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Regulation A+: The SEC Approves Long-Awaited Alternatives for Capital Raising
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Recently adopted regulations from the Securities and Exchange Commission (the ***"SEC"***) came into effect on June 19, 2015, facilitating qualifying companies' access to capital and providing investors with additional investment choices. Commonly referred to as Regulation A+, the regulations amend and expand the exemption for smaller public offerings under Regulation A (Rules 251 to 263 under the Securities Act of 1933, as amended (the ***"Securities Act"***)). Depending on the size and particular goals of the company, Regulation A+ may offer issuers with an attractive and more cost-effective method to raise capital. A link to the rule may be found here.

Background

Since 1992, companies have been able to rely on Regulation A for small public offerings under $5 million during a 12-month period. Regulation A issuers were exempt from the registration requirements of Section 5 of the Securities Act, and securities sold in these offerings were generally freely transferable. However, the relatively low offering limits, a myriad of state securities laws that applied to these offerings and high transactional costs discouraged issuers from relying on the exemption. In an effort to bolster the effectiveness of Regulation A and incentivize investments in small businesses, Congress passed the Jumpstart Our Business Startups Act (the "***JOBS Act***") in April 2012. Title IV of the JOBS Act directed the SEC to create a new exemption for public offerings whereby up to $50 million of qualifying securities could be offered by an issuer in a 12-month period.

Scope of the Exemption

Eligible Issuers and Securities

Regulation A+ will be available only to companies incorporated in and with their principal place of business in the United States or Canada. The exemption is available irrespective of an issuer's size or enterprise value, but remains unavailable to:

- Companies that are currently subject to SEC reporting requirements under the Securities Exchange Act of 1934, as amended (the "***Exchange Act***");
- Investment companies registered or required to be registered under the Investment Company Act of 1940 (including business development companies);
- Blank check companies;
- Entities issuing fractional undivided interests in oil or gas rights, or similar interests;
- Issuers that have failed to file required ongoing reports under Regulation A during the past two years preceding the filing of a new offering statement;
- Issuers that have had their registration under the Exchange Act suspended or revoked by SEC action pursuant to Section 12(j) of such Act, within five years of filing a new offering statement; and
- Issuers designated as "bad actors" under Rule 262 (which has been conformed to substantially mimic the bad actor provisions of Regulation D of the Securities Act).

Eligible securities under Regulation A+ are limited to (i) equity securities, including warrants, (ii) debt securities, (iii) debt securities convertible or exchangeable into equity interests, and (iv) any guarantees of the aforementioned securities.

Offering Limitations

Eligible issuers may choose between a Tier 1 or Tier 2 offering, depending on the size of the offering. Under Tier 1, up to $20 million of eligible securities (which may include up to $6 million offered by selling security holders that are affiliates of the issuer) in any 12-month period. Tier 2 offerings are limited to $50 million (including up to $15 million offered by affiliate-selling security holders) over any 12-month period.

While the rules permit sales by selling security holders in Regulation A+ offerings, there is also a limit to the total amount that can be sold by all selling security holders during the first 12 months after the issuer's initial Regulation A+ offering. Selling security holders may not sell in the Regulation A+ offering more than 30 percent of the aggregate offering price of a particular offering – in either the initial offering or any subsequent Regulation A+ offering that is qualified within that first year. After this initial 12-month period, the amount of securities that non-affiliate security holders can sell in a Regulation A+ offering will not be subject to a limit. However, following the initial 12-month period, sales by affiliate selling security holders in Regulation A offerings will be limited to $6 million (under Tier 1) or $15 million (under Tier 2) in any 12-month period. In reaching the 30 percent cap for the first year and distinguishing between affiliate and non-affiliate security holder sellers, the SEC attempted to strike a balance between providing security holders with access to liquidity, and protecting investors from insider trading risks.

Investment Limitations

Previously, Regulation A did not limit the amount of securities that could be purchased by an investor. To address investor protection concerns, the new regulations place an investment limit for Tier 2 offerings on non-accredited investors. Non-accredited natural persons may not invest an amount exceeding the greater of 10 percent of their annual income or net worth, and non-accredited non-natural persons may not invest an amount exceeding the greater of 10 percent of their annual revenue or net assets, calculated as of the end of their most recently completed fiscal year.

Integration with Other Offerings

The rules provide a safe harbor to protect Regulation A+ offerings from being integrated with:

- Prior offers or sales of securities; or
- Subsequent offers or sales of securities that are:
  - Registered under the Securities Act;
  - Made pursuant to Rule 701 of the Securities Act;
  - Made pursuant to an employee benefit plan;
  - Made in reliance on Regulation S;
  - Made under the crowdfunding rules of Section 4(a)(6) of the Securities Act; or
  - Made more than six months after completion of the Regulation A+ offering.

