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## SEC Adopts Regulation A+ Rules

***As amended, Regulation A now provides an exemption from registration for certain issuers offering up to US\$50 million of securities in a 12-month period.***

On March 25, 2015, the Securities and Exchange Commission (SEC) adopted final amendments to Regulation A under the Securities Act of 1933 (the Securities Act).<sup>1</sup> The amended Regulation A, often called Regulation A+, updates and expands the prior exemption from registration under Regulation A in response to the mandate under Title IV of the Jumpstart Our Business Startups (JOBS) Act. Historically, Regulation A offerings have been rare. For example, only seven Regulation A offerings occurred in 2010 and 2011 combined, as compared to 15,711 Regulation D offerings during that same period.<sup>2</sup> Regulation A+ is intended to increase the utility of the historically seldom-used Regulation A exemption.

Regulation A+ provides for two tiers of offerings that are exempt from the ordinary registration requirements of the Securities Act:

- Tier 1 offerings of up to US\$20 million in securities in a 12-month period (with a limit of US\$6 million in offers by selling security-holders that are affiliates of the issuer)
- Tier 2 offerings of up to US\$50 million in securities in a 12-month period (with a limit of US\$15 million in offers by selling security-holders that are affiliates of the issuer)<sup>3</sup>

In addition to the limits on sales by affiliates, Regulation A+ limits sales by all selling security-holders to 30 percent of offerings during the subsequent 12 months.<sup>4</sup>

The primary advantage of a Tier 2 offering over a Tier 1 offering (other than the higher maximum offering amount of US\$50 million) is that Regulation A+ provides for the preemption of registration and qualification requirements under state blue sky securities laws. While both Tier 1 and Tier 2 offerings are subject to certain basic requirements, Tier 2 issuers must include audited financial statements in their offering documents and file annual, semi-annual and current reports with the SEC. In addition, purchasers in Tier 2 offerings are subject to limitations on the amount they may invest, unless they are accredited investors<sup>5</sup> or the securities are registered on a national exchange. The final rules also preserve several existing provisions of Regulation A, including provisions regarding issuer eligibility, offering circular contents, testing the waters, and “bad actor” disqualifications.<sup>6</sup>

Tier 1 offerings under Regulation A+ may be of limited utility for issuers because Tier 1 offerings remain subject to state blue sky securities laws, similar to Regulation A offerings before the JOBS Act. Tier 2 offerings, in contrast, may see wider market acceptance, given the preemption of state blue sky securities laws and the increased limit in the size of offerings.

However, unlike private placements under Section 4(a)(2) of the Securities Act or pursuant to Regulation D, offerings under Regulation A+ are subject to liability under Section 12(a)(2) of the Securities Act, and Regulation A+ requires initial and continuing disclosure obligations, although such obligations are less onerous than those required of most public companies. In addition, Regulation A+ is not available to companies that are subject to the reporting requirements of the Securities Exchange Act of 1934 (the Exchange Act), which significantly limits the availability of Regulation A+.

## **Scope of the Regulation A+ Exemption**

### **Eligible Issuers**

The Regulation A+ exemptions are only available to companies organized in and with their principal place of business in the United States or Canada; non-Canadian foreign private issuers may not take advantage of Regulation A+. In addition, Regulation A+ will not be available to:

- Public companies subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act
- Companies that are registered or required to be registered under the Investment Company Act of 1940; are business development companies (also known as BDCs); or are blank check companies
- Companies that issue fractional undivided interests in oil, gas or mineral rights
- Companies that have not filed the ongoing reports required by Regulation A+ during the two years immediately preceding the filing of a new offering statement (or for such shorter period that the issuer was required to file such reports)
- Companies that have been subject to an order by the SEC under Section 12(j) of the Exchange Act that was entered within five years before the filing of the offering statement
- Companies that are subject to “bad actor” disqualification under Securities Act Rule 262<sup>7</sup>

