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The SEC Delivers A+ Effort: New Rules Designed to Breathe Life into Regulation A

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On March 25, 2015, the U.S. Securities and Exchange Commission (the "**SEC**" or "**Commission**") adopted final rules that amend Regulation A, which provides an exemption for certain offerings of securities from the registration requirements of Section 5 of the Securities Act of 1933 (the "**Securities Act**"). The new rules, sometimes referred to as **Reg A+**, allow for exempt offerings of securities, essentially "mini IPOs," by certain companies in amounts of up to $50 million. The SEC press release indicated that these new rules will provide an effective path to raising capital while also providing suitable investor protections. The changes come as the latest rulemaking mandated by the 2012 Jumpstart Our Business Startups Act (the "**JOBS Act**"), which, among other things, directed the Commission to exempt from the Section 5 registration requirements a new class of securities for offerings up to the $50 million offering limit.

Background and Overview

Prior to adoption of the new rules, Regulation A provided an exemption from the Section 5 registration requirements for offerings of up to $5 million, subject to certain eligibility and disclosure requirements. Unlike securities issued pursuant to other exemptions, such as Regulation D, securities issued pursuant to Regulation A are unrestricted and can be freely transferred in secondary markets. This feature, along with the public filing and disclosure requirements (discussed below), makes Regulation A offerings more like "mini-IPOs" instead of private placements. However, even with the allure of an exempt offering of unrestricted securities, few companies have relied on Regulation A. With the passage of the JOBS Act, Congress asked the Government Accountability Office ("**GAO**") to study current usage of the old Regulation A. The GAO's report found that Regulation A was substantially underutilized for two critical reasons: (1) the offerings were still subject to compliance with state securities regulations, often referred to as "**Blue Sky laws**"; and (2) the costs associated with the Commission's review process, while less than a full registration under the Securities Act, were still significant compared to the size of the maximum potential offering.

Reg A+ creates a new, two-tiered system of exempt offerings that attempts to address the concerns highlighted by the GAO while also maintaining sufficient investor protections:

Tier 1

- Offering Limit: $20 Million
- Subject to Blue Sky laws
- Subject to substantially similar disclosure requirements as under the old Regulation A

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Tier 2

- Offering Limit: $50 Million
- Exempt from Blue Sky laws
- Increased disclosure requirements
- Ongoing reporting obligations
- Certain investment limitations

The practical effect of these changes is to create two alternative paths for pre-IPO companies to raise capital pursuant to Regulation A: (1) the traditional route subject to state oversight, but with a dramatically increased offering limit; and (2) a true "mini-IPO" with a scaled version of public company reporting obligations. One critical question expected to impact the use of Regulation A going forward will be whether companies believe the new $50 million offering limit justifies the public disclosure and reporting obligations, as well as the associated compliance costs.

Eligibility

Eligible Issuers. The new exemption will only be available to companies that are organized in, and with their principal place of business in, the United States or Canada. There are also several categories of ineligible issuers, including:

- companies that are subject to the ongoing reporting requirements under the Securities Exchange Act of 1934 (the "**Exchange Act**");
- companies registered or required to be registered under the Investment Company Act of 1940 and business development companies;
- blank check companies;
- issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights;
- companies that are required to, but that have not, filed with the Commission the ongoing reports required by Regulation A during the two years immediately preceding the filing of a new offering statement under Regulation A (or for such shorter period that the issuer was required to file such reports);
- companies that are or have been subject to a Commission order pursuant to Exchange Act Section 12(j) that was entered within five years before the filing of the offering statement; and
- companies subject to "bad actor" disqualification under Rule 262 of Regulation A.

The Commission has indicated that it may consider expanding the categories of eligible issuers (for example, by including non-Canadian foreign issuers) once it has had an opportunity to observe how the market responds to the new rules.

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Securities. The exemption is available for the offer and sale of equity securities, debt securities, and securities convertible or exchangeable into equity interests, including any guarantees of such securities. Asset-backed securities are explicitly excluded under the final rules.