In the absence of an explicit safe harbor exemption, whether a Regulation A+ offering will be integrated with other offerings will depend on the "particular facts and circumstances" surrounding the issuer and the offering.

Exchange Act Section 12(g)

Under Section 12(g) of the Exchange Act, an issuer having assets of greater than $10 million and a class of securities held by 2,000 or more persons (or 500 non-accredited investors) must comply with additional requirements. Regulation A+ provides a conditional exemption for securities in a Tier 2 offering that would otherwise trigger this registration requirement, so long as the issuer:

- Is subject to and current in its Tier 2 reporting obligations;
- Engages a registered transfer agent for the offering; and
- Has a public float of less than $75 million, or in the absence of a float, earns revenues of less than $50 million in the most recently completed fiscal year. An issuer that exceeds either of these thresholds, in addition to the Section 12(g) threshold, may take advantage of a two-year transition period in order to comply.

The Offering Statement

Filing and Delivery Requirements

Regulation A+ requires offering statements on Form 1-A (that include offering circulars, which are similar to prospectuses) to be filed on EDGAR and adopts the “access equals delivery model” for final offering circulars. Issuers do not have to pay filing fees. Offering statements are qualified by the SEC’s Division of Corporation Finance issuing a “notice of qualification.” If an issuer is not at such time subject to the Tier 2 ongoing reporting requirements and it provides a preliminary offering circular for potential investors, the issuer and any participating broker-dealer must deliver the preliminary offering circular to prospective investors at least 48 hours in advance of any sales.

<u>Non-Public Review</u>

Issuers whose securities have not previously been sold pursuant to a qualified Form 1-A offering statement under Regulation A+ or an effective registration statement under the Securities Act may submit an offering statement for non-public review by the SEC. The statement must be substantially complete in order for the SEC to begin its review. If seeking confidential review, the issuer must file the document publicly at least 21 days before qualification of the offering statement.

<u>Form 1-A</u>

The rules require issuers to file offering statements on Form 1-A. Form 1-A includes three parts: Part I consists of basic issuer information; Part II contains the offering circular – the text of the disclosure document and financial statements; and Part III contains signatures and exhibits. The disclosure requirements in Part II are extensive, and can either follow the Offering Circular disclosure format or include the information required under Part I of Form S-1. The specificity and level of detail of the required disclosures depends on whether the issuer is conducting a Tier 1 or Tier 2 offering.

<u>Financial Statements</u>

The rules require issuers in both Tier 1 and Tier 2 to file balance sheets, income statements and other required financial statements as of the end of and for their two most recently completed fiscal years, where applicable. Tier 1 issuers may file unaudited financial statements, but Tier 2 issuers must file audited annual financial statements. U.S.-domiciled issuers must file financial statements in accordance with U.S. generally accepted accounting procedures (“***U.S. GAAP***”), while Canadian issuers may choose between U.S. GAAP and International Financial Reporting Standards.

Continuous and Delayed Offerings

Issuers can conduct continuous or delayed offerings under Regulation A+ for up to three years following the qualification date of the particular offering, although Tier 2 issuers must be current in their annual and semi-annual reporting obligations in order to conduct such an offering. Issuers may conduct the following types of continuous or delayed offerings:

- Securities offered or sold by or on behalf of a person other than the issuer or its parent or subsidiaries;
- Securities offered and sold pursuant to a dividend or interest reinvestment plan or an employee benefit plan of the issuer;
- Securities issued upon the exercise of outstanding options, warrants, or rights;
- Securities issued upon conversion of other outstanding securities;
- Securities pledged as collateral; or
- Securities that are part of an offering which commences within two calendar days after the qualification date, will be offered on a continuous basis, may continue to be offered for a period in excess of 30 days from the date of initial qualification, and will be offered in an amount that, at the time the offering statement is qualified, is reasonably expected to be offered and sold within two years from the initial qualification date.

Testing the Waters

One of the most important provisions in Regulation A+ is its “testing the waters” provision, which allows issuers to informally solicit interest for an offering both before and after the filing of a Regulation A+ offering statement, so long as certain filing and disclaimer requirements are met. After filing a preliminary offering statement, the issuer must include with any solicitation materials sent to investors, the preliminary offering circular or a link to the website containing such information. Any solicitation materials must be filed as an exhibit when the offering statement is filed for review, though issuers need not submit solicitation materials at or before the time of their first use. An investor’s expression of interest under this provision will not be a binding offer.

“Testing the waters” communications are subject to antifraud and other civil liability provisions of federal securities laws. However, regularly released factual business communications will generally not constitute solicitation materials under the revised rules.

Treatment under State Securities Laws

Tier 1 issuers will remain subject to applicable state securities laws, largely due to the rules’ expanded use of solicitation materials and the SEC’s expectation that Tier 1 offerings will be generally local in nature.

