Also Visit – [LawCast.com](http://www.LawCast.com)
The Securities Law Network

June 20, 2017

SEC Issues Additional Guidance on Regulation A+

The following is written by Laura Anthony, Esq., a going public attorney focused on OTC listing requirements, direct public offerings, going public transactions, reverse mergers, Form 10 and Form S-1 registration statements, SEC compliance and OTC Market reporting requirements.

On March 31, 2017, the SEC Division of Corporation Finance issued six new Compliance and Disclosure Interpretations (C&DI) to provide guidance related to Regulation A/A+. Since the new Regulation A+ came into effect on June 19, 2015, its use has continued to steadily increase. In my practice it is the most popular method for a public offering under $50 million.

As an ongoing commentary on Regulation A+, following a discussion on the CD&I guidance, I have included practice tips, and thoughts on Regulation A+, and a summary of the Regulation A+ rules, including interpretations and guidance up to the date of this blog.

New CD&I Guidance

In the first of the new CD&I, the SEC clarifies the timing of the filing of a Form 8-A to register a class of securities under Section 12(b) or (g) of the Exchange Act. In particular, in order to be able to file a Form 8-A as part of the Regulation A+ process, in addition to utilizing Form S-1 format in the Regulation A+ offering circular, a company must file the Form 8-A concurrent with qualification of the offering circular. Registration under 12(g) occurs automatically; however, Registration under 12(b) requires that the applicable national securities exchange certify the registration within five calendar days. As with any SEC filings based on calendar days, where the fifth day falls on a Saturday, Sunday or federal holiday, the certification may be received on the next business day.

In the second new CD&I, the SEC confirms that a company may withdraw a Tier 2 Regulation A offering after qualification but prior to any sales or the filing of an annual report, by filing an exit report on Form 1-Z and thereafter be relieved of any further filing requirements.

The third new CD&I addresses the age of financial statements to be included in a Tier 2 offering circular. In particular, financial statements generally do not go stale for nine months, as opposed to 135 days for other filings under Regulation S-X. Interim financial statements should be for a period of six months following the date of the fiscal year-end.

In the fourth new CD&I, the SEC confirmed that a tax opinion is not required to be filed as an exhibit to Form 1-A, but a company may do so voluntarily.

In the fifth new CD&I, the SEC confirmed that it will not object if an auditor's consent is not included as an exhibit to an annual report on Form 1-K, even if though the report contains audited financial statements. The report would still need to contain the auditor's report, but a separate consent is not required.

Finally in the last of the new CD&I, the SEC confirms that the requirement under Industry Guide 5 that sales material be submitted to the SEC before use, does not apply to Regulation A offerings. Industry Guide 5 relates to registration statements relating to interests in real estate limited partnerships.

Refresher on CD&I Issued November 2016

In November 2016, the SEC issued three CD&I providing guidance on Regulation A. In the first, the SEC has clarified that where a company seeks to qualify an additional class of securities via post-qualification amendment to a previously qualified Form 1-A, Item 4 of Part I, which requires "Summary Information Regarding the Offering and Other Current or Proposed Offerings," need only include information related to the new class of securities seeking qualification.

In a reminder that Regulation A+ is technically an exemption from the registration requirements under Section 5 of the Securities Act, the SEC confirmed that under Item 6 of Part I, requiring disclosure of unregistered securities issued or sold within the prior year, a company must disclose all securities issued or sold pursuant to Regulation A in the prior year.

Question 182.13 clarified the calculation of a 20% change in the price of the offering to determine the necessity of filing a post-qualification amendment which would be subject to SEC comment and review, versus a post-qualification supplement which would be effective immediately upon filing. In particular, Rule 253(b) provides that a change in price of no more than 20% of the qualified offering price, may be made by supplement and not require an amendment. An amendment is subject to a whole new review and comment period and must be declared qualified by the SEC. A supplement, on the other hand, is simply added to the already qualified Form 1-A, becoming qualified itself upon filing. The 20% variance can be either an increase or decrease in the offering price, but if it is an increase, it cannot result in an offering above the respective thresholds for Tier 1 ($20 million) or Tier 2 ($50 million).

In the third CD&I, the SEC confirmed that companies using Form 1-A benefit from Section 71003 of the FAST Act. In particular, the SEC interprets Section 71003 of the FAST Act to allow an emerging growth company (EGC) to omit financial information for historical periods if it reasonably believes that those financial statements will not be required at the time of the qualification of the Form 1-A, provided that the company file a pre-qualification amendment such that the Form 1-A qualified by the SEC contains all required up-to-date financial information. Interestingly, Section 71003 only refers to Forms S-1 and F-1 but the SEC has determined to allow an EGC the same benefit when filing a Form 1-A. Since financial statements for a new period would result in a material amendment to the Form 1-A, potential investors would need to be provided with a copy of such updated amendment prior to accepting funds and completing the sale of securities.

