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SEC Has Published Final Rules Adopting 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 25, 2015, the SEC pleasantly surprised the business community by releasing final rules amending Regulation A. The new rules are commonly referred to as Regulation A+. The existing Tier I Regulation A, which does not preempt state law, has been increased to \$20 million and the new Tier II, which does preempt state law, allows a raise of up to \$50 million. Issuers may elect to proceed under either Tier I or Tier II for offerings up to \$20 million. As is becoming common in the industry, I will refer to the new rules, including both Tier I and Tier II offerings, as Regulation A+.

In its press release announcing the passage, SEC Chair Mary Jo White was quoted as saying, “These new rules provide an effective, workable path to raising capital that also provides strong investor protections. It is important for the Commission to continue to look for ways that our rules can facilitate capital raising by smaller companies.”

The new final rules will be effective on or near May 25, 2015. The SEC is required to conduct a study and submit a report on the impact of the Regulation A+ rules and offerings on capital formation and investor protection within 5 years of enactment of the new rules.

In a future blog I will review and summarize the SEC’s 453-page rule release in detail, but initially the following is a high-level summary of the new Regulation A+.

Personally, I am excited and pleased by the new rules and am looking forward to utilizing this new opportunity on behalf of clients.

Background on Rules

On December 18, 2013, the SEC published proposed rules to implement Title IV of the JOBS Act, commonly referred to as Regulation A+. The proposed rules both added a new Section 3(b)(2) (i.e., Tier II) provisions and modified the existing Regulation A (Section 3(b)(1)). The proposed rules were the subject of numerous comment letters and debate mainly centered on the issue of preemption of state law. Notably, both certain members of the NASAA and certain members of the U.S. Senate wrote strong letters opposing the state law preemption of any Regulation A offerings. Practitioners were vocal both in support of and opposition of the preemption issue. The business community, on the other hand, almost unilaterally supported preemption.

The final rules sought a compromise on the issue of state law preemption by increasing the annual securities offering limit for Tier I offerings and limiting state law preemption to Tier II offerings to qualified investors.

The SEC is very cognizant of the support, or lack thereof, by the NASAA in its rule making. At one point the NASAA had indicated that it would file suit against the SEC if the rules, as previously proposed, had been adopted. In the new rule release, and the SEC press release announcing the rules, the SEC gives nods to the NASAA and commits to working together in the implementation of the rules and process.

The Final Rules – Summary of Regulation A+

The final rules, provide for two tiers of offerings: (i) Tier I for offerings of securities up to \$20 million in any 12-month period, of which not more than \$6 million can be resale by affiliate selling shareholders; and (ii) Tier II for offering of securities up to \$50 million in any 12-month period, of which not more than \$15 million can be resale by affiliate selling shareholders. Tier II offerings require additional disclosures and ongoing reporting requirements.

Tier II offerings will preempt state blue sky laws for securities offered or sold to “qualified purchasers” while Tier 1 offerings will be subject to full state registration and qualification requirements. The SEC, in its press release, encouraged issuers to utilize the NASAA-coordinated review program.

Both Tier I and Tier II 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 I or Tier II. 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. As part of the entire Regulation A+ rules, the SEC has made changes to align the Regulation A+ offering process with the current registered offering process and practice.

Eligibility Requirements

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

- Companies currently subject to the reporting requirements of the Securities Exchange Act of 1934 (“Exchange Act”);
- Certain investment companies under the Investment Company Act of 1940;
- 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;
- 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) entered within the past five years;
- Issuers that become subject to Exchange Act reporting requirements such as through a Tier II offering and do not file required ongoing reports during the preceding two years;
- Issuers that are disqualified under the “bad actor” rules.

General Solicitation and Advertising

All Regulation A+ offerings will be allowed to engage in general solicitation and advertising, at least according to the SEC. However, Tier I offerings will be required to review and comply with applicable state law related to such solicitation and advertising, including any prohibitions related to same.

Solicitation of Interest (“Testing the Waters”)

Regulation A+ allows for pre-qualification solicitations of interest in an offering commonly referred to as “testing the waters.” All solicitation material must be submitted to the SEC as an Exhibit under Part III of Form 1-A. Issuers can use “test the waters” solicitation materials both before and after the initial filing of the offering statement. In the event that materials are issued after the filing of an offering circular, the materials must include a current preliminary circular or information on where one can be obtained. “Test the waters” solicitations may be made both orally and in writing.

Unlike the “testing of the waters” by emerging growth companies that are limited to QIBs 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.

Additional Tier II Requirements

In addition to the basic requirements that will apply to all Regulation A+ offerings, Tier II offerings will also require: (i) audited financial statements (though I note that state blue sky laws almost unilaterally require audited financial statements, so this federal distinction may 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 (new Forms 1-K, 1-SA and 1-U respectively); and (iii) a limitation on the amount of securities non-accredited investors can purchase of no more than 10% of the greater of the investor’s annual income or net worth.

This third provision provides additional purchaser suitability standards and the Regulation A+ definition of “qualified purchaser” for purposes of allowing state law

preemption. During the proposed rule comment process many groups, including certain U.S. senators, were very vocal about the lack of suitability standards of a “qualified purchaser.” Many pushed to align the definition of qualified purchaser to the current definition of “accredited investor.” The SEC final rules offer a compromise by adding suitability requirements to non-accredited investors to establish quantitative standards for a non-accredited investors.

Although the ongoing reporting requirements will be substantially similar in form to a current annual report on Form 10-K, the issuer will not be considered to be subject to the Exchange Act reporting requirements. Accordingly, such issuer would not qualify for a listing on the OTCQB or national exchange, but would also not be disqualified from engaging in future Regulation A+ offerings.

