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DISPELLING MYTHS AROUND REGULATION A+

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On March 25, 2015, the SEC promulgated its final rules related to the implementation of Title IV of the JOBS Act, better known "Reg. A+". This represents a watershed event in the securities law, providing a workable means for issuers to engage in public offerings of securities that are EXEMPT from the registration requirements of Section 5 of the Securities Act of 1933. Already several misconceptions of the new law are out in the market. Let's look at some of these and dispel them in turn.

Myth #1: "Regulation A+ is Expensive."

Critics say that it's estimated that a Regulation A+ offering will cost companies upwards of $100,000 or more to prepare the necessary documents. Then, as the myth goes, there's the added expense of accountants' fees, in order to comply with reporting obligations, as well as state regulatory fees, depending on the size of the offering.

THE FACTS:

This estimate of fees is not necessarily off, but this amount is not necessarily out of line with what might be charged by many large law firms for private offerings. In the context of venture capital or private equity, one must factor the expense of negotiating with such investors – not just the hourly rate for attorneys but what one must give up in equity and control in order to obtain their capital. It's hard to properly value the ability to craft terms to a broader public, rather than have terms dictated to you by institutional capital.

Does their accounting of expenses also account the benefit to a company of using the A+ route to grow further value when they can't get through the VC bottle neck or be heard over the cacophony of companies seeking money strictly from accredited investors? Consider the size of the investing audience allowed under regulation A+ and the opportunities this presents to vary capital raising strategies, and the cost becomes very reasonable.

Myth #2: "Regulation A+ is Overly Time-Consuming."

Per the Title IV rules, the SEC must review a company's offering documents and audited financials before giving it the green light to raise money. Some industry observers expect the SEC to apply the same level of scrutiny to Title IV offerings as it does to companies preparing for a traditional IPO's. Therefore, the myth goes, it's going to take a *long* time for a company to get approval. Some point to statistics such as, from 2012 to 2014, it took the SEC an average of over 300 days to approve Regulation A+ offerings.

<u>THE FACTS:</u>

The statistic cited is very misleading because so few deals were conducted in that period. Of those offerings that sought qualification under Regulation A, many, if not the vast number of deals, were filed without counsel, or with the assistance of inexperienced practitioners. It also doesn't account for issuers' response time to SEC comments, as well. If you make the request for copies of representative filings, as I have, one sees that often these issuers would get comments and take weeks, if not months to respond. Finally, pre-JOBS Act, SEC would not qualify until a State review was done, so they could finish quickly but then have to wait for States to be done with their review.

Our firm is one of the most, if not the most, prolific practitioners in Regulation A currently in the country. We are one of the most experienced law firms in the country with filing and qualifying these deals. Typically, we advise our clients to budget 90-120 days. I have qualified a deal in as little as 10 weeks. The fact is that you need knowledgeable and responsive counsel and accountants to keep the timing on track. Not much different from other deal types.

Also, consider how long it may take to raise capital through a Regulation D offering. We typically advise clients, and hear the same from our colleagues at the bar and financial advisors that issuers should expect it to take several months to a year to begin to raise meaningful capital. Regulation A+ has a somewhat lengthy process for qualification, but an issuer can market in that period to a much more diverse crowd on investors. Is the timing really that different?

Myth #3: "The Regulation A Market Suffers from a Lack of Infrastructure."

Critics are quick to point out that, while Regulation A securities are liquid, an established secondary market isn't set up yet to facilitate such transfers. Until one is, so the critics' mantra goes, the full potential of this clear benefit can't be realized or marketed to encourage investment.

<u>THE FACTS</u>:

The infrastructure does indeed need to develop further and sophisticate. Right now, trades typically occur through intra-dealer type bid arrangements – one off trades, broker to broker, but that is not a reason not to do it!

As some volume of deals develops here, and it should with some velocity, infrastructure will develop to facilitate this process. If there is one thing our economic history has taught, is that our system abhors a vacuum, and entrepreneurs thrive, where there is money to be made.

Consider that up into the 90's you saw public registrations regularly at less than $25MM. Diverse strata of players exist in our securities markets. Many of these folks who had thriving businesses doing deals at this size were edged out of the IPO game by the consistent consolidation of public deals and markets amongst a few on Wall Street – a phenomenon I attribute in no small measure to the massive burdens imposed by Sarbanes-Oxley and Dodd-Frank. Now you have an entirely new level of public securities ready to be developed at levels where smaller brokerages, regional wire-houses, independent broker-dealers, to name a few, are uniquely positioned to be the engines of that market. Infrastructure will develop amongst these players, and SEC is already examining ways to facilitate this process through its Advisory Committee on Small and Emerging Companies.

Myth #4: Better Alternatives Exist.

While Regulation A+ offerings allow companies to raise money from the everyday crowd, the myth goes, it's easier, cheaper, and faster to stick to accredited investors and raise money via Regulation D offerings. Often critics point out that in 2014, 11,228 Regulation D offerings were completed; raising over $1 trillion from accredited investors.

THE FACTS:

First, anyone trying to argue that Regulation A+ will not work by comparing it to Regulation D does not understand what Regulation A+ is intended to address. First, bear in mind that, until Regulation A+, there was no other meaningful option to Regulation D for exempt transactions. Regulation A+ is intended to provide an option to Regulation D. One is not necessarily better than the other – they have different attributes and strategic purposes. The point is to provide alternative channels for businesses of varying strategies and sizes to reach folks with diverse investment priorities to raise capital.

Consider what the critics point to here. 11,228 Regulation D transactions in 2014 – how many businesses are there in this country middle market size or smaller, late-stage start-ups, disruptive technology players or sponsors of alternative investments? A lot more than 11,000!!!

Now consider that the figures cited come typically from Form D's filed with the SEC – that encompasses a huge universe of different types of private securities transactions exempt under Regulation D. Take out the extremely large deals funded by venture capital and/or private equity and the really tiny "friends and family" deals, and you have a vast sea of issuers in the middle that are desperate for new capital routes right now. Regulation A+ can be a meaningful way for these issuers to find capital amongst a far more diverse audience of investors and investment priorities.

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[1] See Agenda of the March 4, 2015, meeting of the Advisory Committee on Small and Emerging Companies.

It’s a huge mistake for anyone to argue one form is, as a rule, better than the other. Responsible legal and financial professionals should understand each and assist issuers to determine how to leverage the options to the best effect.

That’s why I, for one, am so excited about the future of Regulation A+!

*Richmond-based **Kaplan Voekler Cunningham & Frank, (KVCF)** is one of the few law firms regularly providing counsel on Regulation A deals. Partner Robert R Kaplan, Jr. has been involved in Reg. A+ since its inception, working on enactment of the JOBS Act in Congress and the A+ rules of implementation with the SEC. For more information, contact Robert R Kaplan, Jr. at rkaplan@kv-legal.com or (804) 823-4055.*