Regulation A+ is available to issuers irrespective of their size or enterprise value, and the eligible securities include essentially all equity and debt securities other than asset-backed securities.<sup>8</sup>

### **Limitations on Offering Amounts and Sales by Security-holders**

Tier 1 offerings are limited to US\$20 million in any 12-month period while Tier 2 offerings are limited to US\$50 million in any 12-month period. In calculating the offering amount, issuers are required to include any rights to acquire the securities that are convertible, exercisable, or exchangeable into such securities within the first year after qualification or at the discretion of the issuer (which is consistent with the treatment of rights in the context of a registered offering).<sup>9</sup>

The final rules permit sales by selling security-holders generally, but limit the total amount of such sales in the first 12 months following a Regulation A+ offering to 30 percent of the aggregate offering price.<sup>10</sup>

After the expiration of the 12-month period following the offering, the limitations on secondary sales affect selling security-holders differently, depending on whether they are an affiliate of the issuer. Sales by affiliates of the issuer that are made pursuant to a qualified offering statement are always limited to either US\$6 million (for Tier 1) or US\$15 million (for Tier 2) over a 12-month period, even for sales that occur following the expiration of the first year after the issuer's initial qualification of an offering statement. In contrast, non-affiliates' sales that are made pursuant to a qualified offering statement following the expiration of the first year after an issuer's initial qualification of an offering statement are limited to the maximum offering amount permitted (US\$20 million for Tier 1 or US\$50 million for Tier 2).

## Investment Limitations

Under the final rules, purchasers who do not qualify as accredited investors under Rule 501 of Regulation D may not purchase securities in a Tier 2 offering in an amount that exceeds either of the following:

- 10 percent of the greater of annual income or net worth (for natural persons)
- 10 percent of the greater of annual revenue or net assets at fiscal year end (for non-natural persons)<sup>11</sup>

These investment limitations do not apply to purchasers who qualify as accredited investors. Furthermore, these investment limitations do not apply if the securities will be listed on a national securities exchange. While the final rules do not contain investment limitations with respect to purchasers in a Tier 1 offering, applicable state blue sky securities laws may contain investment limitations based on the status of the purchaser.

Issuers are required to notify investors of these investment limitations and may rely on an investor's representation that he/she is in compliance with the investment limitations unless the issuer knew at the time of sale that such representation was inaccurate.

## Integration with Other Securities Offerings

Regulation A+ contains an integration safe harbor, which provides that offerings pursuant to Regulation A+ will not be integrated with:

- Prior offers or sales of securities
- Subsequent offers and sales of securities that are:
  - registered under the Securities Act, except as provided in Securities Act Rule 255(c)
  - made pursuant to Securities Act Rule 701
  - made pursuant to an employee benefit plan
  - made pursuant to Regulation S
  - made pursuant to Section 4(a)(6) of the Securities Act; or
  - made more than six months after completion of the Regulation A+ offering<sup>12</sup>

## Exchange Act Section 12(g)

For issuers that would otherwise trigger the registration under Section 12(g) of the Exchange Act, Regulation A+ contains a conditional exemption for securities issued in a Tier 2 offering, provided that the issuer:

- Engages a registered transfer agent to conduct the offering
- Remains subject to Tier 2 reporting obligations
- Is current in its Tier 2 reporting obligations such as annual and semi-annual reporting to the SEC; and
- Had a public float under US\$75 million as of the end of the most recent semi-annual reporting period; or, in the absence of a public float, had annual revenues of less than US\$50 million as of the most recent fiscal year end<sup>13</sup>

If an issuer later exceeds either the US\$75 million float threshold or the US\$50 million annual revenue threshold (in addition to exceeding the threshold for registration under Section 12(g) of the Exchange Act), the issuer 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 timely files all ongoing reports due pursuant to Rule 257 during such period. An issuer entering Exchange Act reporting will be considered an “emerging growth company” to the extent the issuer otherwise qualifies for such status.