Investor and Investment Limitations. Reg A+ does not impose limitations on the types of investors that may purchase in a Tier 1 offering, nor does it place investment limitations (other than the maximum amounts of securities that may be offered in a 12-month period) on investors in a Tier 1 offering. However, purchasers in a Tier 2 offering that are not "accredited investors," as that term is defined in Regulation D, will be limited to purchasing no more than (1) 10 percent of the greater of annual income or net worth (for natural persons); or (2) 10 percent of the greater of annual revenue or net assets at fiscal year-end (for non-natural persons). Issuers must notify investors in a Tier 2 offering of the investment limitations, and issuers are permitted to rely on an investor's representation of compliance with the investment limitations unless the issuers know that the representation is untrue. The Tier 2 investment limitations do not apply if the securities will be listed on a national securities exchange upon qualification of the required offering statement (see "Reporting Obligations – Exchange Act Registration" below).

Selling Securityholders. The new rules permit existing securityholders to sell securities in a Tier 1 or Tier 2 offering under Reg A+, provided that sales by selling securityholders in the issuer's first Regulation A offering (and any subsequent Regulation A offering within 12 months of the qualification date of the issuer's first offering statement under Regulation A) are limited to no more than 30 percent of the aggregate offering price (offering size). Following the first year after qualification of an issuer's initial Regulation A offering statement, the rules distinguish between affiliates and non-affiliates of an issuer. For non-affiliate selling securityholders, sales after the first year will no longer be limited, except by the maximum offering amount permitted. Sales by affiliates, however, will be subject to a $6 million cap in Tier 1 offerings and a $15 million cap in Tier 2 offerings.

The Offering Process

Testing the Waters. Through the use of solicitation materials both before and after filing an offering statement with the SEC (see "Electronic Filing; Delivery Obligations" and "Reporting Obligations – Amended Form 1-A" below), companies relying on Reg A+ will be able to gauge potential interest in the market, or "test the waters," before fully committing to an offering. Companies that opt to test the waters will not be required to submit their solicitation materials to the Commission at or before the time of first use, but they will be required to submit or file such materials as an exhibit to their offering statement upon non-public submission or public filing of the offering statement with the SEC. Accordingly, solicitation materials will be available to the public, along with the issuer's offering statement.

Once an issuer publicly files an offering statement, solicitation materials must either be accompanied by a current preliminary offering circular or notify potential investors as to how they can obtain the most current preliminary offering circular. If any of such materials becomes materially inadequate or inaccurate, the issuer must update and redistribute the solicitation materials in substantially the same manner as the original distribution.

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Solicitation materials used prior to qualification of the offering statement must include a legend indicating that: (1) no money or other consideration is being solicited, and if sent, will not be accepted; (2) no sales will be made or commitments to purchase accepted until the offering statement is qualified; and (3) a prospective purchaser's indication of interest is non-binding.

Electronic Filing; Delivery Obligations. Companies relying on Reg A+ will be required to file certain materials with the SEC (see "Reporting Obligations" below). All Reg A+ filings, including non-public confidential submissions (see "The Offering Process – Non-Public Review" below), must be filed with the Commission electronically on the EDGAR filing system, where they will be made available to the public. If the issuer is not already subject to a Tier 2 reporting obligation (see "Reporting Obligations – Ongoing Reporting Obligations" below), the issuer must deliver a preliminary offering circular to prospective purchasers at least 48 hours in advance of sale. In addition, within two business days after a sale, companies must deliver a final offering circular to purchasers. The Commission has adopted an "access equals delivery" notice model for final offering circulars. Under this rule, companies are deemed to satisfy their delivery obligations to purchasers by filing the final offering circular on EDGAR, so long as they included a notice in any preliminary offering circular that informed potential investors of how to access the final offering circular.

Non-Public Review. Similar to the non-public review process created under the IPO on-ramp provisions of the JOBS Act for emerging growth companies ("**EGCs**"), companies conducting a Reg A+ offering will be able to seek non-public review by the Commission of a draft offering statement. Non-public review will only be available to companies that have not already sold securities pursuant to a qualified offering statement under Regulation A or an effective registration statement under the Securities Act. An issuer that opts for non-public review will be required to publicly file its offering statement on EDGAR at least 21 days prior to qualification of the offering statement. The offering statement must include certain exhibits, including the issuer's initial non-public offering statement, all non-public amendments thereto, and all correspondence submitted by or on behalf of the issuer to the Commission staff regarding such submissions. As a result of this requirement, all non-public submissions will be publicly available upon the public filing of the offering statement

