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**A NEW ERA IN CAPITAL RAISING:  
REGULATION A+ -- AN OVERVIEW**

On March 25, 2015, the Securities and Exchange Commission adopted final rules to amend Regulation A as required under Title IV of the JOBS Act. The final rules provide an exemption for U.S. and Canadian companies that are not required to file reports under the Exchange Act of 1934 to raise up to \$50 million in a 12-month period. The final rules create two tiers: Tier 1 for smaller offerings raising up to \$20 million and Tier 2 for offerings raising up to \$50 million.

The new rules amend Regulation A by, among other things, requiring that disclosure documents be filed on EDGAR, allowing an issuer to make a non-public submission with the SEC, permitting certain test-the-waters communications and disqualifying bad actors. The final rules impose different disclosure requirements for Tier 1 and Tier 2 offerings, with more disclosure required for Tier 2 offerings, including audited financial statements. Tier 1 offerings will be subject to both SEC and state blue sky pre-sale review. Tier 2 offerings will be subject to SEC review but will be preempted from state review; however states will be able to require notice filings.

Investors in a Tier 2 offering will be subject to investment limits, except when securities are sold to accredited investors or are listed on a national securities exchange, and Tier 2 issuers will be required to comply with periodic filing requirements, including filing current reports upon the occurrence of certain events, semi-annual reports and annual reports. The final rules provide a means for an issuer in a Tier 2 offering to concurrently list a class of securities on a national exchange through a short-form Form 8-A. The new rules also allow for the sale of securities by existing stockholders, subject to limitations on the amount.

**Offering Amounts**

Prior to final adoption of these rules, Regulation A was limited to offers of up to \$5,000,000 in securities in a 12-month period. Title IV mandated that the SEC adopt rules to permit for raises of up to \$50,000,000, in addition to the \$5,000,000 exemption. Under the originally proposed rules by the SEC, the rules contained two tiers – Tier 1 for original raises of up to \$5,000,000 and Tier 2 for raises of up to \$50,000,000.

The SEC has opted to liberalize these standards under the final rules. Under Tier 1, an issuer may offer and sell up to \$20 million in a 12-month period, of which up to \$6 million may include secondary sales by affiliates of the issuer. Under Tier 2, an issuer may offer and sell up to \$50 million in a 12-month period, of which up to \$15 million may constitute secondary sales by affiliates of the issuer.

However, the SEC has also adopted a unique corollary to this rule. That being that secondary sales offered as part of an offering, irrespective of whether those securities are owned by an affiliate of an issuer, cannot exceed 30% of the aggregate offering price of the issuer's first offering or any subsequent Regulation A offering qualified within one year of the issuer's first offering. So, for example, if an issuer were to qualify \$15,000,000 of new issuances in its first Regulation A offering, and then qualifies another \$35,000,000 offering six months thereafter, only \$10,500,000 can be comprised of securities currently held by existing holders and offered for secondary sale through that offering.

### **Investment Limitation**

The proposed rules required an investment cap of 10% of the higher of any investor's net worth or income in an initial issuance under Tier 2. The final rules have relaxed this requirement. The investment limit will not apply to accredited investors. Non-accredited natural persons are subject to the investment limit in an initial issuance of not more than 10% of the greater of the investor's annual income and net worth, determined as provided in Rule 501 of Regulation D. The offering material must notify Investors of the investment limitations. An issuer need only rely on a representation from the investor as to compliance with these requirements, unless the issuer knew at the time of sale that any such representation is untrue.

In addition, both accredited and non-accredited investors are exempt from the investment cap if the subject securities of the offering are listed on a "National Exchange" as defined in the Exchange Act of 1934 (see below – "The Backdoor-IPO").

### **Eligible Issuers and Securities**

The new Regulation A exemption for both Tier 1 and Tier 2 will be available to issuers organized in and having their principal place of business in the United States or Canada. The following issuers will be "ineligible" to offer or sell securities under Regulation A:

- (1) an issuer that is an SEC-reporting company;
- (2) a blank check company;
- (3) any investment company registered or required to be registered under the Investment Company Act of 1940 (this includes business development companies);
- (4) issuers that have not filed with the SEC the ongoing reports required by Regulation A during the two years immediately preceding the filing of a new offering statement,
- (5) issuers that have had their registration revoked pursuant to an Exchange Act Section 12(j) order that was entered into within five years before the filing of the offering statement and

- 6) certain bad actors disqualified by the provisions of Rule 262 (see “Bad Actor Disqualification” below).

