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Regulation A+; An In-Depth Overview

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 released 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 2, which does preempt state law, allows a raise of up to $50 million. Issuers may elect to proceed under either Tier I or Tier 2 for offerings up to $20 million. The new rules are expected to be effective on or near June 19, 2015.

On March 31, 2015, I published a blog with a high-level summary of the new rules. In this blog, I will give a deeper review of the entire new Regulation and then in future installments will drill down on different aspects of the new rules as such become relevant to this new offering regime.

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 2) 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 in opposition to 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 2 offerings.

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 2 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 2 offerings require additional disclosures and ongoing reporting requirements.

Securities issued to non-affiliates in a Regulation A+ offering will be freely tradable. Securities issued to affiliates in a Regulation A+ offering will be 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.

Tier 2 offerings will preempt state blue sky laws for securities offered or sold to "qualified purchasers" defined as all Tier 2 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 for Tier I blue sky compliance. For a brief discussion on the NASAA-coordinated review program, see my blog HERE.

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

The final rule release also amends Section 12(g) of the Securities Exchange Act of 1934, as amended ("Exchange Act") to allow issuers to rely on a conditional exemption from mandatory registration and amend Rule 15c2-11 to allow broker-dealers to rely on the Tier 2 ongoing reports to satisfy the information requirements to support the quotation of the issuers' securities on the OTC Markets.

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 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 become subject to Exchange Act reporting requirements such as through a Tier 2 offering and do not file required ongoing reports during the preceding two years;
- Issuers that are disqualified under the "bad actor" rules and in particular Rule 262 of Regulation A+.

Eligible Securities

The final rule limits securities that may be issued under Regulation A+ 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.

Continuous or Delayed Offerings

Continuous or delayed offerings (a form of a shelf offering) will be allowed if (i) they commence within two days of the offering statement qualification date, (ii) are made on a continuous basis, (iii) will continue for a period of in excess of thirty days following the offering statement qualification date, and (iv) at the time of qualification is reasonably expected to be completed within two years of the qualification date.

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.

Continuous or delayed offerings are available for all securities qualified in the offering, including securities underlying convertible securities, securities offered by an affiliate or other selling security holder, and securities pledged as collateral.

Additional Tier 2 Requirements; Ability to list on an Exchange

In addition to the basic requirements that will apply to all Regulation A+ offerings, Tier 2 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.

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.

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 non-accredited investors.

The new rules allow Tier 2 issuers to file a Form 8-A to be filed concurrently with a Form 1-A, to register under the Exchange Act, and the immediate application to a national securities exchange. Where the securities will be listed on a national exchange, the accredited investor limitations will not apply.

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.

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. 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.

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.

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." 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. Moreover, 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.

"Test the waters" solicitations may be made both orally and in writing.

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.

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.

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.

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, which is not yet legal).

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 statement with, and have it qualified by, the SEC. The offering statement will be filed with the SEC using the EDGAR database filing system. Prospective investors must be provided with the filed pre-qualified 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 will be reviewed much like an S-1 registration statement and 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 indicated that reviewers will be assigned filings based on industry group.

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

As is allowed for Emerging Growth Companies, 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 21 calendar days before qualification. When an S-1 is filed confidentially, the offering materials need be filed 21 calendar days before effectiveness, but the SEC comment letters and responses are not required to be filed. This, together with the requirement to file "test the waters" communications, are significant increased pre-offering disclosure requirements for Regulation A+ offerings.

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 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 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 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.

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 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 exit 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 2 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 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).

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 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 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 Pink tier of the OTC Markets. Such issuer, however, would not be deemed to be "subject to the Exchange Act reporting requirements" to support a listing on the OTCQB or OTCQX levels of OTC Markets.

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.

However, since neither Tier 1 nor Tier 2 Regulation A+ issuers are subject to the SEC reporting requirements, the shareholders of issuers would not be able to rely on Rule 144 for prior shell companies. Moreover, the Tier 2 reports do not constitute reasonably current public information for the support of the use of Rule 144 for affiliates in the future.

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 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;
•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;
•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 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 I offerings do not pre-empt state law and remain subject to state blue sky qualification. The SEC, in its press release, encouraged issuers to utilize the NASAA-coordinated review program for Tier I blue sky compliance. For a brief discussion on the NASAA-coordinated review program, see my blog HERE.

Tier 2 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, 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 2 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 2 offering.

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 agent will be required to comply with FINRA Rule 5110 regarding filing of underwriting compensation, for a Regulation A+ offering.

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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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