Issuers of securities in Tier 2, on the other hand, will be largely protected from otherwise applicable state registration and qualification requirements. The final rules define a “qualified purchaser,” for the purposes of the preemption provisions of Section 18(b)(4)(D)(ii) of the Securities Act, as any person to whom securities are offered or sold in a Tier 2 offering. Despite this broad grant of preemption, states retain power under Section 18(c) of the Securities Act to regulate certain aspects of Tier 2 offerings, including:

- Investigating and prosecuting fraudulent transactions;
- Requiring issuers to file any documents that have been filed with the SEC; and
- Enforcing filing and fee requirements by suspending offerings within a given state.

The SEC decided to provide preemption benefits to securities in Tier 2 offerings due to concerns of costly and duplicative compliance requirements in several jurisdictions. Even for issuers that otherwise could file under Tier 1, the preemption benefits of Tier 2 offerings may be valuable enough to those smaller companies that wish to solicit investors in several states or in states with detailed securities law requirements that such companies elect to comply with the Tier 2 requirements.

The North American Securities Administrators Association is initiating a coordinated review program designed to facilitate the filing of Regulation A filings in multiple U.S. jurisdictions.

Ongoing Reporting Requirements

Tier 1 issuers are not subject to ongoing reporting requirements, although they must disclose certain basic information regarding the results of the offering within 30 days after the completion or termination of a Regulation A+ offering, on a new form, Form 1-Z.

Tier 2 issuers must file the following reports on an ongoing basis:

- Annual reports on a Form 1-K (within 120 calendar days after the end of the fiscal year);
- Semi-annual reports on a Form 1-SA (within 90 calendar days after the end of the six-month period covered by the report);
- Current reports on Form 1-U for certain events, which include fundamental changes, modification of security holders' rights, or changes in control (within four business days after the occurrence of the event); and
- Notice of the suspension of ongoing reporting obligations on Part II of Form 1-Z.

Filing quarterly statements on Form 1-U and semi-annual reports on Form 1-SA will also allow a Tier 2 issuer to satisfy the "adequate current public information" requirements of Rules 144(c), and thereby facilitate resales by selling security holders under Rule 144.

Additionally, Regulation A+ amends Rule 15c2-11, which requires a broker-dealer to review and maintain records containing basic information about an issuer and its securities. Under the amendments, a Tier 2 issuer's ongoing reports may satisfy the requisite information that a broker-dealer must review and maintain before publishing a quotation for a security.

Listing on a National Securities Exchange

Tier 2 issuers that have chosen to provide disclosure under Part II of Form 1-A that follows Part I of Form S-1 will be permitted to list securities on a national securities exchange by filing the more streamlined Form 8-A, as an alternative to the traditional Form 10. Real estate investment trust issuers must follow Part 1 of Form S-11 in the offering circular in order to list securities on a national exchange.

After the Form 8-A is effective, a Tier 2 issuer's ongoing reporting requirements under Regulation A+ will be suspended for so long as it is subject to the Exchange Act's reporting requirements. Additionally, issuers who take this path will be deemed "emerging growth companies" if otherwise qualified for such status, and thereby will be able to take advantage of the accommodations available to that class of issuers.

Impact

Traditionally, Regulation A has been one of the most rarely used exemptions for securities offerings, due to a combination of burdensome state and federal requirements and low offering caps. The revised regulations alleviate much of these concerns. By lifting the registration exemption from $5 million to $20 million for Tier 1 offerings and to $50 million for Tier 2 offerings, Regulation A+ significantly alters the cost-benefit analysis of undergoing the registration and disclosure process.

The framework established for Tier 2 issuers appears to be a significant highlight of the JOBS Act. The preemption of state securities laws for Tier 2 offerings removes a significant burden to larger issuers, who should be able to significantly cut legal costs and reduce unforeseen risks. Further, the “testing the waters” provision allows issuers to better anticipate the level of demand for their securities, without committing to substantial up-front costs.

Nonetheless, Regulation A+ will not prove ideal for every company. Issuers primarily seeking liquidity through a national securities exchange listing may be better suited by following the traditional IPO route. Though Regulation A+ allows for listing on a national securities exchange with the short-form 8-A, the issuer will become subject to more burdensome Exchange Act reporting requirements, including the requirements of the Sarbanes-Oxley Act. Registering through a traditional IPO also imposes no limits on the aggregate offering size or investor types. Alternatively, companies seeking investors who are not concerned with immediate liquidity opportunities may find that capital raising through Regulation D is a simpler, cheaper, and quicker process. Regulation D does not require ongoing reporting or public disclosure of the issuer’s affairs, nor does it impose offering size limits. These differences may translate to less accounting costs, legal fees, and distractions for many companies.

If you are considering raising capital under Regulation A+ or have any questions about this topic, please contact any of the following lawyers:

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