In addition, on June 23, 2015, the SEC updated its Division of Corporation Finance C&DI to provide guidance related to Regulation A/A+ by publishing 11 new questions and answers and deleting 2 from its forms C&DI which are no longer applicable under the new rules. The summary below includes that guidance.

Regulation A/A+ – Private or Public Offering?

The legal nuance that Regulation A/A+ is an "exempt" offering under Section 5 has caused confusion and the need for careful thought by practitioners and the SEC staff alike. So far, it appears that Regulation A/A+ is treated as a public offering in almost all respects except as related to the applicability of Securities Act Section 11 liability. Section 11 of the Securities Act provides a private cause of action in favor of purchasers of securities, against those involved in filing a false or misleading public offering registration statement. Any purchaser of securities, regardless of whether they bought directly from the company or secondarily in the aftermarket, can sue a company, its underwriters, and experts for damages where a false or misleading registration statement had been filed related to those securities. Regulation A is not considered a public offering for purposes of Section 11 liability.

Securities Act Section 12, which provides a private cause of action by a purchaser of securities directly against the seller of those securities, specifically imposes liability on any person offering or selling securities under Regulation A. The general antifraud provisions under Section 17 of the Securities Act, which apply to private and public offerings, of course apply to Regulation A/A+.

When considering integration, in addition to the discussion in the summary below, the SEC has now confirmed that a Regulation A/A+ offering can rely on Rule 152 such that a completed exempt offering, such as under Rule 506(b), will not integrate with a subsequent Regulation A filing. Under Rule 152, a securities transaction that at the time involves a private offering will not lose that status even if the issuer subsequently makes a public offering. The SEC has also issued guidance that Rule 152 applies to prevent integration between a completed 506(b) offering and a subsequent 506(c) offering, indicating that the important factor in the Rule 152 analysis is the ability to publicly solicit regardless of the filing of a registration statement.

Along the same lines, as Rule 506(c) is considered a public offering for this analysis, there would be nothing preventing a company from completing a Rule 506(c) offering either before, concurrently or after a Regulation A/A+ offering.

Regulation A/A+ is definitely used as a going public transaction and, as such, is very much a public offering. Securities sold in a Regulation A+ offering are not restricted and therefore are available to be used to create a secondary market and trade, such as on the OTC Markets or a national exchange.

Tier 2 issuers that have used the S-1 format for their Form 1-A filing will be permitted to file a Form 8-A to register under the Exchange Act and become subject to its reporting requirements and to register with a national exchange. A Form 8-A is a simple registration form used instead of a Form 10 for issuers that have already filed the substantive Form 10 information with the SEC. Upon filing a Form 8-A, the issuer will become subject to the full Exchange Act reporting obligations, and the scaled-down Regulation A+ reporting will automatically be suspended. A form 8-A can also be used as a short form registration to list on a national exchange under Section 12(b) of the Exchange Act.

A Regulation A process is clearly the best choice for a company that desires to go public and raise less than $50 million. An initial or direct public offering on Form S-1 does not preempt state law. By choosing a Tier 2 Regulation A+ offering followed by a Form 8-A, the issuer can achieve the same result – i.e., become a fully reporting trading public company, without the added time and expense of complying with state blue sky laws. In addition to the state law preemption benefit, Regulation A provides relief from the strictly regulated public communications that exist in an S-1 offering.

Also, effective July 10, 2016, the OTCQB amended their rules to allow a Tier 2 reporting entity to qualify to apply for and trade on the OTCQB; however, unless the issuer has filed a Form 8-A or Form 10, they will not be considered “subject to the Exchange Act reporting requirements” for purposes of benefiting from the shorter 6-month Rule 144 holding period.

Practice Tip on Registration Rights Contracts

In light of the fact that Regulation A/A+ is technically an exemption from the Section 5 registration requirements, it might not be included in contractual provisions related to registration rights. In particular, the typical language in a piggyback or demand registration right provision creates the possibility that the company could do an offering under Regulation A/A+ and take the position that the shareholder is not entitled to participate under the registration rights provision because it did not do a "registration." As an advocate of avoiding ambiguity, practitioners should carefully review these contractual provisions and add language to include a Form 1-A under Regulation A/A+ if the intent is to be sure that the shareholder is covered. Likewise, if the intent is to exclude Regulation A/A+ offerings from the registration rights, that exclusion should be added to the language to avoid any dispute.

Refresher: The Final Rules – Summary of Regulation A+

I've written about Regulation A/A+ on numerous occasions, including detailing the history and intent of the rules. Title IV of the JOBS Act that was signed into law on April 5, 2012, set out the framework for the new Regulation A and required the SEC to adopt specific rules to implement the new provisions, which it did. The new rules quickly became known as Regulation A+ and came into effect on June 19, 2015. Importantly, as I point out in that blog and others I have written on the subject, Tier 2 of Regulation A preempts state blue sky law.