## Offering Statement and Offering Process

### Form 1-A

Issuers are required to file an offering statement on Form 1-A with the SEC electronically using the EDGAR system. Form 1-A consists of three parts: Part I (Notification); Part II (Offering Circular); and Part III (Exhibits). Issuers are permitted to incorporate by reference certain information that is already available on EDGAR. Other documents which must be submitted in conjunction with a Regulation A+ offering, such as ongoing reports, must generally be submitted or filed electronically on EDGAR as well.<sup>14</sup>

Issuers may submit non-public offering statements and amendments for review by the staff of the Division of Corporation Finance before filing such documents with the SEC, so long as all such documents are publicly filed not later than 21 calendar days before qualification.<sup>15</sup>

The Offering Circular disclosure in Part II of Form 1-A is fairly substantial and “akin to what is required of smaller reporting companies in a prospectus for a registered offering.”<sup>16</sup> The Offering Circular disclosure covers the following (although the specific nature of the required disclosures may vary slightly depending on whether the issuer is conducting a Tier 1 or Tier 2 offering):

- Basic information about the issuer, the offering and any underwriters
- Disclosure of any underwriting discounts and commissions
- Summary of risk factors
- Material disparities between offering price and cost of shares acquired by insiders during the past year
- Plan of distribution
- Disclosure regarding selling security-holders
- Use of proceeds
- Business operations for the prior three fiscal years (or since inception, if less than three years)
- Physical property/real estate
- Discussion and analysis of the issuer’s liquidity and capital resources and results of operations
- Identification and discussion of directors, executive officers and significant employees
- Scaled executive compensation disclosure
- Beneficial ownership of voting securities by officers, directors and 10 percent owners
- Transactions with related persons, promoters and certain control persons
- Material terms of the securities being offered<sup>17</sup>

### Financial Statements

Both Tier 1 and Tier 2 issuers are required to file balance sheets and other required financial statements as of the two most recently completed fiscal year end dates. Tier 2 issuers are required to file audited financial statements, while Tier 1 issuers may file unaudited financial statements (provided that they have not already obtained audited financial statements for other purposes).

Issuers domiciled in the US must prepare their financial statements in accordance with US generally accepted accounting procedures (GAAP), while Canadian issuers may prepare their financial statements in accordance with either US GAAP or International Financial Reporting Standards as issued by the International Accounting Standards Board (IASB IFRS).<sup>18</sup>

Consistent with the treatment of emerging growth companies under Section 102(b)(1) of the JOBS Act, Regulation A+ permits issuers, where applicable, to delay implementing new accounting standards to the same extent as private companies.<sup>19</sup>

## Offering Circular Delivery Requirements

During the prequalification period, issuers and intermediaries generally are required to deliver a preliminary offering circular to prospective purchasers at least 48 hours in advance of sale. However, when an issuer is subject to (and current with respect to) ongoing Tier 2 reporting obligations, such delivery is not required and issuers and intermediaries are only subject to the general delivery requirements for offers.<sup>20</sup>

With respect to the final offering circular, the rules reflect an “access equals delivery” model provided that sales are made on the basis of offers conducted during the prequalification period and the final offering circular is available on EDGAR. Within two business days after completing a sale, issuers and intermediaries must provide purchasers either with a copy of the final offering circular or a notice identifying where the final offering circular may be obtained on EDGAR along with instructions on how to contact the issuer or intermediary to request a copy of the final offering circular.<sup>21</sup>

## Qualification and Withdrawal

Offering statements must be “qualified” by the SEC before sales may be made pursuant to Regulation A+, and offering statements may be declared qualified by a “notice of qualification” issued by the Division of Corporation Finance. The notice of qualification is analogous to a notice of effectiveness in registered offerings.<sup>22</sup>