Reporting Obligations

Amended Form 1-A. To commence an offering in reliance on Reg A+, an issuer will be required to file an offering statement on **Form 1-A** with the SEC. Although the final rules amended Form 1-A, the form will continue to consist of three parts: Part I (Notifications), Part II (Offering Circular), and Part III (Exhibits). Part I and Part III will require issuers to disclose certain basic information about themselves, their financials, and the offering, as well as to file certain exhibits to the offering statement. Part II has been updated to require additional disclosures for Tier 2 offerings, which are similar to, but on a smaller scale than, the prospectus disclosures required of EGCs in a registered public offering.

The new rules removed the Model A (Question-and-Answer) disclosure format from Form 1-A. Other changes to the Form 1-A disclosure requirements relate to the reporting of related-party transactions and executive compensation. In this regard, Tier 2 issuers will now be required to disclose all transactions with related persons during the prior two fiscal years that exceed the lesser of $120,000 or 1 percent of the average total assets at year-end for the

last two completed fiscal years. Companies in Tier 2 offerings will also be required to disclose compensation paid during the last fiscal year to each of their three highest paid executive officers or directors, as well as the aggregate compensation paid to their directors as a group. In contrast, instead of providing compensation data on an individual basis, Tier 1 issuers will only be required to disclose group-level compensation data for the most recent fiscal year as it applies to (1) their three highest paid directors or officers and (2) all of their directors as a collective group.

Financial Statements. All Reg A+ issuers are required to file certain financial statements with the SEC, and such financial statements must be prepared in accordance with U.S. GAAP, although companies that are Canadian companies may choose to prepare their financial statements in accordance with IFRS. All issuers must file financial statements, including balance sheets, for the two most recently completed fiscal years (or for such shorter time that they have been in existence). In addition, the financial statements of Tier 2 issuers must be audited in accordance with U.S. GAAS or standards issued by the Public Company Accounting Oversight Board ("**PCAOB**"). Such financial statements must also comply with the other requirements of Article 2 of Regulation S-X. Tier 1 issuers are not required to provide audited financial statements unless an audit has already been obtained for other purposes. Both Tier 1 and Tier 2 issuers may be required to file interim financial statements if their financial statements are older than nine months.

Ongoing Reporting Requirements. In addition to amending Form 1-A, the new rules also adopt four new forms: Form 1-K (Annual Report), Form 1-SA (Semiannual Report), Form 1-U (Current Report), and Form 1-Z (Exit Report). Tier 1 issuers will be required to file a Form 1-Z no later than 30 days after termination or completion of an offering to disclose certain summary information about the offering, such as the amount of securities sold pursuant to the offering. Only Tier 2 issuers will be subject to ongoing reporting obligations, which must be satisfied by filing Form 1-K, Form 1-SA, and Form 1-U with the Commission at the prescribed intervals of time.

New Form	Comparison to Exchange Act Requirements
Form 1-K	o Must be filed within 120 days after the end of the issuer's fiscal year. o Offering-specific disclosures are not required (with the exception of certain sales information in the issuer's first Form 1-K filed after termination or completion of an offering if such information was not provided in a previously filed Form 1-Z).
Form 1-SA	o Must be filed within 90 days after the end of the semiannual period covered by the report. o Consists primarily of unaudited financial statements and management's discussion and analysis.
Form 1-U	o Must be filed within four business days after the occurrence of certain events. o Triggered by fewer events with higher thresholds than those events triggering a Form 8-K filing for public companies.

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Under certain circumstances, Tier 2 issuers may suspend or terminate their ongoing reporting obligations. Once a Tier 2 issuer has completed reporting for the fiscal year in which its offering statement was qualified, the issuer may file a Form 1-Z to suspend its ongoing reporting obligations under Regulation A if the securities of each class to which the offering statement relates are held of record by less than 300 people (or fewer than 1,200 people for banks or bank holding companies) and offers or sales under the offering statement are not ongoing.