In addition to the federal government, every state has its own set of securities laws and securities regulators. Unless the federal law specifically "preempts" or overrules state law, every offer and sale of securities must comply with both the federal and the state law. There are 54 U.S. jurisdictions, including all 50 states and 4 territories, each with separate and different securities laws. Even in states that have identical statutes, the states' interpretations or focuses under the statutes differ greatly. On top of that, each state has a filing fee and a review process that takes time to deal with. It's difficult, time-consuming and expensive.

However, as I will discuss below, this does not include preemption of state law related to broker-dealer registration. Five states do not have “issuer exemptions” for public offerings such as a Regulation A offering.

Specifics of Regulation A+ – How Does it Work?

The new Regulation A+ divided Regulation A into two offering paths, referred to as Tier 1 and Tier 2. Tier 1 remains substantially the same as the old pre-JOBS Act Regulation A but with a higher offering limit and allowing for more marketing and testing the waters. A Tier 1 offering allows for sales of up to $20 million in any 12-month period. Since Tier 1 does not preempt state law, it is really only useful for offerings that are limited to one but no more than a small handful of states. Tier 1 does not require the company to include audited financial statements and does not have any ongoing SEC reporting requirements. Tier 1 will likely not be used for a going public transaction.

Both Tier I and Tier 2 offerings have minimum basic requirements, including issuer eligibility provisions and disclosure requirements. In addition to the affiliate resale restrictions, resales of securities by selling security holders are limited to no more than 30% of a total particular offering for all Regulation A+ offerings. For offerings up to $20 million, an issuer can elect to proceed under either Tier 1 or Tier 2. Both tiers will allow companies to submit draft offering statements for non-public SEC staff review before a public filing, permit continued use of solicitation materials after the filing of the offering statement and use the EDGAR system for filings.

Tier 2 allows a company to file an offering circular with the SEC to raise up $50 million in a 12-month period. Tier 2 pre-empts state blue sky law. A company may elect to either provide the disclosure in the new Form 1-A or the disclosure in a traditional Form S-1 when conducting a Tier 2 offering. The Form S-1 format is a precondition to being able to file a Form 8-A as discussed further in this summary. Either way, the SEC review process is a little shorter, and a company can market in a way that it cannot with a traditional IPO. Regulation A has specific company eligibility requirements, and there are investor qualifications and associated per-investor investment limits.

Also, the process is not inexpensive. Attorneys' fees, accounting and audit fees and, of course, marketing expenses all add up. A company needs to be organized and ready before engaging in any offering process, and especially so for a public offering process. Even though a lot of attorneys, myself included, will provide a flat fee for the process, that flat fee is dependent on certain assumptions, including the level of organization of the company.

Eligibility Requirements

Regulation A+ is available to companies organized and operating in the United States and Canada. The following issuers are not eligible for a Regulation A+ offering:

Companies currently subject to the reporting requirements of the Exchange Act;

Investment companies registered or required to be registered under the Investment Company Act of 1940, including BDC's;

Blank check companies, which are companies that have no specific business plan or purpose or whose business plan and purpose is to engage in a merger or acquisition with an unidentified target; however, shell companies are not prohibited, unless such shell company is also a blank check company. A shell company is a company that has no or nominal operations; and either no or nominal assets, assets consisting of cash and cash equivalents; or assets consisting of any amount of cash and cash equivalents and nominal other assets. Accordingly, a start-up business or minimally operating business may utilize Regulation A+;

Issuers seeking to offer and sell asset-backed securities or fractional undivided interests in oil, gas or other mineral rights;

Issuers that have been subject to any order of the SEC under Exchange Act Section 12(j) denying, suspending or revoking registration, entered within the past five years;

Issuers that became subject to Exchange Act reporting requirements, such as through a Tier 2 offering, and did not file required ongoing reports during the preceding two years; and

Issuers that are disqualified under the "bad actor" rules and, in particular, Rule 262 of Regulation A+.

A company will be considered to have its "principal place of business" in the U.S. or Canada for purposes of determination of Regulation A/A+ eligibility if its officers, partners, or managers primarily direct, control and coordinate the company's activities from the U.S. or Canada, even if the actual operations are located outside those countries.

A company that was once subject to the Exchange Act reporting obligations but suspended such reporting obligations by filing a Form 15 is eligible to utilize Regulation A/A+. A company that voluntarily files reports under the Exchange Act is not "subject to the Exchange Act reporting requirements" and therefore is eligible to rely on Regulation A/A+. A wholly owned subsidiary of an Exchange Act reporting company parent is eligible to complete a Regulation A/A+ offering as long as the parent reporting company is not a guarantor or co-issuer of the securities being issued.

