of the fact patterns that we regularly encounter.

The SEC formally articulated the "five-factor test" almost sixty years ago. The test requires that, in considering whether various offerings of securities should be integrated, a practitioner evaluate whether:

1. the offerings are part of a single plan of financing;
2. the offerings involve the issuance of the same class of securities;
3. the offerings are made at or about the same time;
4. the same consideration for the offerings is expected to be received; and/or
5. the offerings are for the same general purposes.[1]

This test has been applied by numerous courts; however, despite the many applications of the test, it remains remarkably ambiguous. For example, a couple of the factors are rarely helpful. Most sales of securities are for cash consideration, so as a practical matter, it is difficult to distinguish one offering from another based on the type of consideration. Particularly in the case of growing companies, most offerings are made to raise growth capital, so it is often impossible to distinguish the "purpose" of one offering versus that of another. The "purpose" prong also seems quite similar to the "single plan of financing" prong. Therefore, practitioners tend to place most weight on the time that has elapsed between one offering and another and on whether the offered security is the same. As far as the relevant time period, the staff has focused on offerings that occur within six months of one another, which is the relevant period for now.

In light of the fluidity of financings and the increased reliance by issuers on exempt offerings, including exempt offerings that have characteristics associated with public offerings, such as the use of general solicitation, it may be time to reevaluate the utility of the five-factor test. As discussed below, as a result of a number of safe harbors, practitioners are relegated to reliance on the five-factor test in only a limited number of circumstances. The five-factor test remains most useful in connection with evaluating various exempt offerings occurring in close proximity to one another. The number of factors, to the extent deemed relevant today, should be pared down. Perhaps more important, the six-month time period should be shortened to thirty days.

> It may be time to reevaluate the utility of the SEC's five-factor test.

Safe Harbors

Practitioners tend to prefer reliance on one of the many integration safe harbors that have been adopted over the years. Many of the safe harbors were adopted years ago and are somewhat prescriptive. These merit close review. As further discussed below, over time, especially in recent years, the Commission has adopted specific safe harbors at the time that it has adopted new, or amended existing, offering exemptions, such as Rule 147, Rule 147A, Regulation A, and Regulation CF. The staff also has provided guidance regarding various integration questions in the form of Compliance and Disclosure Interpretations. In order to rationalize the approach to integration, it may be prudent to assess whether to continue to adopt individual safe harbors, whether to consolidate all integration safe harbors in one release, or whether to take a more principles-based approach to integration issues.

Changing Offering Formats

There are two integration safe harbors, Rule 152 and Rule 155, which address moving to or from a registered offering to an exempt offering, whether sequentially or as the result of an abandonment of an offering in favor of a different financing approach.

Rule 152. Rule 152 provides that the phrase "'transactions by an issuer not involving any public offering' in section 4(2) [now 4(a)(2)] shall be deemed to apply to transactions not involving any public offering at the time of said transactions although subsequently thereto the issuer decides to make a public offering and/or files a registration statement." Over time, through various no-action letters, the staff has interpreted the Rule 152 safe harbor to make clear that a proposed public offering, even one contemplated at the time a private placement is undertaken, need not be integrated with the private placement provided that the conditions for the exempt offering have been met. In the two no-action letters that once were so important to any integration discussion, the Black Box letter and the Squadron, Ellenoff letter, the staff further expanded its interpretation of the safe harbor to permit contemporaneous private and public offerings subject to the private offering having been limited in character. We rely on Rule 152 in connection with traditional PIPE transactions, wherein a public company enters into definitive securities purchase agreements relating to private sales made in reliance on section 4(a)(2) and/or Rule 506 of Regulation D to certain institutional or accredited investors and subsequent to the entry into such agreements files a registration statement covering the resale from time to time by such PIPE purchasers of the securities purchased in the PIPE transaction. The Rule 152 safe harbor is helpful generally in connection with any completed private placement (as such term is understood under the securities laws) followed by a public offering. Recently, the staff has interpreted the Rule 152 safe harbor to be applicable in the case of a private placement completed in reliance on Rule 506(b), which does not involve general solicitation, followed by an exempt offering made in reliance on Rule 506(c), which involves public offers albeit not a public offering made pursuant to a registration statement. The Rule 152 construct also could be expanded to address a completed private placement followed by any number of other exempt offerings that are "public" in nature. The safe harbor also could be expanded to address offerings of convertible securities, including securities that are immediately convertible.

