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New Capital Raising Alternatives for Non-SEC Reporting Companies: Regulation A+

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Non-SEC Reporting US and Canadian companies may now raise up to $50 million in a 12-month period under an expanded exemption from the registration requirements of the Securities Act of 1933 (the "Securities Act") under amendments to Regulation A; often referred to as Regulation A+. The final Regulation A+ rules were published in the Federal Register earlier this week and will become effective on June 19, 2015.

As required by the Jumpstart Our Business Startups Act (the "**JOBS Act**") enacted in 2012, the SEC adopted amendments to Regulation A, which historically provided an exemption from the registration requirements of the Securities Act for small public offerings. Prior to the adoption of the amendments, offerings under Regulation A were limited to $5 million in any 12-month period, required significant disclosure and were subject to compliance with state securities or "Blue Sky" laws. As a result, Regulation A offerings were few and far between. Instead, issuers relied on private offering exemptions like Regulation D that do not limit the amount of money that can be raised and have significantly fewer compliance requirements.

Regulation A+ permits offerings of up to $50 million with reduced disclosure and compliance requirements as compared to a typical registered public offering in hopes of providing a new capital raising alternative. The potential utility of the amended rule remains subject to significant debate. Many argue that, given the $50 million maximum offering threshold, the continuing regulatory requirements and attendant costs, issuers will continue to favor other capital raising options. Others take the view that Regulation A+ will significantly alter the way that small businesses access capital. Regulation A+ offers a potential longer-term solution to some companies with some of the benefits of being a public company, including access to capital – particularly if trading venues develop, but with reduced ongoing obligations and costs.

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The amended rule creates two tiers of offerings: Tier 1 for offerings of up to $20 million in any 12-month period, and Tier 2 for offerings of up to $50 million in any 12-month period. These two tiers have different disclosure and ongoing reporting obligations. Under the amended rule, the exemption is available for sales by existing stockholders, though subject to tighter limits. The amended rule provides many of the benefits available to "emerging growth companies" under the JOBS Act, including permitting issuers to make confidential submissions to the SEC for the first offering, engage in certain test-the-waters activities and delay implementation of new accounting rules in certain circumstances. Tier 2 offerings are not subject to registration or qualification requirements under Blue Sky laws, although issuers may still be required to make filings and pay fees in states where securities are sold. Tier 1 offerings remain subject to Blue Sky laws.

Eligible Transactions

As mentioned above, the amendments provide for two tiers of offerings by US and Canadian companies that are not already subject to SEC reporting requirements under the Securities Exchange Act of 1934 (the "**Exchange Act**"):

- **Tier 1** offerings of up to $20 million in a rolling 12-month period, of which up to $6 million may be sold by existing stockholders; and
- **Tier 2** offerings of up to $50 million in a rolling 12-month period, of which up to $15 million may be sold by existing stockholders.

The types of securities that may be offered under Regulation A+ are limited to an enumerated list set forth in the amended rule, but includes equity securities, warrants, debt securities, convertible debt securities and guarantees. Regulation A+ is not available for sales of asset-backed securities. Regulation A+ provides for primary offerings for capital raising purposes, offerings by stockholders, securities issued upon the conversion of other outstanding securities or exercise of warrants, options or other rights or traditional shelf offerings. Notwithstanding the suggestions of commenters, the SEC did not extend the Regulation A+ exemption to at-the-market offerings.

While the amended rule provides for secondary sales by both affiliates and non-affiliates, those sales are subject to tighter limitations. The SEC recognized the tension between providing existing securityholders access to liquidity, on the one hand, and providing capital to companies and protecting investors, on the other hand. Accordingly, the amended rule limits the amount of securities that selling stockholders can sell in the issuer's first Regulation A+ offering and in any other Regulation A+ offering qualified within one year of the first offering to no more than 30% of the aggregate offering price of such offering. Sales by affiliates remain limited following the first anniversary of an issuer's initial qualification under Regulation A+ to no more than $6 million, in the case of Tier 1 offerings, or no more than $15 million, in the case of Tier 2 offerings, in each case over a 12-month period. Sales

by non-affiliates are not subject to limitation following the first anniversary of an issuer's initial qualification, but will be counted for purposes of calculating compliance with the offering thresholds.