Unfortunately, in what is clearly a legislative miss, companies that are already publicly reporting – that is, are already required to file reports with the SEC – are not eligible. OTC Markets has petitioned the SEC to eliminate this eligibility criteria, and pretty well everyone in the industry supports a change here, but for now it remains. One of the top recommendations by the SEC Government-Business Forum on Small Business Capital Formation has also been to expand Regulation A/A+ to allow reporting issuers to utilize the process.

Regulation A/A+ can be used for business combination transactions, but is not available for shelf SPAC's (special purpose acquisition companies).

Eligible Securities

Regulation A is limited to equity securities, including common and preferred stock and options, warrants and other rights convertible into equity securities, debt securities and debt securities convertible or exchangeable into equity securities, including guarantees. If convertible securities or warrants are offered that may be exchanged or exercised within one year of the offering statement qualification (or at the option of the issuer), the underlying securities must also be qualified and the value of such securities must be included in the aggregate offering value. Accordingly, the underlying securities will be included in determining the offering limits of $20 million and $50 million, respectively.

Asset-backed securities are not allowed to be offered in a Regulation A offering. REIT's and other real estate-based entities may use Regulation A and provide information similar to that required by a Form S-11 registration statement.

General Solicitation and Advertising; Solicitation of Interest ("Testing the Waters")

Other than the investment limits, anyone can invest in a Regulation A offering, but of course they have to know about it first – which brings us to marketing. All Regulation A offerings will be allowed to engage in general solicitation and advertising, at least according to the SEC. However, Tier 1 offerings will be required to review and comply with applicable state law related to such solicitation and advertising, including any prohibitions related to same.

Regulation A allows for prequalification solicitations of interest in an offering, commonly referred to as "testing the waters." Issuers can use "test the waters" solicitation materials both before and after the initial filing of the offering statement and by any means. A company can use social media, Internet websites, television and radio, print advertisements, and anything they can think of. Marketing can be oral or in writing, with the only limitations being certain disclaimers and antifraud. Although a company can and should be creative in its presentation of information, there are laws in place with serious ramifications requiring truth in the marketing process. Investors should watch for red flags such as clearly unprovable statements of grandeur, obvious hype or any statement that sounds too good to be true – as they are probably are just that.

When using “test the waters” or prequalification marketing, a company must specifically state whether a registration statement has been filed and if one has been filed, provide a link to the filing. Also, the company must specifically state that no money is being solicited and that none will be accepted until after the registration statement is qualified with the SEC. Any investor indications of interest during this time are 100% non-binding – on both parties. That is, the potential investor has no obligation to make an investment when or if the offering is qualified with the SEC and the company has no obligation to file a registration statement or if one is already filed, to pursue its qualification. In fact, a company may decide that based on a poor response to its marketing efforts, it will abandon the offering until some future date or forever.

As such, solicitation material used before qualification of the offering circular must contain a legend stating that no money or consideration is being solicited and none will be accepted, no offer to buy securities can be accepted and any offer can be withdrawn before qualification, and a person’s indication of interest does not create a commitment to purchase securities.

All solicitation material must be submitted to the SEC as an Exhibit under Part III of Form 1-A. This is a significant difference from S-1 filers, who are not required to file “test the waters” communications with the SEC.

A company can use Twitter and other social media that limit the number of characters in a communication, to test the waters as long as the company provides a hyperlink to the required disclaimers. In particular, a company can use a hyperlink to satisfy the disclosure and disclaimer requirements in Rule 255 as long as (i) the electronic communication is distributed through a platform that has technological limitations on the number of characters or amount of text that may be included in the communication; (ii) including the entire disclaimer and other required disclosures would exceed the character limit on that particular platform; and (iii) the communication has an active hyperlink to the required disclaimers and disclosures and, where possible, prominently conveys, through introductory language or otherwise, that important or required information is provided through the hyperlink.

Unlike the "testing of the waters" by emerging growth companies that are limited to QIB's and accredited investors, a Regulation A+ company could reach out to retail and non-accredited investors. After the public filing but before SEC qualification, a company may use its preliminary offering circular to make written offers.

Of course, all "test the waters" materials are subject to the antifraud provisions of federal securities laws.

Like registered offerings, ongoing regularly released factual business communications, not including information related to the offering of securities, will be allowed and will not be considered solicitation materials.

Continuous or Delayed Offerings

Continuous or delayed offerings (a form of a shelf offering) will be allowed only if the offering statement pertains to: (i) securities to be offered or sold solely by persons other than the issuer (however, note that under the rules this is limited to 30% of any offering); (ii) securities that are offered pursuant to a dividend or interest reinvestment plan or employee benefit plan; (iii) securities that are to be issued upon the exercise of outstanding options, warrants or rights; (iv) securities that are to be issued upon conversion of other outstanding securities; (v) securities that are pledged as collateral; or (vi) securities for which the offering will commence within two days of the offering statement qualification date, will be made on a continuous basis, will continue for a period of in excess of thirty days following the offering statement qualification date, and at the time of qualification are reasonably expected to be completed within two years of the qualification date. Under this last continuous offering section, issuers that are current in their Tier 2 reporting requirements may make continuous or delayed offerings for up to three years following qualification of the offering statement. Moreover, in the event a new qualification statement is filed for a new Regulation A offering, unsold securities from a prior qualification may be included, thus carrying those unsold securities forward for an additional three-year period.

