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ALERT

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SEC Adopts Regulation A+: Two New Alternatives for Exempt Capital Raises

Executive Summary

On March 25, 2015, the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") adopted final rules implementing Title IV of the Jumpstart Our Business Startups Act (the "JOBS Act") by amending SEC Regulation A to create two new exemptions for securities offerings by private U.S. and Canadian companies, described as Regulation A+. These exempt offerings are referred to as Tier 1, for offerings of up to $20 million annually, and Tier 2, for offerings of up to $50 million annually. These offerings may include securities offered by selling securityholders, including affiliates, subject to certain limitations. Eligible securities include debt and equity securities but not asset-backed securities. There are no investment limitations applied to investors in Tier 1 offerings and limitations only on unaccredited investors in Tier 2 offerings (unless the securities are registered on a national securities exchange). A company may "test the waters" to determine interest in a proposed offering prior to filing its qualification statement and may use sales literature in connection with the offering, which must be filed with the SEC. A company may submit its qualification statement for non-public review by the SEC, and the statement need not be publicly filed until 21 days before its qualification. Audited two-year financial statements are required to be included in a Tier 2 filing, but they may be unaudited in a Tier 1 filing, so long as a balance sheet and income statement for two years and for interim periods, if necessary, are included in the filing. Securities in a Tier 2 offering to be listed on a national securities exchange may be registered with the SEC using a short-form registration statement. Tier 2 offerings (but not Tier 1 offerings) are subject to ongoing periodic reporting requirements after completion of the offering. Tier 2 offerings (but not Tier 1 offerings) are preempted from state securities agency review.

Introduction

On March 25, 2015, the SEC announced its adoption of final rules substantially amending Regulation A and other related rules and forms in order to implement Section 401 of the JOBS Act. The new rules (commonly referred to as "Regulation A+") expand Regulation A into two tiers: Tier 1, for securities offerings up to $20 million annually; and Tier 2, for securities offerings up to $50 million annually. Regulation A+ also specifies issuer eligibility and content and filing requirements for offering statements and introduces ongoing reporting requirements. In addition, the new rules impose certain investment limitations on investors in Tier 2 offerings, prescribe conditions for permissible "testing the waters" activity, and address the treatment of Regulation A offerings under state securities laws.[1] The new rules will become effective 60 days following publication in the Federal Register.

Background

Section 401 of the JOBS Act added Section 3(b)(2) to the Securities Act of 1933 (as amended, the "Securities Act"), which directs the SEC to adopt rules exempting from the registration requirements of the Securities Act offerings of up to $50 million of securities in any 12-month period. Prior to these amendments, the Regulation A exemption from registration was limited to offerings of up to $5 million in any 12-month period. In addition, securities sold in Regulation A offerings were typically required to comply with the registration and qualification requirements of the securities laws of the states in which the securities were offered, making offerings more costly. This low offering limit and lack of state securities law pre-emption have been identified as principal reasons for the low number of Regulation A offerings.[2] The Regulation A+ rules seek to address these issues by raising the offering limitations to $20 million (new Tier 1) and introducing the new Tier 2 category for offerings of up to $50 million, and by pre-empting Tier 2 offerings from the registration and qualification requirements of state securities laws.

Scope of Exemption

Eligible Issuers

The new rules preserve the previously existing issuer eligibility requirements of Regulation A, with the limited addition of two new categories of ineligible issuers. Accordingly, eligibility for the exemption continues to be limited to issuers organized, and with a principal place of business, in the United States or Canada. The Commission considered whether to extend the exemption to foreign private issuers generally, as recommended by a number of commentators,[3] but postponed that decision to the next review of the rules in order to better assess the impact of the new rules.[4]

The new rules continue to be unavailable for the following issuers: Companies subject to the ongoing reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"), companies registered or required to be registered under the Investment Company Act of 1940 and business development companies, blank check companies, issuers of fractional undivided interests in oil or gas rights or similar interests in other mineral rights, and issuers subject to "bad actor" disqualification under Rule 262 of Regulation A.

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[1] Securities Act Release No. 33-9741 (March 25, 2015) (the "Release").
[2] See, e.g., Statement of Commissioner Luis A. Aguilar, March 25, 2015
[3] Release at 19 f.
[4] Release at 24.

The new rules add two additional categories that are excluded from Regulation A eligibility in order to incentivize issuers to comply with their Exchange Act reporting obligations: first, issuers that have not complied with their obligation to file ongoing reports under Regulation A during the two years (or shorter) before filing a new offering statement; and second, issuers that are, or have been, subject to any order of the Commission denying, suspending, or revoking the registration of a class of securities pursuant to Section 12(j) of the Exchange Act that was entered within five years before the filing of the offering statement.

