



Professional Perspective

Temporary Amendments to Expedite Regulation Crowdfunding Offerings

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On May 4, 2020, the US Securities and Exchange Commission [announced](#) that it had adopted a [temporary final rule](#) to expedite Regulation Crowdfunding (Reg CF) offerings for smaller established companies affected by Covid-19. The temporary amendments will provide conditional relief from certain timing and financial statement requirements with respect to Reg CF offerings launched by qualified issuers between May 4, 2020 and Aug. 31, 2020. The temporary final rule release and the related announcement include a chart summarizing the regular rules as compared to the new temporary rules.

In the release, the SEC recognized that, as a result of the Covid-19 outbreak, many small businesses urgently need capital in a timely and cost-effective manner and that, based upon feedback from its Small Business Capital Formation Advisory Committee, certain Reg CF requirements make it difficult to launch and close an offering in a suitable time frame.

Eligible Issuers

In addition to the existing issuer eligibility criteria, the temporary amendments are only available for issuers that have been organized and had operations for at least six months. The SEC stated in the release that it “believed this restriction is appropriate because the temporary relief is intended primarily to assist existing businesses that require additional funds because of adverse effects caused by the closures and safety measures designed to slow the spread of Covid-19.” The SEC also made it clear that new businesses, to the extent otherwise eligible, could conduct a Reg CF offering without the relief afforded by the temporary amendments.

For issuers who have previously sold securities under Reg CF, such issuers must have complied with the requirements contained in Section 4A(b) of the Securities Act of 1933, as amended (the 1933 Act), and the related requirements of Reg CF to be eligible. However, the SEC indicated, in a footnote, that filing delinquencies could be cured prior to a new Reg CF offering in order to qualify. See SEC Release 33-10781 [Note 10].

The temporary amendments include a requirement that the applicable intermediary (the broker-dealer or funding portal through which the offering will be conducted), have a reasonable basis for believing that a previous seller under Reg CF complied with the requirements of Section 4A(b) of the 1933 Act and the related requirements under Reg CF in prior offerings. The intermediary would be permitted to rely upon a representation from the issuer for this purpose, unless the intermediary has reason to question the reliability of the representation.

Omission of Financial Statements from Initial Form C

Temporary Rule 201(z)(2) will allow an issuer to commence an offering without the financial statements required by Rule 201(t) of Reg CF being included in the initial Form C filing, but such financial statements must be included in a Form C amendment that would need to be filed and provided to investors and the intermediary before any investment commitments are accepted. Significantly, the SEC confirmed that, since no commitments may be accepted until complete financial statements are provided, the filing of the Form C amendment with the required financial statements will not trigger the reconfirmation requirements of Rule 304(c) of Reg CF, which gives an investor five (5) business days to reconfirm its investment after a material change.

The SEC cited the time and expense of preparing the required financial statements and, if applicable, having such statements reviewed or audited by an independent public accountant during the Covid-19 outbreak, together with the related challenges of launching a timely offering, as the reasons for this temporary amendment.

The SEC also noted that the temporary relief would allow issuers to gauge investor interest before going through the effort and expense of preparing financial statements:

The temporary rules are expected to benefit issuers by allowing greater flexibility to communicate with prospective investors about the contemplated offering and to gauge market interest prior to incurring the full cost of preparation of financial statement disclosures...If, after communicating with investors, the issuer is not confident that it would attract sufficient investor interest, the issuer could amend the offering plans or the target amount of the offering, or explore alternative methods of raising capital.

An issuer relying on Temporary Rule 201(z)(2) is required to include prominent disclosure in the offering materials that the financial information that has been omitted is not otherwise available and will be provided in an amendment to the offering materials; the investor should review the complete set of offering materials, including previously omitted financial information, prior to making an investment decision; and no investment commitments will be accepted until after such financial information is provided. This disclosure requirement is codified in Temporary Rule 201(z)(1)(ii).

Relief for Reviewed Financial Statements

Temporary Rule 201(z)(3) provides that an eligible issuer conducting a Reg CF offering with a target amount exceeding \$107,000 but not exceeding \$250,000 is excused from the requirement to provide financial statements reviewed by an independent public accountant, provided that reviewed or audited financial statements are unavailable at the time of filing. For purposes of calculating these amounts, an eligible issuer would need to aggregate amounts, if any, sold under Reg CF during the preceding 12-month period, and the amount in the offering for which disclosure is being provided. See SEC Release 33-10781 [Note 21].