Additional Tier 2 Requirements; Ability to List on an Exchange

In addition to the basic requirements that apply to all Regulation A offerings, Tier 2 offerings also require: (i) audited financial statements (though I note that state blue sky laws almost all require audited financial statements, so this federal distinction does not have a great deal of practical effect); (ii) ongoing reporting requirements including the filing of an annual and semiannual report and periodic reports for current information (Forms 1-K, 1-SA and 1-U, respectively); and (iii) a limitation on the number of securities non-accredited investors can purchase of no more than 10% of the greater of the investor's annual income or net worth.

The investment limitations for non-accredited investors resulted from a compromise with state regulators that opposed the state law preemption for Tier 2 offerings. It is the obligation of the issuer to notify investors of these limitations. Issuers may rely on the investors' representations as to accreditation (no separate verification is required) and investment limits.

An issuer may file a Form 8-A concurrently with the qualification of the Form 1-A, to register under the Exchange Act, and may make immediate application to a national securities exchange. A Form 8-A is a simple (generally 2-page) registration form used instead of a Form 10 for issuers that have already filed the substantive Form 10 information with the SEC (generally through an S-1). The Form 8-A will only be allowed if it is filed concurrently with the Form 1-A. That is, an issuer could not qualify a Form 1-A, wait a year or two, then file a Form 8-A. In that case, they would need to use the longer Form 10.

Where the securities will be listed on a national exchange, the accredited investor limitations will not apply. When the Form 8-A is for a registration with a national securities exchange under Section 12(b) of the Exchange Act, the national exchange must certify the Form 8-A within five (5) business days of its filing.

Upon filing a Form 8-A, the issuer will become subject to the full Exchange Act reporting obligations, and the scaled-down Regulation A+ reporting will automatically be suspended.

An issuer that reports under Regulation A is not considered to be subject to the Exchange Act reporting requirements and therefore its shareholders will be subject to the longer one-year holding period under Rule 144.

An issuer that reports under Regulation A may apply to trade on any of the three OTC Markets tiers of quotation (Pink, OTCQB or OTCQX).

Integration

The final rules include a limited-integration safe harbor such that offers and sales under Regulation A will not be integrated with prior or subsequent offers or sales that are (i) registered under the Securities Act; (ii) made under compensation plans relying on Rule 701; (iii) made under other employee benefit plans; (iv) made in reliance on Regulation S; (v) made more than six months following the completion of the Regulation A offering; or (vi) made in crowdfunding offerings exempt under Section 4(a)(6) of the Securities Act (Title III crowdfunding – i.e., Regulation CF).

The SEC has now confirmed that a Regulation A offering can rely on Rule 152 such that a completed exempt offering, such as under Rule 506(b), will not integrate with a subsequent Regulation A filing. Under Rule 152, a securities transaction that at the time involves a private offering will not lose that status even if the issuer subsequently makes a public offering. The SEC has also issued guidance that Rule 152 applies to prevent integration between a completed 506(b) offering and a subsequent 506(c) offering, indicating that the important factor in the Rule 152 analysis is the ability to publicly solicit regardless of the filing of a registration statement. As Rule 506(c) is considered a public offering for this analysis, there would be nothing preventing a company from completing a Rule 506(c) offering either before, concurrently or after a Regulation A/A+ offering.

In the absence of a clear exemption from integration, issuers would turn to the five-factor test. In particular, the determination of whether the Regulation A offering would integrate with one or more other offerings is a question of fact depending on the particular circumstances at hand. In particular, the following factors need to be considered in determining whether multiple offerings are integrated: (i) are the offerings part of a single plan of financing; (ii) do the offerings involve issuance of the same class of securities; (iii) are the offerings made at or about the same time; (iv) is the same type of consideration to be received; and (v) are the offerings made for the same general purpose.

Offering Statement – General

A company intending to conduct a Regulation A offering must file an offering circular with, and have it qualified by, the SEC. The offering circular will be filed with the SEC using the EDGAR database filing system. Prospective investors must be provided with the filed prequalified offering statement 48 hours prior to a sale of securities. Once qualified, investors must be provided with the final qualified offering circular. Like current registration statements, Regulation A rules provide for an "access equals delivery" model, whereby access to the offering statement via the Internet and EDGAR database will satisfy the delivery requirements.