Broker-Dealers. The final rules amend Exchange Act Rule 15c2-11 to clarify that Reg A+ reporting will satisfy the information requirements under Rule 15c2-11. Accordingly, so long as the other requirements of Rule 15c2-11 are met, a broker-dealer that reviews a Tier 2 issuer's current, ongoing reports may publish a quotation for such issuer's securities (or submit a quotation for publication) in a quotation medium. However, Reg A+ reporting will not satisfy the "current information" requirements of Securities Act Rules 144 or 144A unless the Tier 2 issuer files a Form 1-U to supplement Form 1-SA by providing certain information on a quarterly basis.

Exchange Act Registration. Tier 2 issuers are exempt from Exchange Act reporting requirements, so long as the companies: (1) engage the services of a transfer agent; (2) remain subject to Tier 2 reporting obligations; (3) are current in their annual and semiannual reporting at fiscal year-end; and (4) either had a public float of less than $75 million as of the last business day of their most recently completed semiannual period, or in the absence of a public float, had annual revenues of less than $50 million as of their most recently completed fiscal year.

In the event Tier 2 issuers opt to register under the Exchange Act the class of securities issued in a Reg A+ offering (such as to facilitate the listing of such securities on an established trading market such as NASDAQ), they can do so through an expedited process using Form 8-A. However, to be eligible to file a Form 8-A, a Tier 2 issuer must (1) provide Part II disclosures in its Form 1-A that follows Part I of Form S-1 or Form S-11 (if the issuer is eligible to use Form S-11) instead of the offering circular format, (2) include audited financial statements in the Form 1-A that are audited in accordance with PCAOB standards by a PCAOB-registered auditor that is independent pursuant to Article 2 of Regulation S-X; and (3) file the Form 8-A in conjunction with the qualification of Form 1-A. The issuer must also meet the listing standards of the applicable exchange and be certified by the exchange before the Form 8-A will be declared effective by the SEC. An issuer that completes this Exchange Act registration process will become an Exchange Act reporting company and will be subject to the Exchange Act reporting requirements rather than the Regulation A reporting requirements.

Insights

Reg A+ and Blue Sky Laws. One of the primary barriers to the use of old Regulation A was the absence of the preemption of Blue Sky laws, which substantially raised the costs of issuing securities pursuant to Regulation A, especially for multi-state offerings. Blue Sky laws, if not preempted, generally required companies to file an offering statement in each state where the offering was being made and to go through a comment process and clear comments with each applicable state securities regulator. This process could often be time consuming and costly.

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To combat this drawback, and in light of added investor protections, the new rules preempt Blue Sky laws for Tier 2 offerings. The SEC's new rules accomplish this preemption by creating a new definition of "qualified purchaser," which causes Tier 2 securities to be covered securities under Section 18 of the Securities Act. The term "qualified purchaser" may create some confusion because of its similarity to the existing definitions of "qualified institutional buyer" and "accredited investor." However, as defined in the new rules, and solely for purposes of Reg A+, a qualified purchaser is any offeree or purchaser in a Tier 2 offering (so long as such person's investment complies with, or is exempt from, the 10 percent thresholds discussed in "Investors and Investment Limitations" above). As a result of this broad definition and the resulting disapplication of Blue Sky laws, Tier 2 offerings can be national in scope and testing the waters materials can be widely distributed to prospective investors without having to go through the review and comment process with the states.

Tier 1 offerings, however, do not enjoy the same benefit of the preemption of Blue Sky laws. Part of the SEC's rationale is that Tier 1 offerings will likely be more local or regional in scope and because such offerings will have scaled disclosures and no ongoing reporting requirements, such as those imposed on Tier 2 offerings, Tier 1 offerings will benefit from the added scrutiny of state securities regulators. However, in response to the perceived regulatory burden associated with state review of Tier 1 offerings, the North American Securities Administrators Association has implemented a coordinated review process for Tier 1 offerings that may ease the burden of making multiple state filings by streamlining the state approval process. The coordinated review process is still new, and it is too early to determine whether the process will achieve its goals. In addition, it remains to be seen whether the new higher offering threshold combined with the coordinated review process will lead companies to raise capital under Tier 1 of Reg A+.