In lieu of such requirement, such issuer is permitted to provide financial statements and certain information from its federal income tax returns, both certified by the issuer's principal executive officer, in accordance with Rule 201(t)(1), the rule that currently applies to Reg CF offerings up to \$107,000.

Currently, aside from Temporary Rule 201(z)(3), issuers conducting an offering under Reg CF must provide financial information as follows: for offerings up to \$107,000, financial statements and certain federal income tax return information, each certified by the principal executive officer; for offerings exceeding \$107,000 but not exceeding \$535,000, financial statements reviewed by an independent public accountant; and for offerings exceeding \$535,000, (A) for first-time Reg CF issuers, financial statements reviewed by an independent public accountant and (B) for issuers that have previously sold securities under Reg CF, financial statements audited by an independent public accountant. In each case, if the more extensive financial information is available, it must be provided instead. In addition, the amounts must include securities sold under Reg CF during the preceding 12-month period. See Rule 201(t).

Eligible issuers relying on Temporary Rule 201(z)(3) need to provide prominent disclosure in the offering materials that financial information certified by the principal executive officer of the issuer has been provided instead of financial statements reviewed by an independent public accountant. This disclosure requirement is codified in Temporary Rule 201(z)(1)(iii).

Suspension of 21-day Timing Requirement

Currently, aside from the temporary amendments, a Reg CF offering statement must be publicly available on the applicable intermediary's platform for at least 21 days before securities can be sold, but commitments can be accepted by the intermediary during this period. See Section 4A(a)(6) of the 1933 Act. In addition, investors are permitted to cancel commitments for any reason up until 48 hours of the deadline set forth in the offering materials, with cancellations during that 48-hour period limited to situations where there is a material change in the offering. See Rule 304(a) and Rule 304(c).

To address the urgent funding needs of businesses disrupted by Covid-19, the SEC adopted Temporary Rule 303(g), which suspends the 21-day period but requires that all disclosure, including any financial information omitted from the initial Form C, be publicly available before any securities are sold. The SEC noted that, notwithstanding the suspension of the 21-day requirement, since investors have 48 hours to cancel their commitments, the earliest an issuer could close after all required information is made publicly available is 48 hours after such time.

Importantly, an intermediary for an issuer relying on the temporary rule to omit the financial information from the initial Form C may not accept investment commitments until such financial information is included in the Form C amendment and made publicly available.

An issuer seeking to rely on the suspension of the 21-day period under Temporary Rule 303(g) would need to provide prominent disclosure in the offering materials of the possibility of an early closing and the modified cancellation procedures, in each case in the manner described in Temporary Rule 201(z)(1)(iv), which is summarized below.

Cancellation and Early Closing

Under the existing rules, without the temporary relief, a Reg CF investor has the right to cancel his or her investment commitment up until 48 hours before the deadline set forth in the offering materials. A cancellation right during such 48-hour period only exists if there is a material change to the offering.

In addition, aside from the temporary amendments, the existing rules provide that an issuer who reaches its target offering amount before the deadline set forth in the offering materials can close early so long as: the offering has been open for at least 21 days; the intermediary provides notice of the early deadline at least five business in advance; the investors are given the right to cancel their investments within 48 hours of the new deadline; and the issuer has continued to reach or exceed the target offering amount as of the new deadline.

To facilitate the use of Reg CF and address urgent funding needs, the SEC adopted Temporary Rule 304(e), which provides that once an issuer has received binding commitments that equal or exceed the target offering amount, it may close earlier than the date identified in its offering materials. The release confirms that issuers relying on Temporary Rule 304(e) may still engage in a “rolling closing” for a min/max offering, whereby an issuer could conduct an initial closing once the minimum amount is reached, followed by additional closings until the maximum amount is reached.

Rule 304(e) gives investors 48 hours to cancel their investment commitments, so “binding commitments” in this context means investor commitments for which the 48-hour cancellation period has expired. After this 48-hour period, investors can only cancel their investments if there is a material change, as provided in Rule 304(c). If there is a material change, the notice, reconfirmation and cancellation procedures set forth in Rule 304(c) would apply.

Under Temporary Rule 304(e), in the event of an early closing, the intermediary would need to provide notice that the target offering amount has been met, but would not be required to provide the five business days’ advance notice of the earlier closing deadline, as would otherwise be required under Rule 304(b).