The new rules also amend the “bad actor” disqualification provisions of Regulation A to align them with the “bad actor” provisions that were incorporated into Regulation D pursuant to the Dodd-Frank Act in 2013.

Eligible Securities

The final rules limit the types of securities eligible for sale under Regulation A to equity securities, debt securities, and debt securities convertible or exchangeable into equity interests, including any guarantees of such securities. Asset-backed securities are expressly excluded from the definition of eligible securities.

New Offering Limitations and Permitted Secondary Sales

The new rules establish two tiers of offerings, Tier 1 and Tier 2.

To be eligible for the Tier 1 exemption, proceeds from offerings pursuant to Regulation A may not exceed $20 million within any 12-month period, including not more than $6 million from offers by selling securityholders that are affiliates of the issuer.

To be eligible for the Tier 2 exemption, proceeds from offerings pursuant to Regulation A may not exceed $50 million within any 12-month period, including not more than $15 million from offers by selling securityholders that are affiliates of the issuer.

The new rules also limit the amount of securities that selling securityholders (both affiliate and non-affiliate) can sell at the time of an issuer’s first Regulation A offering and within the following 12 months to no more than 30 percent of the aggregate offering price of a particular offering.

Non-affiliate securityholders that sell pursuant to a qualified offering statement after one year are not subject to a specific limit other than the maximum offer amount permitted by either Tier 1 or Tier 2.

With respect to the calculation of the offering limit, the new rules require issuers to aggregate the price of all securities for which qualification is being sought, including the securities underlying any rights to acquire that are convertible, exercisable, or exchangeable within the first year after qualification or at the discretion of the issuer. Moreover, the issuer is required to use the maximum estimated price for which such securities may be converted, exercised or exchanged.

The Commission is expected to review the offering limitations by April 2016 and then every two years.

Investment Limitation

The new rules impose investment limitations for certain purchasers in Regulation A offerings:

- accredited investors may purchase without limitation in Tier 1 and Tier 2 offerings;
- unaccredited investors may also purchase without limitation in Tier 1 offerings; and

- unaccredited investors in Tier 2 offerings are subject to a limitation of 10 percent of the greater of their annual income or net worth (if natural persons) or 10 percent of the greater of their annual revenue or net assets (if entities), unless the securities are listed on a national securities exchange.

Importantly, the new rules require issuers to notify investors of the investor limitations, but permit issuers to rely on a representation of compliance with the investment limitation from the investor, unless the issuer knew at the time of sale that any such representation was untrue. The Commission noted that this policy is intended to facilitate protection of confidential financial information of investors while avoiding restrictive practices that would impair the use of the new rules.

Integration

The new rules preserve the existing integration safe harbor under Regulation A, which lists those categories of other offerings that will not be integrated with the Regulation A offering to be considered as one offering, including prior offers or sales of securities, subsequent offers and sales that are registered with the SEC, offerings that take place more than six months after completion of the Regulation A offering, offerings pursuant to Regulation S, and certain other offerings. The new rules add subsequent crowdfunding offers or sales made pursuant to Section 4(a)(6) of the Securities Act to the safe harbor.

Exemption from Registration Requirements of Section 12(g)

Section 12(g) of the Exchange Act requires, among other things, that an issuer with total assets exceeding $10 million and a class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited investors, register such class of securities with the Commission.

The new rules provide an important exemption from these registration requirements for securities issued in a Tier 2 offering for so long as the issuer remains subject to, and is current in, its Regulation A periodic reporting obligations. In addition, the issuer must engage an SEC-registered transfer agent. This exemption from Section 12(g) is only available to companies that have a public float of less than $75 million as of their most recently completed semiannual period or, in the absence of a public float, annual revenue of less than $50 million (similar to the definition of "smaller reporting companies" under the Exchange Act rules). An issuer that exceeds either of these two thresholds, in addition to exceeding the other thresholds in Section 12(g), would be granted a two-year transition period before it would be required to register its class of securities pursuant to Section 12(g), provided it continues to timely file all ongoing reports required pursuant to Regulation A.

Offering Statements

Filing Requirements

All offerings under Regulation A will continue to require an offering statement on Form 1-A, which is subject to SEC staff review. The new rules require that an offering statement be declared qualified by a "notice of qualification" issued by the Division of Corporation Finance (analogous to a notice of effectiveness in registered offerings).

Non-Public Submission of Draft Offering Statements

The new rules permit non-public submission of draft offering statements to the SEC by issuers whose securities have not been previously sold pursuant to a qualified offering statement under Regulation A or an effective registration statement under the Securities Act.

The initial non-public submission, all non-public amendments to such submission, and correspondence with the Commission staff regarding such submission, must be publicly filed and available on EDGAR as exhibits to the public offering statement not less than 21 calendar days before qualification of the offering statement.

Electronic Filing; Delivery Requirements

The new rules generally require all forms to be submitted electronically on EDGAR.