Equity securities, including warrants, debt securities and debt securities convertible into or exchangeable into equity interests, including any guarantees of such securities may be offered under Regulation A. Asset backed securities and fractional undivided interests in oil or gas rights, or similar interests in other mineral rights are expressly excluded.

### **State Securities Blue Sky Requirements**

Title IV of the JOBS Act mandated that Regulation A offerings sold solely to “qualified purchasers,” as defined by the SEC in its discretion, would be exempt from state securities registration requirements under Section 18(b)(3) of the National Securities Markets Improvement Act (NSMIA). The proposed rules had defined a “qualified purchaser” as any offeree in a Tier 1 offering, and any offeree or purchaser in a Tier 2 offering, thus preempting the state securities regulators from requiring registration of Regulation A securities prior to a sale in the Tier 1 context, and entirely in the Tier 2.

The final rules eliminate the offeree in Tier 1 offerings from the qualified purchaser definition. As such, the entirety of the Tier 1 offering process will remain subject to state securities law registration and merit review requirements. Those offerings should be eligible for use of NASAA’s newly established coordinated review program.

Consistent with the proposed rules, however, Tier 2 offerings will not BE subject to state registration requirements or merit review. States will, of course, continue to have authority to require notice filing of offering materials and enforce antifraud provisions in connection with a Tier 2 offering. In addition, the SEC has mentioned that it intends to allow the states to designate a representative to participate in the SEC review process.

### **Offering Communications**

Regulation A will allow substantial flexibility regarding marketing of the offering – referred to by the SEC as offering communications – prior to and during the pendency of an issuer’s filing.

Under the previous rules for Regulation A, an issuer must stop using broad marketing materials once an initial filing under Regulation A pertinent to that offering was made, and had to confine themselves to the use of “tombstone” information and/or a preliminary offering circular.

The issuer must file its solicitation materials with the SEC, but, may now can use a plethora of materials to market the offering throughout the process. Solicitation materials used after an offering circular is filed must be accompanied by the offering circular or a notice that includes a link to where the most recent offering circular may be found on EDGAR. Solicitation materials will need to contain certain legends proscribed in the rule. The release of regular factual business communications that do not implicate an offering will not constitute solicitation materials.

## **Filing and Delivery Requirements**

Regulation A offering statements will be filed on EDGAR. The Form 1-A has been amended to consist of three parts:

- Part I, which will be an XML-based fillable form with basic issuer information;
- Part II, which will be a text file that will contain the disclosure document and financial statements; and
- Part III, which will be a text file that will contain exhibits and related materials. Periodic reports and any other documents required to be submitted to the SEC in connection with a Regulation A offering must be filed on EDGAR.

As proposed, the final rules adopt an access equals delivery model for Regulation A final offering circulars. In the case where a preliminary offering circular is used to offer securities to potential investors and the issuer is not already subject to the Tier 2 periodic reporting requirements, an issuer and participating broker-dealer will be required to deliver the preliminary offering circular to prospective purchasers at least 48 hours in advance of sales.

In addition, if the investor has previously agreed to it, electronic delivery of documents made be done. A notice of qualification is now similar to a notice of effectiveness in an SEC-registered offering.

## **Exchange Act Threshold**

A point of particular focus by both the private securities bar and regulators since the publishing of the proposed rules was the application of Section 12(g) of the Securities Exchange Act of 1934 (the “Exchange Act”) to Regulation A+ securities. Section 12(g) provides a “fail-safe” for when issuers must submit to registering and reporting under the Exchange Act upon achieving a certain size. Under Section 12(g) an issuer with (i) \$10,000,000 in assets, and (ii) 2,000 “shareholders of record,” 500 of which may be non-accredited, in a given class of equity securities, must register and report under the Exchange Act.

The proposed rules maintained that standard for Regulation A securities of either Tier. Many representatives of the securities industry commented on this aspect of the rules.

In response, the final rules provide a specific exemption for securities issued in Tier 2 offerings from the Section 12(g). An issuer must:

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The shareholder of record standard means that one ostensibly could also avoid registration by having the securities held in “street name” by nominees, pursuant to established jurisprudence under Section 12(g).