There are no filing fees for the process. The offering statement is reviewed, commented upon and then declared "qualified" by the SEC with an issuance of a "notice of qualification." The notice of qualification can be requested or will be issued by the SEC upon clearing comments. The SEC has been true to its word in that the review process has been substantially lighter than that normally associated with an S-1 or other Securities Act registration statement.

Issuers may file offering circular updates after qualification in lieu of post-qualification amendments similar to the filing of a post-effective prospectus for an S-1. To qualify additional securities, a post-qualification amendment must be used.

Offering Statement – Non-Public (Confidential) Submission

The rules permit an issuer to submit an offering statement to the SEC on a confidential basis. However, only companies that have not previously sold securities under a Regulation A or a Securities Act registration statement may submit the offering confidentially.

Confidential submissions will allow a Regulation A issuer to get the process under way while soliciting interest of investors using the "test the waters" provisions without negative publicity risk if it alters or withdraws the offering before qualification by the SEC. However, the confidential filing, SEC comments, and all amendments must be publicly filed as exhibits to the offering statement at least 15 calendar days before qualification.

Confidential submissions to the SEC are completed by choosing a "confidential" setting in the EDGAR system. To satisfy the requirement to publicly file the previous confidential information, the company can file all prior confidential information as an exhibit to its non-confidential filing, or change the setting in the EDGAR system on its prior filings, from "confidential" to "public." In the event the company chooses to change its EDGAR setting to "public," it would not have to re-file all prior confidential material as an exhibit to a new filing.

Legal & Compliance, LLC
330 Clematis Street, West Palm Beach, FL 33401
Local: 561-514-0936 Toll-Free: 800-341-2681
LAnthony@LegalAndCompliance.com
www.LegalAndCompliance.com
www.SecuritiesLawBlog.com
www.LawCast.com

If a company wants to keep certain information confidential, even after the required time to make such information public, it will need to submit two confidential requests, one as part of the registration review process and one when prior confidential filings are made public. During the confidential Form 1-A review process, the company should submit a request under Rule 83 in the same manner it would during a typical review of a registered offering. Once the company is required to make the prior filings “public” (15 days prior to qualification), the company would make a new request for confidential treatment under Rule 406 in the same manner other confidential treatment requests are submitted. In particular, for a confidential treatment request under Rules 83 and 406, a company must submit a redacted version of the document via EDGAR with the appropriate legend indicating that confidential treatment has been requested. Concurrently, the company must submit a full, unredacted paper version of the document to the SEC using the ordinary confidential treatment procedure (such filings are submitted via a designated fax line to a designated person to maintain confidentiality).

Offering Statement – Form and Content

An offering statement is submitted on Form 1-A. Form 1-A consists of three parts: Part I – Notification, Part II – Offering Circular, and Part III – Exhibits. Part I calls for certain basic information about the issuer and the offering, and is primarily designed to confirm and determine eligibility for the use of the Form and a Regulation A offering in general. Part I includes issuer information; issuer eligibility; application of the bad-actor disqualification and disclosure; jurisdictions in which securities are to be offered; and unregistered securities issued or sold within one year. As Regulation A is legally an unregistered offering, all Regulation A securities sold within the prior year must be included in this section.

Part II is the offering circular and is similar to the prospectus in a registration statement. Part II requires disclosure of basic information about the issuer and the offering; material risks; dilution; plan of distribution; use of proceeds; description of the business operations; description of physical properties; discussion of financial condition and results of operations (MD&A); identification of and disclosure about directors, executives and key employees; executive compensation; beneficial security ownership information; related party transactions; description of offered securities; and two years of financial information.

The required information in Part 2 of Form 1-A is scaled down from the requirements in Regulation S-K applicable to Form S-1. Issuers can complete Part 2 by either following the Form 1-A disclosure format or by including the information required by Part I of Form S-1 or Form S-11 as applicable. Note that only issuers that elect to use the S-1 or S-11 format will be able to subsequently file an 8-A to register and become subject to the Exchange Act reporting requirements.

Moreover, issuers that had previously completed a Regulation A offering and had thereafter been subject to and filed reports with the SEC under Tier 2 can incorporate by reference from these reports in future Regulation A offering circulars.

Form 1-A requires two years of financial information. All financial statements for Regulation A offerings must be prepared in accordance with GAAP. Financial statements of a Tier 1 issuer are not required to be audited unless the issuer has obtained an audit for other purposes. Audited financial statements are required for Tier 2 issuers. Audit firms for Tier 2 issuers must be independent and PCAOB-registered. An offering statement cannot be qualified if the date of the balance sheet is more than nine months prior to the date of qualification. Interim periods are only required for six-month intervals.