The Commission has adopted an "access equals delivery" model for final offering circulars when sales are made on the basis of offers conducted during the prequalification period and the final offering circular is filed and available on EDGAR. Where a preliminary offering circular is used and the issuer is not already subject to the ongoing reporting requirements for Tier 2 offerings, the issuer and any broker dealers will be required to deliver the preliminary offering circular to prospective purchasers at least 48 hours prior to a sale.

The new rules also permit "electronic-only" offerings subject to obtaining consent of the investors or otherwise being able to evidence the receipt by investors of all required documents. Under specified circumstances an offering circular can be withdrawn by an issuer if securities are not sold, and the SEC can declare an offering abandoned if it languishes for more than nine months.

Form and Content

Offering Circular

The offering statement requirements set forth in Part II of amended Form 1-A allow issuers to choose between two disclosure formats — a revised Model B format (renamed "Offering Circular") and Part I of Form S-1,[5] eliminating the current third choice of a Model A, which is in question-and-answer format.

The most notable change to the disclosure requirements for an Offering Circular (Model B) is the inclusion of a new section containing management discussion and analysis of the issuer's liquidity, capital resources and business operations (MD&A) covering the two most recently completed fiscal years and interim periods, if required. The new MD&A disclosure requirements are similar to the disclosures required under Item 303 of Regulation S-K for registered offerings, except that they do not require disclosure of off-balance sheet arrangements or tabular disclosure of contractual obligations.

Financial Statements

The final rules largely maintain the existing financial statement requirements for Tier 1 offerings, except that balance sheets now need to be filed for two years (along with the other required financial statements as of the two most recently completed fiscal year ends). In particular, financial statements for Tier 1 offerings need not be audited, as is currently the case.

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[5] See Part II of Form 1-A.

For Tier 2 offerings, a new requirement for audited financial statements has been included, which can be audited in accordance with either the auditing standards of the American Institute of Certified Public Accountants (AICPA) (referred to as U.S. Generally Accepted Auditing Standards or GAAS) or the standards of the Public Company Accounting Oversight Board (PCAOB). This provision is intended to provide issuers more flexibility in order to help contain issuer compliance costs.[6]

Additionally, consistent with the treatment of emerging growth companies under Section 102(b)(1) of the JOBS Act, the final rules permit issuers, where applicable, to delay the implementation of new accounting standards to the extent such standards provide for delayed implementation by non-public business entities, but that requires an issuer to make this choice at the time of the first Regulation A filing and to delay implementation of all such standards rather than only some.

Canadian issuers may prepare financial statements in accordance with either U.S. GAAP or International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

The new rules extend the permissible age of financial statements included in Form 1-A to nine months. Where the full year financial statements are more than nine months old, the offering statement must include interim financial statements that cover a period of at least six months.

Continuous or Delayed Offerings and Offering Circular Supplements

The new rules generally permit continuous or delayed offerings subject to certain conditions. The new rules also permit offering circular supplements to be used for final pricing information.

Short Form Registration under the Exchange Act

The new rules permit a Tier 2 issuer to use a Form 8-A short-form registration statement to register under the Exchange Act in conjunction with obtaining a listing on a national securities exchange, instead of requiring a full Form 10 registration statement. The Form 8-A must be filed in conjunction with the qualification of the relevant Form 1-A offering statement, the issuer must provide the information required by Part I of Form S-1 as opposed to the Model B Offering Circular, and the issuer's financial statements must be audited in accordance with the standards of the PCAOB.

After effectiveness of the Form 8-A, the issuer will be subject to Exchange Act ongoing reporting and, to the extent it otherwise qualifies for such status, will be considered an "emerging growth company."

Solicitation of Interest (Testing the Waters)

Under the new rules, issuers will be permitted to test the waters with all potential investors and use solicitation materials both before and after the offering statement is filed. Testing the waters materials must be filed as exhibits to the offering statement.

All solicitation materials remain subject to the antifraud and other civil liability provisions of the federal securities laws. In addition, some state securities laws may impose limitations on the use of testing the waters materials by Tier 1 issuers.

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[6] Release at 296.

Periodic and Current Reporting

Tier 1 issuers do not incur ongoing reporting obligations other than the filing of an exit report containing certain summary information prescribed in new Form 1-Z not later than 30 calendar days after the termination or completion of the offering.

The new rules include the following extensive periodic and current reporting requirements for Tier 2 issuers to file annual reports, semi-annual reports, and current event reports:

- Annual reports on new form 1-K must be filed within 120 days after the end of the issuer's fiscal year and must include disclosure with respect to, among other things: the business operations of the issuer for the prior three fiscal years (or since inception); an MD&A discussing the issuer's operating results, liquidity and capital resources, and trend information for the two most recently completed fiscal years; directors, executive officers, and significant employees; executive compensation for the most recent fiscal year for the three highest paid executive officers; beneficial ownership of voting securities by executive officers, directors, and 10 percent owners; related-party transactions; and audited financial statements for the two most recent fiscal years.