Issuers may withdraw an offering statement, with the consent of the Director of the Division of Corporation Finance, if none of the securities that are the subject of such offering statement have been sold and such offering statement is not the subject of temporary suspension order issued by the SEC.<sup>23</sup>

## Continuous or Delayed Offerings and Offering Circular Supplements

Regulation A+ permits continuous or delayed offerings, but issuers in continuous or delayed Tier 2 offerings are required to be current in their annual and semi-annual reporting obligations in order to conduct such an offering. Additionally, issuers may qualify additional securities in reliance on Regulation A+ by filing a post-qualified amendment to a qualified offering statement.<sup>24</sup>

The final rules provide for the following types of continuous or delayed offerings:

- Securities offered or sold by or on behalf of a person other than (i) the issuer, (ii) its subsidiary or (iii) a person of which the issuer is a subsidiary
- Securities offered and sold pursuant to (i) a dividend or interest reinvestment plan or (ii) an employee benefit plan
- Securities issued upon the exercise of outstanding options, warrants or rights
- Securities issued upon conversion of other outstanding securities
- Securities pledged as collateral
- Securities that are part of an offering which commences within two calendar days after the qualification date, will be offered on a continuous basis, may continue to be offered for a period in excess of 30 days from the date of initial qualification, and will be offered in an amount that, at the time the offering statement is qualified, is reasonably expected to be offered and sold within two years from the initial qualification date<sup>25</sup>

## Testing the Waters

Issuers may solicit interest in a potential offering from the general public, both before or after the filing of the offering statement. However, any solicitation materials the issuer uses after publicly filing the offering

statement must be accompanied by a preliminary offering circular or contain the URL where the preliminary offering statement may be obtained.<sup>26</sup>

Such “testing the waters” is subject to issuer compliance with the rules on filing and disclaimers, and solicitation material are subject to the antifraud and other civil liability provisions of the federal securities laws. Solicitation materials must be filed as exhibits to the offering statement once submitted for non-public review or filed, but issuers are not necessarily required to submit solicitation materials at or before the time of their first use.

The treatment of solicitation materials in Regulation A+ offerings is generally consistent with the treatment of solicitation materials used by emerging growth companies under Securities Act Section 5(d), with two notable exceptions:

- Solicitation materials used in Regulation A+ offerings must be included with the offering statement.
- Solicitation materials used by Regulation A+ issuers that file an offering statement with the Commission will be publicly available as a matter of course.<sup>27</sup>

## Ongoing Reporting Obligations

Tier 1 issuers are not subject to any ongoing reporting obligations other than the obligation to provide certain information on Form 1-Z within 30 days after the completion or termination of the offering (such as the date that the offering commenced, the total amount of securities sold, the price of the securities sold, net proceeds to the issuer, etc.). Tier 2 issuers provide similar information on either Form 1-K or Form 1-Z, depending on when the offering is terminated or completed.<sup>28</sup>

Tier 2 issuers are required to file each of the following reports with the SEC on an ongoing basis using EDGAR:

- Annual reports on Form 1-K
- Semi-annual reports on Form 1-SA
- Current event reports on Form 1-U<sup>29</sup>

Form 1-K is similar in scope to Form 1-A and covers:

- Business operations of the issuer for the prior three fiscal years (or since inception)
- Transactions with related persons, promoters and certain control persons
- Beneficial ownership of voting securities by executive officers, directors and 10 percent owners
- Identities of directors, executive officers and significant employees; with a description of their business experience and involvement in certain legal proceedings
- Executive compensation data for the most recent fiscal year for the three highest paid executive officers or directors
- Management discussion and analysis of the issuer’s liquidity, capital resources and results of operations covering the two most recently completed fiscal years
- Two years of audited financial statements<sup>30</sup>

Form 1-K includes requirements for financial statements prepared on the same basis, and subject to the same requirements as to audit standards and auditor independence, as the financial statements required in the Regulation A+ offering circular for Tier 2 offerings. Form 1-K must be filed within 120 calendar days after the issuer’s fiscal year end.<sup>31</sup>