Eligible Issuers

Regulation A+ is available only to companies that are organized in, and have their principal place of business inside, the United States or Canada that are not already subject to SEC reporting requirements under the Exchange Act. However, the exemption is not available to:

- Investment companies;
- Special purpose acquisition companies (SPACs);
- Business development companies (BDCs);
- Blank check companies;
- Companies subject to "bad boy" disqualification;
- Issuers of fractional undivided interests in oil or gas rights;
- Issuers that have not satisfied their ongoing reporting obligations under Regulation A+ during the immediately preceding two years; or
- Issuers that have had their registration revoked by the SEC pursuant to Section 12(j) of the Exchange Act within the prior five years.

Investment Limitations

The amended rule limits the amount of securities that non-accredited investors (as defined under Regulation D) can purchase in a Tier 2 offering, unless the securities being sold will be listed on a national securities exchange upon qualification. Specifically, a non-accredited investor may not purchase securities with a purchase price of more than 10% of: (i) the greater of such purchaser's revenue or net assets in the case of a non-natural person or (ii) the greater of such purchaser's annual income or net worth in the case of a natural person. An issuer may rely on representations from investors to confirm compliance with these investment limitations, unless the issuer knew at the time of sale that the representation was untrue.

Offering Process

The offering process under Regulation A+ is similar to the typical registered offering process in many respects, but with some important differences, including relief from certain obligations and costs attendant to the registration process. Issuers must file their Regulation A+ offering statement with the SEC electronically via EDGAR. There are no filing fees for Regulation A+ offerings. Issuers who have not previously sold securities in a Regulation A+ offering or pursuant to registration statement under the Securities Act may submit a draft offering statement for non-public review by the SEC. All confidential filings and related correspondence must eventually be filed publicly, unless confidential treatment of particular materials has been separately requested and approved by the SEC.

The SEC has the opportunity to review and comment on offering statements before they may be qualified. An offering statement shall not be qualified less than 21 calendar days after the public filing of the offering statement, all confidential drafts of the offering statement and all non-public correspondence, subject to any separately approved confidential treatment requests.

The amended rule provides that oral offers and written offers made pursuant to a preliminary offering circular may be made prior to qualification, subject to requirements to deliver the final qualified offering statement once it is available, which in many cases is satisfied by filing the final offering statement on EDGAR.

Issuers and their representatives are permitted to contact potential investors and solicit their interest in participating in the offering, or to test-the-waters, both before and after the offering statement is filed. Companies relying on Regulation A+ can test-the-waters with all potential investors, rather than only "qualified institutional buyers" and "institutional accredited investors" as is the case for registered offerings of emerging growth companies. Solicitation materials are subject to the antifraud and other civil liability provisions of the federal securities laws and must be submitted or filed with the offering statement.

Filings with FINRA and payment of related fees will be necessary in Regulation A+ offerings in which FINRA members participate. FINRA's rules with respect to underwriting compensation would also apply.

Offering Statement – Form 1-A

The offering statement is a disclosure document that is intended to provide potential investors with information that will form the basis for their investment decision. Form 1-A, which has been amended, sets forth the content and other requirements for offering statements under Regulation A+:

- Part I: is an online form requiring key information about the issuer, its eligibility and the offering. The SEC intends for this form to assist issuers in determining whether they satisfy the criteria to rely on Regulation A+.
- Part II: is the narrative portion of the offering statement that requires, among other information, a description of the company's business, risk factors, information about the company's officers and directors, information about the offering and financial statements, which must be audited in the case of a Tier 2 offering.
- Part III: requires signatures and exhibits, including organizational documents and material contracts, among others.

Ongoing Reporting and Compliance

Following termination or completion of a Regulation A+ offering, both Tier 1 and Tier 2 issuers are required to disclose information about the offering, including the date it was qualified and commenced, the amount of securities qualified, the amount of securities sold by both the issuer and selling securityholders, the price, any fees associated with the offering and the net proceeds to the issuer.

Additionally, Tier 2 issuers are required to file:

- Annual reports on Form 1-K, with audited financial statements, within 120 days of the end of the fiscal year;
- Semiannual reports on Form 1-SA, within 90 days after the end of the first six months of the fiscal year;
- Current event reports on Form 1-U, within 4 business days of the occurrence of a triggering event such as a fundamental change, change of control, change in accountants, change in officers and directors; and
- Notice to the SEC of the suspension of their ongoing reporting obligations on Part II of Form 1-Z.

Tier 2 issuers' ongoing reporting obligations are applicable for any year in which offers and sales are made pursuant to a Tier 2 offering and for so long as the issuer has more than 300 stockholders of record.