Under Temporary Rule 201(z)(1)(iv), issuers relying on Temporary Rules 303(g) and 304(e) must include prominent disclosure in the offering materials stating that: investors may cancel an investment commitment for any reason within 48 hours from the time of their investment commitment (or such later period as the issuer may designate); the intermediary will notify investors when the target offering amount has been met; the issuer may close the offering at any time after it has aggregate investment commitments for which the 48-hour right to cancel (or such later period as the issuer may designate) has elapsed that equal or exceed the target offering amount (absent a material change that would require an extension of the offering and reconfirmation of the investment commitment); and if an investor does not cancel an investment commitment within 48 hours from the time of the initial investment commitment, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment.

Disclosure

In addition to the specific disclosure requirements specified above, any issuer relying on these temporary amendments must include prominent disclosure in the offering materials that the offering is being conducted on an expedited basis due to circumstances related to Covid-19 and pursuant to the temporary relief provided by the SEC.

In addition, the SEC made a conforming temporary amendment to the introductory paragraphs of the “Optional Question and Answer Format for an Offering Statement” section of Form C by adding a new paragraph reminding issuers relying on the temporary rules to review and tailor their responses appropriately.

Possible Extension and Additional Conditions or Relief

The release provides that the SEC will monitor the situation and may extend the time period for which the temporary amendments apply, possibly with additional conditions or relief, as the SEC deems appropriate.

More broadly, the SEC's announcement of the temporary rules stated "[t]he Commission and its staff continue to assess impacts relating to the coronavirus on investors and market participants, and will consider additional relief from other regulatory requirements where necessary or appropriate."

Practical Application

The temporary amendments will likely be most helpful to companies that have already sold securities under Reg CF. Updating the offering materials from a prior transaction, without the initial burden of providing financial statements, would be a streamlined process requiring minimal effort and expense. For companies that have not sold securities under Reg CF, preparation of the offering materials would require a significant time and expense commitment, even without the requirement to initially provide financial statements. A company in this category would need to provide all other information described in Rule 201, including a description of its business and business plan, risk factors, use of proceeds and ownership and capital structure. Creating this disclosure from scratch is a significant undertaking.

In addition, as the SEC pointed out in the release, there is a reputational risk for a small business that fails to attract sufficient investor commitments on the basis of a public offering statement.

Liability

While all issuers should be cautious in providing accurate disclosure in a securities offering, a rush to complete offering materials can be particularly risky under Reg CF. Section 4A(c) of the 1933 Act provides investors with a private right of action against the issuer for material misstatements and omissions in a Reg CF offering and, for these purposes, "issuer" includes the principal executive officer, the principal financial officer and any director. Principals of a company exploring a Reg CF offering should be mindful that they could have personal liability, and this could be a heightened risk in situations where offering materials are prepared in haste.

Alternatives

Companies with an imminent need for working capital that are exploring a private securities offering should consider alternatives that may be less time consuming, less costly and less risky than an offering under Reg CF.

As an example, under Rule 504, issuers can offer and sell up to \$5 million of securities within a 12-month period and there are no investor qualification or specific disclosure requirements. While Rule 504 prohibits a general solicitation in most cases and does not preempt state registration requirements (which Reg CF does), it may be a less time-consuming and less costly alternative for a small business seeking equity capital. Note also that the SEC has [proposed](#) raising the 12-month funding cap under Rule 504 to \$10 million.

Although Rule 504 has no specific disclosure requirements, there is potential liability exposure for material misstatements or omissions under Section 10(b) of the 1934 Act and Rule 10b-5 thereunder. Unlike the specific disclosure requirements under Reg CF, the disclosure in a Rule 504 offering can be tailored to the nature of the business and the investors in a manner that adequately addresses the Rule 10b-5 risk.

While the challenge with a Rule 504 offering will typically be getting sufficient investors without a general solicitation, there would be less reputational risk associated with a failed offering than with an offering under Reg CF.

It is also worth mentioning that investors commencing a Rule 10b-5 action for a sale under Rule 504 would face a more difficult burden than Reg CF investors. Rule 10b-5, unlike Section 4A(c) of the 1933 Act, requires proof of "scienter", which is essentially intentional or reckless fraud. This distinction is another reason Rule 504 may be a more attractive alternative than Reg CF.

Any company contemplating a securities offering should consult with legal counsel.