A recently created entity may choose to provide a balance sheet as of its inception date as long as that inception date is within nine months before the date of filing or qualification and the date of filing or qualification is not more than three months after the entity reached its first annual balance sheet date. The date of the most recent balance sheet determines which fiscal years, or period since existence for recently created entities, the statements of comprehensive income, cash flows and changes in stockholders' equity must cover. When the balance sheet is dated as of inception, the statements of comprehensive income, cash flows and changes in stockholders' equity will not be applicable.

Part III requires an exhibits index and a description of exhibits required to be filed as part of the offering statement.

Offering Price

All Regulation A+ offerings must be at a fixed price. That is, no offerings may be made "at the market" or for other than a fixed price.

Ongoing Reporting

Both Tier I and Tier 2 issuers must file summary information after the termination or completion of a Regulation A offering. A Tier I company must file certain information about the Regulation A offering, including information on sales and the termination of sales, on a Form 1-Z exit report no later than 30 calendar days after termination or completion of the offering. Tier I issuers do not have any ongoing reporting requirements.

Tier 2 companies are also required to file certain offering termination information and have the choice of using Form 1-Z or including the information in their first annual report on Form 1-K. In addition to the offering summary information, Tier 2 issuers are required to submit ongoing reports including: an annual report on Form 1-K, semiannual reports on Form 1-SA, current event reports on Form 1-U and notice of suspension of ongoing reporting obligations on Form 1-Z (all filed electronically on EDGAR).

A Tier 2 issuer may file an exit form 1-Z and relieve itself of any ongoing requirements if no securities have been sold under the Regulation A offering and the Form 1-Z is filed prior to the company's first annual report on Form 1-K.

The ongoing reporting for Tier 2 companies is less demanding than the reporting requirements under the Securities Exchange Act. In particular, there are fewer 1-K items and only the semiannual 1-SA (rather than the quarterly 10-Q) and fewer events triggering Form 1-U (compared to Form 8-K). Companies may also incorporate text by reference from previous filings.

The annual Form 1-K must be filed within 120 calendar days of fiscal year-end. The semiannual Form 1-SA must be filed within 90 calendar days after the end of the semiannual period. The current report on Form 1-U must be filed within 4 business days of the triggering event. Successor issuers, such as following a merger, must continue to file the ongoing reports.

The rules also provide for a suspension of reporting obligations for a Regulation A issuer that desires to suspend or terminate its reporting requirements.Termination is accomplished by filing a Form 1-Z and requires that a company be current over stated periods in its reporting, have fewer than 300 shareholders of record, and have no ongoing offers or sales in reliance on a Regulation A offering statement. Of course, a company may file a Form 10 to become subject to the full Exchange Act reporting requirements.

The ongoing reports will qualify as the type of information a market maker would need to support the filing of a 15c2-11 application. Accordingly, an issuer that completes a Tier 2 offering could proceed to engage a market maker to file a 15c2-11 application and trade on the OTC Markets. The OTC Markets allows Regulation A reporting companies to apply for any of its tiers of listing, including the Pink, OTCQB or OTCQX depending on which tier the company qualifies.

Freely Tradable Securities

Securities issued to non-affiliates in a Regulation A offering are freely tradable. Securities issued to affiliates in a Regulation A offering are subject to the affiliate resale restrictions in Rule 144, except for a holding period. The same resale restrictions for affiliates and non-affiliates apply to securities registered in a Form S-1.

However, since neither Tier 1 nor Tier 2 Regulation A+ issuers are subject to the Exchange Act reporting requirements, the Rule 144 holding period for shareholders is the longer 12 months and such shareholders would not be able to rely on Rule 144 at all if the company has been a shell company at any time in its history.

Treatment under Section 12(g)

Exchange Act Section 12(g) requires that an issuer with total assets exceeding $10,000,000 and a class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited, register with the SEC, generally on Form 10, and thereafter be subject to the reporting requirements of the Exchange Act.

Regulation A exempts securities in a Tier 2 offering from the Section 12(g) registration requirements if the issuer meets all of the following conditions:

> The issuer utilizes an SEC-registered transfer agent. Such transfer agent must be engaged at the time the company is relying on the exemption from Exchange Act registration;
>
> The issuer remains subject to the Tier 2 reporting obligations;
>
> The issuer is current in its Tier 2 reporting obligations, including the filing of an annual and semiannual report; and
>
> The issuer has a public float of less than $75 million as of the last business day of its most recently completed semiannual period or, if no public float, had annual revenues of less than $50 million as of its most recently completed fiscal year-end.

Moreover, even if a Tier 2 issuer is not eligible for the Section 12(g) registration exemption as set forth above, that issuer will have a two-year transition period prior to being required to register under the Exchange Act, as long as during that two-year period, the issuer continues to file all of its ongoing Regulation A reports in a timely manner with the SEC.

State Law Preemption

Tier I offerings do not preempt state law and remain subject to state blue sky qualification. The SEC encourages Tier 1 issuers to utilize the NASAA-coordinated review program for Tier I blue sky compliance. However, in practice, I do not think this program is being utilized; rather, when Tier 1 is being used, it is limited to just one or a very small number of states and companies are completing the blue sky process independently.