Rule 155. The Rule 155 safe harbor was adopted to provide more flexibility for issuers seeking to complete a financing transaction amid changing market conditions. The safe harbor addresses the circumstances under which an issuer may abandon a private offering made in reliance on section 4(a)(2) and/or Rule 506(b) to commence a public offering and the circumstances under which an issuer may commence a private offering after having abandoned a public offering. The safe harbor addresses certain sequential offerings, but not contemporaneous or even completed sequential offerings. In order to rely on Rule 155(b), an issuer that abandons a private offering in order to commence a registered public offering must meet all of the conditions of the safe harbor. The private placement must have been a bona fide private placement; no securities can have been sold in the private placement; all offering activity relating to the private placement must have been terminated; a period of thirty days must have elapsed between the termination of the private placement and the filing of the registration statement; and the public offering prospectus must contain certain disclosures relating to the abandoned private placement. Rule 155(c) provides a safe harbor for an issuer that abandons a public offering in favor of commencing a private placement. The issuer must satisfy all of the conditions for the safe harbor, including that: no securities have been sold in the public offering; the registration statement is withdrawn; the issuer wait thirty days after the effective date of the withdrawal of the registration statement before commencing the private placement; and the issuer make certain disclosures to offerees in the private placement. The conditions of Rule 155 are quite prescriptive and presume that there are bright lines between "private" and "public" offerings. While at the time that Rule 155 was adopted there may have been clearer lines demarcating a private placement from a public offering, this is no longer the case. Furthermore, an issuer may not be willing to wait thirty days given that market conditions often change quickly. Also, an issuer may be reluctant to announce the "abandonment" or "termination" of a proposed offering. In the absence of relying on Rule 155 in the case of a switch from private to public offering or public offering to private placement, an issuer would be relegated to relying on the ambiguous five-factor test or the guidance that focuses on how offerees were identified and solicited. It also is not clear whether, given the availability of information, it is necessary for investor protection purposes to continue to require the specified disclosures as a condition to the safe harbor under Rule 155.

Offering-Specific Safe Harbors

There are a number of safe harbors that address specific offerings, including the following:

- The Regulation D six-month safe harbor establishing a safe harbor for Regulation D offerings made more than six months apart;
- The Rule 701 safe harbor providing a safe harbor for offerings contemporaneous with stock-based compensation issuances made in reliance on the exemption from registration provided by Rule 701;

- The Regulation A safe harbor providing that a Regulation A offering will not be integrated with prior offers or sales of securities, subsequent offers or sales of securities made pursuant to a Securities Act registration statement, made in reliance on Rule 701, made pursuant to an employee benefit plan, made in reliance on Regulation S, made in reliance on the section 4(a)(6) exemption for crowdfunded offerings, or offerings made more than six months apart;
- An offering made pursuant to section 4(a)(6) will not be integrated with another exempt offering that precedes the crowdfunded offering, that takes place concurrently, or that takes place subsequent to completion of the first such offering provided that the issuer has satisfied as to each such offering the conditions for the exemption that it is claiming for the applicable offering;
- The Rule 147 and Rule 147A safe harbors providing that offers and sales made pursuant to these intrastate exemptions will not be integrated with prior offers or sales of securities, with Securities Act registered offerings, Regulation A offerings, Rule 701 issuances, Regulation S offerings, crowdfunded offerings, or offerings made more than six months apart;
- The Regulation S safe harbor providing that offshore offerings will not be integrated with contemporaneous private placements; and
- The Rule 144A safe harbor providing that resales made in reliance on Rule 144A will not affect the availability of any exemption or safe harbor relating to a prior or subsequent offering of securities by the issuer.

Following enactment of the JOBS Act and the final rules relaxing the prohibition on general solicitation in connection with Rule 506(c) and Rule 144A offerings, the staff has provided some guidance in the form of Compliance and Disclosure Interpretations, which guidance has focused principally on the types of communications that would be deemed to constitute "general solicitation." In the adopting releases relating to Regulation A and Regulation Crowdfunding, the Commission also provided guidance regarding the analysis that should be undertaken in connection with Rule 506 offerings as well as Regulation Crowdfunding offerings conducted in close proximity to Regulation A offerings or even concurrently. However, many questions remain, especially in light of the various types of exempt offering formats that involve "general solicitation."