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.

The new Regulation A+ exempts securities in a Tier II 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;
- The issuer remains subject to the Tier II reporting obligations;
- The issuer is current in its Tier II reporting obligations, including the filing of an annual and semiannual report;
- 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 II 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 having 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 II offerings are not subject to state law review or qualification – i.e., state law is preempted. As mentioned, state law preemption was the largest topic of debate surrounding the proposed rules. The text of Title IV of the JOBS Act provides, among other items (see refresher discussion below), a provision that certain Regulation A securities should be treated as covered securities for purposes of the National Securities Markets Improvement Act (NSMIA). Federally covered securities are exempt from state registration and overview. For a discussion on the NSMIA, see my blogs [HERE](#) and [HERE](#).

Title IV of the JOBS Act related to the revamp of 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.” In other words, Title IV of the JOBS Act provides that the Regulation A/A+ securities will be considered covered securities and therefore not subject to state registration or overview as long as they are sold on a national securities exchange or sold to qualified purchasers.

The definition of “qualified purchaser” became the subject of debate and contention during the comment process associated with the initially issued Regulation A+ proposed rules. In a compromise, the SEC has imposed a limit on Tier II offerings such that the amount of securities non-accredited investors can purchase is to be no more than 10% of the greater of the investor’s annual income or net worth. In light of this investor suitability limitation, the SEC has then defined a “qualified purchaser” as any purchaser in a Tier II offering.

Federally covered securities, including Tier II offered securities, are still subject to state antifraud provisions, and states may require certain notice filings.

Offering Statement – Electronic Delivery

A company intending to conduct a Regulation A+ offering must file an offering statement with, and have it qualified by, the SEC. The offering statement will be filed with the SEC using the EDGAR database filing system. Investors must be provided with the final qualified offering statement prior to a sale of securities. 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.

Offering Statement – Non-Public (Confidential) Submission

As is allowed for Emerging Growth Companies, the rules permit an issuer to submit an offering statement to the SEC on a confidential basis. 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. The confidential filing, SEC comments, and all amendments must be publicly filed as exhibits to the offering statement at least 21 calendar days before qualification.

Offering Statement – Form and Content

The rules require use of new modified 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 will include 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.

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 II of Form 1-A is scaled down from the requirements in Regulation S-K applicable to Form S-1. Moreover, issuers that had previously completed a Regulation A offering and had thereafter been subject to and filed reports with the SEC could 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 I issuer are not required to be audited unless the issuer has obtained an audit for other purposes. Audited financial statements are required for Tier II issuers. Audit firms for Tier 2 issuers must be independent and PCAOB-registered.

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

Regulation A+ requires two levels of reporting for the two levels of offering (Tier I and Tier II). A Tier I company will need to file certain information about the Regulation A offering, including information on sales and the termination of sales, on new Form 1-Z exist report, no later than 30 calendar days after termination or completion of the offering. Tier I issuers will not have any ongoing reporting requirements.

Tier II companies are also required to file certain offering termination information and would have the choice of using Form 1-Z or including the information in their first annual report on new Form 1-K. In addition to the offering summary information, Tier II 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).

The ongoing reporting for Tier 2 companies is less demanding than the reporting requirements under the Securities Exchange Act of 1934. In particular, there are fewer 1-K items and only semiannual 1-SA (rather than the quarterly 10-Q) and fewer events triggering Form 1-U (compared to Form 8-K). The SEC anticipates that companies would use their Regulation A+ offering circular as the groundwork for the ongoing reports, and they may incorporate by reference text from previous filings.

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.

Freely Tradable Securities

Securities sold in a Regulation A+ offering are not subject to transfer restrictions and are not restricted under Rule 144. Accordingly, it is contemplated that Regulation A+ issuers could have a market maker file a 15c2-11 application on their behalf and establish a secondary trading market in their securities.

Additional Background – The JOBS Act Provisions

Section 401 of the JOBS Act amended Section 3(b) of the Securities Act to renumber the current Regulation A as Section 3(b)(1) and add new Section 3(b)(2), which requires the SEC to adopt a new exemption that includes the following terms and conditions:

- A. The aggregate offering amount of all securities offered and sold within the prior 12-month period in reliance on the exemption shall not exceed \$50,000,000.
- B. The securities may be offered and sold publicly.
- C. The securities shall not be restricted.
- D. The civil liability provisions in Section 12(a)(2) shall apply to any person offering or selling the securities.

- A. (E) The issuer may solicit interest in the offering prior to filing any offering statement in accordance with rules to be written by the SEC.
- B. (F) The SEC shall require the issuer to file annual financial statements with the SEC.
- C. (G) A suggestion that the SEC require the issuer to prepare and file an offering document and prospectus with the SEC, and that the SEC enact disqualifying bad boy provisions (Regulation A already has such provisions).
- D. (H) The new exemption provided under Section 401 is limited to equity, debt and convertible debt securities, including any guarantees of such securities.
 - (I) The JOBS Act allows the SEC to require Regulation A+ issuers to file periodic reports analogous to current 10-Q and 10-K reports by issuers subject to the reporting requirements of the Exchange Act. (Currently, Regulation A issuers are not required to file periodic reports with the SEC.)
- E. (J) Securities sold under Section 401(b) of the Jobs Act are “covered securities” for purposes of exempting those securities from state securities registration and offering requirements if such securities are offered on a national exchange or sold to qualified investors.

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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.

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