Tier 2 issuers must submit a current report on Form 1-U when they experience one or more of the following events:

- Fundamental changes
- Bankruptcy or receivership
- Material modification to the rights of security-holders
- Changes in the issuer's certifying accountant
- Non-reliance on previous financial statements or a related audit report or completed interim review
- Changes in control of the issuer
- Departure of the principal executive officer, financial officer or accounting officer
- Unregistered sales of 10 percent or more of outstanding equity securities<sup>32</sup>

Regulation A+ permits Tier 2 issuers to terminate or suspend their ongoing reporting obligations on a basis similar to the provisions that allow issuers to suspend their ongoing reporting obligations under Section 13 and Section 15(d) of the Exchange Act, provided that certain conditions are met. An issuer's obligation to continue to file ongoing reports in a Tier 2 offering under Regulation A+ will be suspended immediately upon the filing of a notice to the SEC on Part II of proposed Form 1-Z.<sup>33</sup>

### **Ongoing Reporting on Exchange Act Rule 15c2-11 and Resales Under Rules 144 and 144A**

To facilitate market making by broker-dealers, Regulation A+ amends Exchange Act Rule 15c2-11(a) so that a Tier 2 issuer's ongoing reports satisfy the specified information about an issuer and its security that a broker-dealer must review before publishing a quotation for a security in a quotation medium.<sup>34</sup>

In order to satisfy the information requirements of Rules 144 and 144A, a Tier 2 issuer must voluntarily file quarterly financial statements in addition to the semi-annual financial statement requirements of Regulation A+. That is, a Tier 2 issuer that is current in its semi-annual reporting as required under Regulation A+ *and* voluntarily provides quarterly financial statements on Form 1-U during a given year will have provided reasonably current and adequate current public information for the entirety of such year for purposes of Rule 144 and Rule 144A.<sup>35</sup>

### **Bad Actor Disqualification**

Regulation A+ conforms the bad actor disqualification provisions of Regulation A substantially to those adopted under Rule 506 of Regulation D.<sup>36</sup>

Regulation A+ also contains a reasonable care exception to the disqualification provisions, consistent with Rule 506(d). An issuer will not lose the benefit of the Regulation A+ exemption if it is able to show that it did not know, and in the exercise of reasonable care could not have known, of the existence of a disqualification.<sup>37</sup>

### **Liability Considerations**

Regulation A+ offerings expose issuers to increased liability in private litigation as compared to private placements under Section 4(a)(2) of the Securities Act or Regulation D. In particular, Regulation A+ offerings are subject to Section 12(a)(2) liability under Section 3(b)(2)(D) of the Securities Act. As a result, potential private plaintiffs in Regulation A+ offerings will not need to show *scienter* (intent to deceive, manipulate or defraud) when conducting private litigation against Regulation A+ issuers. By contrast, Section 12(a)(2) does not apply to other unregistered offerings, as a result of the US Supreme Court's 1995 decision in *Gustafson v. Alloyd Co.*, 513 US 561, 564, 584 (1995).

## State Law Preemption

Regulation A+ allows for the preemption of registration and qualification requirements of state blue sky securities laws for securities offered or sold to “qualified purchasers,” which are defined as any person to whom securities are offered or sold in a Tier 2 offering. Preemption of state blue sky securities laws is not available for Tier 1 offerings.<sup>38</sup>

## Conclusion

Regulation A+ significantly expands the existing Regulation A exemption from registration under the Securities Act and provides for two Tiers of exempt offerings, both of which may be offered and sold to the general public.

Tier 1 offerings are capped at a maximum offering amount of US\$20 million in a 12-month period. These offerings are not exempt from blue sky registration and, unless limited to regional offerings, they may thus find limited utility in much the same way as the current Regulation A.