- Semi-annual reports on new form 1-SA must be filed within 90 days after the end of the first six months of the issuer's fiscal year and must include interim financial statements and an MD&A, which do not need to be audited or reviewed. The interim report is similar to Form 10-Q but with reduced disclosure requirements. For example, there is no requirement to include quantitative and qualitative disclosures about market risk or controls and procedures disclosures.

- Current reports on new form 1-U must be filed within four business days after the occurrence of the triggering event. Triggering events are similar to a number of the events that SEC registered companies report on Form 8-K but do not include all of the Form 8-K items. It does include fundamental changes in the nature of an issuer's business, bankruptcy or receivership, material modification to the rights of securityholders, changes in the issuer's certifying accountant, non-reliance on previous financial statements, changes in control of the issuer, departure of key management, and unregistered sales of 10 percent or more of outstanding equity securities.

Suspension of Ongoing Reporting

A Tier 2 issuer must continue to report under Regulation A until it becomes subject to the periodic reporting requirements under the Exchange Act. In a manner analogous to the ability of larger issuers to cease reporting under certain circumstances, an issuer under Regulation A may suspend reporting at any time after filing its first Form 1-K, if it has filed all reports required by Regulation A for the shorter of (1) the period since the issuer became subject to such reporting obligation, or (2) its most recent three fiscal years and the portion of the current year preceding the date of filing an exit report on Form 1-Z, and the securities of each class to which the offering statement relates are held of record by fewer than 300 persons and offers or sales made in reliance on a qualified Tier 2 offering statement are not ongoing.

Relationship with Information Requirements Under Rules 144 and 144A

The SEC decided that Tier 2 ongoing reports do not satisfy the current information requirements for purposes of the resale safe harbors in Rule 144 and Rule 144A for an issuer's entire fiscal year, but instead only for those portions of the fiscal year during which the financial statements satisfy those rules.

The SEC noted that issuers can voluntarily submit quarterly financial and other information on Form 1-U to satisfy the information requirements of these resale safe harbors.[7]

State Securities Law

As a result of federal pre-emption and the JOBS Act, Tier 2 offerings are exempt from state law registration and qualification requirements if sold to qualified purchasers or listed on a national securities exchange. Notwithstanding this pre-emption, states may still require the filing of all offering materials, payment of fees, and issuer consent to service of process, and they retain the power to enforce anti-fraud provisions. Tier 1 offerings will continue to be subject to all state securities law requirements but may be able to benefit from the multistate review program the North American Securities Administrators Association Inc. recently implemented to accelerate the review of Regulation A filings.

Conclusions

The requirements for the new category of Tier 1 offerings remain largely in line with the previously existing rules under Regulation A other than the useful increase in the maximum offering size. The increase in the offering limit from $5 to $20 million may make capital raisings under this alternative more attractive to a number of issuers as the cost of preparing an offering can be a smaller percentage of the offering size. However, Tier 1 offerings remain subject to state securities laws and a number of public disclosure obligations, including the new requirement for an MD&A.

The new Tier 2 regime creates a form of "mini-public offering" with a number of requirements that resemble those of a fully registered offering, in particular the requirements for two years of audited financial statements and the new periodic and current reporting requirements. Unlike a registered public offering, however, Tier 2 does not require certain MD&A items that are required for public offerings, and there is more flexibility around the standards applied to the issuer's audited financial statements. In addition, Tier 2 issuers need only prepare a six-month interim report as compared to the quarterly reports required for registered issuers, and the obligation to file current reports is not as broad as for registered issuers. Companies wishing to plan a Tier 2 offering will need to plan ahead in particular to be ready for the timelines of ongoing reporting and the process of auditing their financial statements, but will benefit from the elimination of many state securities law burdens.

The planned review of the offer limitations in April 2016 will allow a timely assessment of whether the thresholds need to be further increased in order to incentivize small and medium-sized companies to use the Regulation A+ regime. In addition, the overall review of the rules planned after five years will provide an opportunity to review whether the new system of two tiers of offerings is too complex and whether the alleviations in Tier 2 compared to fully registered offerings make it sufficiently attractive for companies to use the Tier 2 rules. Before the five-year review of the rules, it is likely that market participants will make further comments on the operation of the rules and that the SEC will issue guidance on various aspects of the functioning of the rules. We will keep you informed of any future guidance.

The new rules are complex and often technical and the foregoing should not be taken as legal advice with respect to any particular company's or individual's circumstances. Greenberg Traurig attorneys would be happy to discuss the new rules with you in more detail and to answer any questions in light of your specific circumstances.

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[7] Release at 186.

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