- 1) retain the services of a transfer agent registered under Section 17 of the Exchange Act,
- 2) have a public float of less than \$75 million or, in the absence of a float, revenues of less than \$50 million, in the most recently completed fiscal year, and
- 3) is current in its periodic reporting obligations.

At the same time, an issuer that exceeds the Section 12(g) threshold and this exemption standard will still have a two-year transition period in order to register under 12(g) of the Exchange Act, and can do so as an “emerging growth company” if they still meet the definition.

### **The “Backdoor IPO”**

The final rules facilitate the ability of a Tier 2 issuer to list a class of Regulation A securities on a national securities exchange. The final rule permits a Tier 2 issuer that has provided disclosure in Part II of Form 1-A that follows Part 1 of Form S-1 or Form S-11 to file a Form 8-A to list its securities on a national securities exchange. Thereafter, the issuer would be subject to Exchange Act reporting requirements, but would be considered an emerging growth company.

### **Filings**

#### *Form 1-A*

An issuer that seeks to rely on Regulation A must file and qualify an offering statement on Form 1-A. The offering statement is intended to be a disclosure document similar to those on Form S-1 and Form S-11.

#### Part I

As noted above, Part I requires certain basic information regarding the issuer, its eligibility, the offering details, the jurisdictions where the securities will be offered, and sales of unregistered securities.

#### Part II

Part II contains the narrative portion of the Offering Circular and requires disclosures of basic information about the issuer; material risks; use of proceeds; an overview of the issuer’s business; an MD&A type discussion; disclosures about executive officers and directors and compensation; beneficial ownership information; related party transactions; and a description of the offered securities. This is similar to Part I of Form S-1 and Form S-11, and an issuer can choose to comply with Part I of Form S-1 or Form S-11 as applicable.

Tier 1 and Tier 2 issuers must file balance sheets and other required financial statements as of the two most recently completed fiscal year ends (or for such shorter

time as they have been in existence). U.S. issuers are required to prepare financial statements in accordance with GAAP.

The financial statements for an issuer in a Tier 1 offering are not required to be audited; however, if a Tier 1 issuer already obtained an audit of its financial statement for other purposes and such audit was performed in accordance with GAAP or the PCAOB standards and the auditors meet the independence standards, then the audited financial statements must be filed.

The financial statements for an issuer in a Tier 2 offering are required to be audited in accordance with either GAAS or PCAOB standards. The auditing firm must satisfy the independence standard but need not be PCAOB-registered.

The final rule also addresses that financial statements may not be older than nine months. Issuers in Tier II offerings are not required to provide financial statements in an interactive data format using XBRL.

### Part III

The exhibit requirements in Part III of Form 1-A are the same, however, the final rule allows for incorporation by reference of exhibits that were previously filed on EDGAR.

## **Ongoing Reporting Requirements**

Tier 1 issuers will be required to provide certain information about their Regulation A offerings on a new form, Form 1-Z.

Tier 2 issuers will be subject to an ongoing reporting regime and would be required to file:

- annual reports on Form 1-K;
- semi-annual reports on Form 1-SA;
- current reports on Form 1-U;
- special financial reports on Form 1-K and Form 1-SA; and
- exit reports on Form 1-Z.

The Form 1-K is required to be filed within 120 calendar days of the issuer's fiscal year-end and would require disclosures:

- relating to the issuer's business and operations for the preceding three fiscal years (or since inception if in existence for less than three years);

- related party transactions;
- beneficial ownership;
- executive officers and directors;
- executive compensation;
- MD&A; and
- two years of audited financial statements.

The semi-annual report is required to be filed within 90 days after the end of the first six months of the issuer's fiscal year and would be similar to a Form 10-Q, although it would be subject to scaled disclosure requirements.

A current report on Form 1-U must be filed within four business days of the triggering event and will be required to announce:

- fundamental changes in the issuer's business;
- entry into bankruptcy or receivership proceedings;
- material modifications to the rights of securityholders;
- changes in accountants;
- non-reliance on audited financial statements;
- changes in control;
- changes in key executive officers; and
- sales of 10 percent or more of outstanding equity securities in exempt offerings.

An exit report on Form 1-Z would be required to be filed within 30 days after the termination or completion of a Regulation A-exempt offering.

### **Rule 15c2-11, Rule 144 and Rule 144A**

The periodic reports of a Tier 2 issuer's will satisfy Exchange Act Rule 15c2-11 broker-dealer requirements in connection with publishing quotations on any facility other than a national securities exchange.