Tier 2 offerings allow for a maximum offering amount of US\$50 million in a 12-month period and provide for preemption of state blue sky securities laws. Tier 2 offerings require the issuer to file audited financial statements as part of the Regulation A+ offering statement and to file ongoing annual, semi-annual and current reports with the SEC. While these ongoing requirements are not insignificant, they are not as extensive as the reporting requirements for most public companies. Accordingly, Tier 2 offerings may be attractive to certain issuers.

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**Endnotes**

<sup>1</sup> See SEC Release No. 33-9741 (Mar. 25, 2015) (hereinafter, Final Rules), available at: <http://www.sec.gov/rules/final/2015/33-9741.pdf>.

<sup>2</sup> See Factors that May Affect Trends in Regulation A Offerings, GAO-12-839 (July 2012), available at: <http://www.gao.gov/assets/600/592113.pdf>.

<sup>3</sup> See Final Rules at II.A.; see also Securities Act Rule 251(a)(1) and Rule 251(a)(2).

<sup>4</sup> See Final Rules at II.A.; see also Securities Act Rule 251(a)(3).

<sup>5</sup> See Rule 501(a) or Regulation D for the definition of an "accredited investor."

<sup>6</sup> See SEC Press Release 2015-49 (Mar. 25, 2015).

<sup>7</sup> See Final Rules at II.B.1.c.

<sup>8</sup> See Final Rules at II.B.2.c.; see also Securities Act Rule 261(c).

<sup>9</sup> See Final Rules at II.B.3.c.; see also note to Securities Act Rule 251(a).

<sup>10</sup> See Final Rules at II.B.3.c.; see also Securities Act Rule 251(a)(3).

<sup>11</sup> See Final Rules at II.B.4.c.; see also Securities Act Rule 251(d)(2)(i)(C).

<sup>12</sup> See Final Rules at II.B.5.c.; see also Securities Act Rule 251(c).

<sup>13</sup> See Final Rules at II.B.6.c.; see also Exchange Act Rule 12g5-1(a)(7).

<sup>14</sup> See Final Rules at II.C.3.; see also Securities Act Rule 251(e) and Rule 251(f).

<sup>15</sup> See Final Rules at II.C.2.; see also Securities Act Rule 252(d).

<sup>16</sup> See Final Rules at II.C.3.b.(1)(c).

<sup>17</sup> See Final Rules at II.C.2.c.

<sup>18</sup> See Final Rules at II.C.3.b.(2)(a).

<sup>19</sup> See Final Rules at II.C.3.b.(2)(c).

<sup>20</sup> See Final Rules at II.C.2.c.(2); see also Securities Act Rule 251(d)(2)(i).

<sup>21</sup> See Final Rules at II.C.2.c.(2).

<sup>22</sup> See Final Rules at II.C.5.; see also Securities Act Rule 252(e).

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<sup>23</sup> See Final Rules at II.C.1.c.(3); *see also* Securities Act Rule 259(a).

<sup>24</sup> See Final Rules at II.C.4.

<sup>25</sup> See Final Rules at II.C.4.c; *see also* Securities Act Rule 251(d)(3).

<sup>26</sup> See Final Rules at II.D.3.; *see also* Securities Act Rule 252.

<sup>27</sup> See Final Rules at II.D.3..

<sup>28</sup> See Final Rules at II.E.1.c.

<sup>29</sup> *Id.*

<sup>30</sup> See Final Rules at II.E.1.c.(1)(b).

<sup>31</sup> *Id.*

<sup>32</sup> See Final Rules at II.E.1.c.(3).

<sup>33</sup> See Final Rules at II.E.4.b.(2).

<sup>34</sup> See Final Rules at II.E.2.c.

<sup>35</sup> *Id.*

<sup>36</sup> See Final Rules at II.G.3.

<sup>37</sup> *Id.*; *see also* Securities Act Rule 262(b)(4).

<sup>38</sup> See Final Rules at II.H.3.