Who Was Solicited and How Solicitations Were Made

In 2008, the staff of the Commission affirmed certain interpretive guidance through the issuance of Compliance and Disclosure Interpretations relating to concurrent private and public offerings. Under appropriate circumstances, an issuer may conduct a concurrent private and public offering, without the need to limit the private offering to institutional investors that are either qualified institutional buyers as defined in Rule 144A or institutional accredited investors as suggested by prior no-action letters. In the 2007 proposing release relating to amendments to Regulation D, which amendments were never adopted, and in the subsequent Compliance and Disclosure Interpretation, the focus was on how the offerees were identified. If the issuer can meet the conditions for the applicable private offering exemption and the offerees were not solicited by means of the registration statement, the issuer may complete a private placement concurrent with a registered public offering. The registered public offering will not be viewed as a general solicitation that would render unavailable the private placement exemption if, for example, the issuer or the financial intermediary acting on the issuer's behalf had a preexisting substantive relationship to the offerees in the private placement. The staff of the Commission's Division of Corporation Finance has recently provided guidance regarding the manner in which a pre-existing and substantive relationship may be established. This guidance, which re-affirmed views expressed over many years in various no-action letters, is helpful in light of the increased reliance on Internet-based communications and the number of exempt offerings that involve "public offerings." Presumably, this approach of assessing whether the issuer has a preexisting relationship with offerees and the manner in which offerees are solicited can be applied to other contemporaneous offerings. In addition, in the period following the JOBS Act, when so many issuers undertaking IPOs rely on confidential submissions, a potential "general solicitation" is deferred until the IPO registration statement is actually filed, so many of the concurrent offering questions are obviated. It is worth considering whether we need many of the other specific integration safe harbors if the relevant question to be considered is how an offeree is contacted.

Communications Issues

As discussed above, while "gun jumping" questions are different from, and separate from, integration questions, they are often inextricably related. To the extent that an issuer is perceived to have jumped the gun and through its communications engaged in solicitations in a private placement that it subsequently abandons in favor of a registered public offering, one must consider whether the private placement discussions related to a bona fide offering. Were discussions related to a purported private placement a means of conditioning the market for the issuer's securities? Similarly, an issuer that sought to conduct a public offering (using general solicitation) may not be able to make a private placement immediately after abandoning the public offering to investors that became aware of the investment opportunity by having received the registration statement. The ability to test the waters and contact institutional investors in connection with an IPO by an emerging growth company is specifically excluded from the definition of an "offer" under the Securities Act. Is the concept of "gun jumping" still relevant? Should the analysis rely on the 2008 Compliance and Disclosure Interpretation discussed immediately above?

Since establishing whether a communication constitutes an "offer" is often important to identifying whether an offering exemption is available or whether offerings should be integrated, a careful review should be undertaken of the communications related safe harbors under the Securities Act. Securities offering reform in 2005 focused principally on easing communications restrictions for the largest issuers, well-known seasoned issuers (WKSIs), premised on the view that these issuers were widely followed by research analysts, professional investors, and others and there was current public information available to investors about WKSIs. The availability of current, reliable information about these issuers mitigated any investor protection concerns that might arise in relation to communications undertaken in proximity to securities offerings. Given the availability of information generally, it may be prudent to revisit whether additional safe harbors and communications flexibility could be made available to other categories of issuers.

Finally, it may be time to acknowledge officially the death of the "quiet period" immediately following completion of an issuer's IPO. Issuers rely on social media and other channels in ways that were unanticipated when restrictions on communications were adopted. There is little purpose to be served by creating artificial information barriers or imposing gag orders on issuers.

Conclusion

The Financial CHOICE Act contains a number of provisions that are designed to encourage capital formation. In fact, some of these provisions have been referred to as comprising a "JOBS Act 2.0." There are also ongoing discussions relating to reviving the U.S. IPO market. However, absent from the proposed legislation and from the IPO dialogue is any consideration of the need to revamp the securities integration and communications regulatory framework. As practitioners who counsel companies often trying to navigate volatile markets and seize financing opportunities, we believe that rethinking or at least modernizing integration and communications safe harbors should feature prominently in any capital formation initiatives.

Anna T. Pinedo and James R. Tanenbaum are authors of PLI's Exempt and Hybrid Securities Offerings.

NOTES

1. *See* 17 C.F.R. § 230.502(a).