In the final rule release, the SEC noted that these ongoing reporting obligations are intended to help foster the development of a secondary market in such securities, while balancing the compliance burden that would be imposed on smaller issuers. While the ongoing reporting provisions require a significant amount of information, Regulation A+ issuers are excepted from many of the ongoing reporting and compliance obligations applicable to public companies,

including the proxy rules, quarterly reporting requirements, Section 16 reporting, Schedule 13D filings, some requirements of the Sarbanes-Oxley Act and some executive compensation disclosure requirements. But, even the significantly reduced ongoing obligations on Regulation A+ issuers are more arduous than ongoing obligations typically imposed on issuers in private offerings, which are negotiated contractual obligations and can vary widely.

Exchange Act Registration

Securities issued in a Tier 2 offering are exempt from registration under Section 12(g) of the Exchange Act if:

- the issuer remains subject to, and is current in (as of its fiscal year end), its Regulation A+ periodic reporting obligations;
- the issuer engages the services of a transfer agent registered with the SEC pursuant to Section 17A of the Exchange Act; and
- the issuer has a public float of less than $75 million, determined as of the last business day of its most recently completed semiannual period, or, in the absence of a public float, annual revenues of less than $50 million, as of the most recently completed fiscal year.

An issuer that exceeds either the public float or annual revenue thresholds, in addition to triggering the requirements to register under Section 12(g) of the Exchange Act (i.e., total assets of more than $10 million and the class of equity securities is held by more than 2,000 persons or 500 persons who are not accredited investors), would be granted a two-year transition period before it would be required to register pursuant to Section 12(g), provided it timely files all ongoing reports due during such period. An issuer entering Exchange Act reporting will be considered an "emerging growth company" to the extent that it otherwise qualifies for such status.

The amended rule also provides a simplified process for Exchange Act registration in connection with Tier 2 offerings for issuers wishing to register securities under the Exchange Act concurrent with an offering. Regulation A+ issuers may utilize the Form 8-A short form registration statement to register under the Exchange Act, if they provide expanded disclosure in the offering statement that is in-line with what would be required in a registered offering.

Secondary Markets

Since securities sold under Regulation A+ are publicly offered securities, not "restricted securities," they can generally be traded freely unlike securities sold in private placements. Additionally, broker-dealers will be able to publish quotes for securities sold in Tier 2 offerings to the extent that the issuer continues to satisfy its ongoing reporting obligations, which should facilitate a secondary market in Regulation A+ securities through the pink sheets and over-the-counter. The SEC has noted that it is considering venture exchanges as a way to provide liquidity for smaller issuers, and is contemplating the use of venture exchanges for Regulation A+ securities as part of that consideration.

Blue Sky

The amended rule provides that Blue Sky law requirements for registration or qualification are preempted with respect to offers and sales of securities in Tier 2 offerings. However, companies will still be required to file offering statements (in the same form filed with the SEC) with state securities regulators and pay related filing fees. Additionally, state regulators will still be entitled to police fraudulent securities transactions and unlawful activities of broker-dealers in Regulation A+ offerings.

By contrast given the anticipated more local nature of Tier 1 offerings, the SEC determined it is more appropriate for states to retain oversight over the conduct of Tier 1 offerings. In most cases, Tier 1 offerings will be subject to the multi-state coordinated review program previously implemented by the North American Securities Administrators

Association for Regulation A+ offerings. The coordinated review program is intended to reduce Blue Sky law disclosure and compliance obligations for Regulation A+ offerings. The coordinated review program requires issuers to file Regulation A+ offering materials with the states electronically and contemplates a 21 business day turnaround from the time of filing of an offering statement until the issuer receives comments from the states. The coordinated review program is relatively new and there is not yet sufficient data to evaluate whether it will in fact reduce the Blue Sky law disclosure and compliance obligations of issuers in Regulation A+ offerings, but the SEC and state regulators will continue to evaluate the program going forward.

Liability

Similar to other offerings exempt from the Securities Act registration requirements, Regulation A+ offerings do not subject participants to Section 11 liability under the Securities Act. However, anti-fraud and other civil liability provisions of the federal securities laws would apply, including Sections 12(a)(2) and 17 of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5. Therefore, underwriters participating in a Regulation A+ offering will likely require a level of diligence and disclosure comparable to that required in registered offerings.

Rule Release

Final Rule Release – Amendments to Regulation A: https://www.sec.gov/rules/final/2015/33-9741.pdf.

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