Liquidity and Potential Trading Markets. Companies relying on Reg A+ will be able to sell securities to an unlimited number of investors, and the securities will not be restricted securities for the purposes of federal securities laws. As a result of the unrestricted nature of the securities, securities issued pursuant to Reg A+ will generally be freely tradable, providing investors with an added level of liquidity that is not readily available under Regulation D. However, the current lack of viable trading markets for securities sold pursuant to Regulation A will, at least initially, act as a constraint on liquidity. Unless an issuer opts to register under the Exchange Act the securities sold in a Reg A+ offering (which would subject the issuer to full ongoing reporting requirements with the SEC), the securities will not be eligible for listing on existing trading markets such as NASDAQ or NYSE. Similarly, the over-the-counter ("OTC") marketplaces generally require that companies comply with, and be current in, Exchange Act reporting requirements. Online venture exchanges, such as SharesPost and SecondMarket, which primarily facilitate sales of restricted securities issued under Regulation D, may develop as viable markets, but as of yet, no marketplace with significant liquidity has emerged.

A Continuum of Offering Alternatives. The new Tier 1 and Tier 2 options under Reg A+ are intended to provide smaller companies with additional alternatives for raising capital by opening offerings up to a larger pool of investors and increasing the dollar amounts that may be raised in the offerings, while minimizing the costs of compliance and maintaining sufficient investor protections. On the continuum between restricted offerings under Regulation D and full-fledged IPOs, Tier 2 offerings would be placed closer to the IPO end of the range. This "mini-IPO" option should be less costly to issuers than a traditional IPO, and it may lower the

barriers to raising capital for some companies. However, the costs of preparing the Tier 2 offering materials and complying with the ongoing reporting requirements are likely to be substantially higher than the costs associated with conducting exempt offerings to accredited investors pursuant to Regulation D.

The SEC's adopting release for Reg A+ reaffirmed the taff's prior guidance that an offering made in reliance on Reg A+ will not be integrated with another exempt offering by the same issuer (so long as each offering is individually compliant with its relevant exemption requirements). Accordingly, an issuer could potentially conduct concurrent capital raises under Regulation D and Reg A+. Similarly, past reliance on Regulation D will not preclude an issuer from raising additional capital in reliance on Reg A+. In addition, if an issuer abandons a Reg A+ offering before the offering statement is qualified, but after soliciting interest in such offering from persons other than qualified institutional buyers and institutional accredited investors, the determination as to whether a subsequent registered offering would result in integration with the abandoned Reg A+ offering would depend on the particular facts and circumstances.

Final Grade

Currently, the amount of capital that has been raised in reliance on Regulation D, and Rule 506 in particular, substantially exceeds the capital raised in reliance on Regulation A. In response to the mandate from Congress in the JOBS Act, the SEC has now provided companies with two new alternatives under Reg A+ that are intended to reduce the barriers to use of the Regulation A exemption. The new requirements fit in well with the new general solicitation rules under Regulation D and the IPO on-ramp provisions for EGCs under the JOBS Act. Reg A+ also seems to be designed to work well with the emergence of online deal syndication platforms that will certainly play a key role in financings for smaller companies going forward. However, there are significant and legitimate reservations in the minds of investors about the lack of liquidity of unregistered securities in the secondary market.

Until active secondary resale markets develop for these securities, the use of Reg A+ will likely be somewhat tepid, but the emergence of viable exchange platforms may help tip the balance toward more wide-scale use of Reg A+. Existing private secondary markets - such as the NASDAQ Private Market, SharesPost, and SecondMarket -may step in to provide Reg A+ resale platforms. The various OTC markets and national exchanges have also expressed interest in creating new quotation and exchange tiers for eligible Reg A+ issuers. In 2011, NASDAQ launched the BX Venture Market, which aimed at providing a venture exchange tier similar to the London AIM Market. The BX Venture Market did not gain traction at that time, but the new Reg A+ rules may prompt renewed interest in such exchanges.

It is too early to issue the SEC a final grade on the new rules. Reg A+ appears to be a very credible effort by the SEC to lay the groundwork for capital formation for emerging growth companies in the 21st century. Whether it will be widely adopted still remains to be seen.

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Additional Resources

1. Detailed summary of the SEC's Reg A+ adopting release.
2. Accredited investor verification in connection with general solicitation under Rule 506(c) of Regulation D.
3. Information relating to the IPO on-ramp under the JOBS Act.
4. Information on Bad Actor disqualifications.
5. New SEC forms:
   a. Form A-1
   b. Form 1-K
   c. Form 1-SA
   d. Form 1-U
   e. Form 1-Z

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