The final rule does not establish that these reports would constitute "current information" for Rule 144 and Rule 144A purposes. A Tier 2 issuer that voluntarily submits quarterly information in a form consistent with that required for semi-annual information would be able to satisfy the "reasonably current information" and "adequate current public information" requirements. The securities sold in a Regulation A offering are not considered "restricted securities" under Securities Act Rule 144. As a result, sales of the securities by persons who are not affiliates of the issuer would not be subject to any transfer restrictions under Rule 144. Affiliates, of course, would continue to be subject to the limitations of Rule 144, other than the holding period requirement. This is important to an issuer that would like an active trading market to develop for its securities following completion of a Regulation A offering.

## **Securities Act Liability**

Sellers of Regulation A securities would have Section 12(a)(2) liability in respect of offers or sales made by means of an offering circular or oral communications that include a material misleading statement or omission. While an exempt offering pursuant to Regulation A is excluded from the operation of Section 11 of the Securities Act, those offerings are subject to the antifraud provisions under the federal securities laws.

## **Bad Actor Disqualification**

Pursuant to Rule 262 of Regulation A, an issuer will not be eligible to use the Regulation A exemption if it, or any of its “covered persons” are subject to one of several events of disqualification set forth in the Rule. In addition to the issuer itself, an issuer’s covered persons are:

- (1) a predecessor of the issuer;
- (2) an affiliated issuer;
- (3) any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer;
- (4) Any beneficial owner of 20% or more of the issuer’s voting securities;
- (5) Any promoter connected with the issuer at the time of the filing of the offering statement, any offer after qualification, or a sale;
- (6) Any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in the offering (a “compensated solicitor”); and
- (7) Any general partner or managing member of a compensated solicitor or any director, executive officer or other officer participating in the offering of a compensated solicitor or any general partner or managing member of such compensated solicitor.

The following are events of disqualification:

- (1) Criminal conviction within ten years prior to the filing date of the offering statement (or five years, in the case of issuers, their predecessors and affiliated issuers) that are (i) in connection with the purchase or sale of a security; (ii) involve the making of any false filing with the SEC; or (iii) arise out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;
- (2) Orders, judgments or decrees of courts entered within five years before the filing of the offering statement that, at the time of the offering statement filing, restrain or enjoin the subject covered person from engaging or continuing to engage in any conduct or practice: (i) in connection with the purchase or sale of a security; (ii) involving the making of any false filing with the SEC; or (iii) arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

- (3) Final orders of certain state regulators (such as state securities, banking and insurance regulators) and certain federal regulators (such as federal banking agencies, the CFTC or NCUA), if the order (A) at the time of filing bars the covered person from: (i) association with an entity regulated by the applicable state or federal regulator; (ii) engaging in the business of securities, insurance or banking; or (iii) engaging in savings association or credit union activities; or (B) is a final order based on violation of law or regulation prohibiting fraudulent, manipulative or deceptive conduct entered within ten years prior to filing;
- (4) Certain SEC disciplinary orders relating to brokers, dealers, municipal securities dealers, investment advisers and investment companies and their associated persons to the extent such order is in effect at the time of filing;
- (5) Cease and desist orders of the SEC to which the applicable covered person is subject as of the filing and which were entered within five years before the filing for scienter-based anti-fraud violations and Section 5 registration violations;
- (6) Suspension or expulsion from, or suspension or barring from association with a member of, a registered national securities exchange or a registered national or affiliated securities association (such as FINRA), for any act or omission constituting conduct inconsistent with just and equitable principles of trade;
- (7) Has filed, or was named as and underwriter in, any registration statement or Regulation A offering statement filed with the SEC that, within 5 years prior to filing of the offering statement, was subject to a stop order or order suspending the Reg A exemption, or at the time of the filing is subject of an investigation to determine whether to issue such an order; and
- (8) Is subject to a USPS false representation order entered within 5 years prior to the filing date of the offering statement.

An issuer will not be subject to disqualification for an event of disqualification that occurred prior to the effective date of the revised Regulation A rules. However, an issuer will be required to disclose in its offering circular any matter that would have been an event of disqualification but for its occurrence prior to the effective date of the rules.

### **Effective Date**

The final rules will be effective 60 days following publication in the Federal Register.

For more information:

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