Tier 2 offerings are not subject to state law review or qualification – i.e., state law is preempted. Securities sold in Tier 2 offerings were specifically added to the NSMIA as federally covered securities. Federally covered securities are exempt from state registration and overview. Regulation A provides that "(b) Treatment as covered securities for purposes of NSMIA… Section 18(b)(4) of the Securities Act of 1933… is further amended by inserting… (D) a rule or regulation adopted pursuant to section 3(b)(2) and such security is (i) offered or sold on a national securities exchange; or (ii) offered or sold to a qualified purchaser, as defined by the Commission pursuant to paragraph (3) with respect to that purchase or sale."

State securities registration and exemption requirements are only preempted as to the Tier 2 offering and securities purchased pursuant to the qualified Tier 2 for 1-A offering circular. Subsequent resales of such securities are not preempted.

State law preemption only applies to the securities offering itself and not to the person or persons who sell the securities. Unfortunately, not all states offer an issuer exemption for issuers that sell their own securities in public offerings such as a Regulation A offering. In particular, Arizona, Florida, Texas, New York and North Dakota require issuers to register with the state as issuer broker-dealers to qualify to sell securities directly. Each of these states has a short-form registration process in that regard. In addition, Alabama and Nevada require that the selling officers and directors of issuers register with the state.

Federally covered securities, including Tier 2 offered securities, are still subject to state antifraud provisions, and states may require certain notice filings. In addition, as with any covered securities, states maintain the authority to investigate and prosecute fraudulent securities transactions.

Broker-Dealer Placement

Broker-dealers acting as placement or marketing agents are required to comply with FINRA Rule 5110 regarding filing of underwriting compensation, for a Regulation A offering.

Further Thoughts

Although I am a big advocate of Regulation A, companies continue to learn that it is just a legal process with added benefits, such as active advertising and solicitation including through social media. There is no pool of funds to tap into; it is not a line of credit; it is just another process that companies can use to reach out to the investing public and try to convince them to buy stock in, or lend money to, their company.

As such, companies seeking to complete a Regulation A/A+ offering must consider the economics and real-world aspects of the offering. Key to a successful offering are a reasonable valuation and rational use of proceeds. A company should demonstrate value through its financial statements and disclosures and establish that the intended use of proceeds will result in moving the business plan ahead and hopefully create increased value for the shareholders. Investors want to know that their money is being put to the highest and best use to result in return on investment. Repayment of debt or cashing out of series A investors is generally not a saleable use of proceeds. Looking for $50 million for 30% of a pre-revenue start-up just isn't going to do it! The company has to be prepared to show you, the investor, that it has a plan, management, vision and ability to carry out the business proposition it is selling.

From the investors' perspective, these are risky investments by nature. Offering materials should be scrutinized. The SEC does not pass on the merits of an offering – only its disclosures. The fact that the registration statement has been qualified by the SEC has no bearing on the risk associated with or quality of the investment. That is for each investor to decide, either alone or with advisors, and requires really reviewing the offering materials and considering the viability of the business proposal. At the end of the day, the success of the business, and therefore the potential return on investment, requires the company to perform – to sell their widgets, keep ahead of the competition, and manage their business and growth successfully.

The Author

Attorney Laura Anthony
Founding Partner
Legal & Compliance, LLC
Corporate, Securities and Going Public Attorneys
LAnthony@LegalAndCompliance.com

Securities Law Blog is written by Laura Anthony, Esq., a going public lawyer focused on OTC Listing Requirements, Direct Public Offerings, Going Public Transactions, Reverse Mergers, Form 10 Registration Statements, and Form S-1 Registration Statements. Securities Law Blog covers topics ranging from SEC Compliance, FINRA Compliance, DTC Chills, Going Public on the OTC, and OTCQX and OTCQB Reporting Requirements. Ms. Anthony is also the host of LawCast.com, the securities law network.

Contact Legal & Compliance, LLC. Inquiries of a technical nature are always encouraged. Follow me on Facebook, LinkedIn, YouTube, Google+, Pinterest and Twitter.

Download our mobile app at iTunes and Google Play.

Disclaimer

Legal & Compliance, LLC makes this general information available for educational purposes only. The information is general in nature and does not constitute legal advice. Furthermore, the use of this information, and the sending or receipt of this information, does not create or constitute an attorney-client relationship between us. Therefore, your communication with us via this information in any form will not be considered as privileged or confidential.

This information is not intended to be advertising, and Legal & Compliance, LLC does not desire to represent anyone desiring representation based upon viewing this information in a jurisdiction where this information fails to comply with all laws and ethical rules of that jurisdiction. This information may only be reproduced in its entirety (without modification) for the individual reader's personal and/or educational use and must include this notice.