Proskauer

SEC Amendments to Regulation A Create New Exemptions for Offerings up to $50 Million

April 8, 2015

On March 25, 2015, pursuant to a JOBS Act mandate, the SEC adopted amendments to Regulation A, exempting offerings now of up to $50 million and eliminating some of the impediments to use of the exemption.

Popularly referred to as "Regulation A+," amended Regulation A now offers issuers and selling shareholders two options for relying on the exemption from registration – Tier 1 for offerings that do not exceed $20 million in a 12-month period and Tier 2 for offerings that do not exceed $50 million in a 12-month period. Previously, Regulation A was available only to offerings that did not exceed $5 million in a 12-month period, and offerings remained subject to state "blue sky" registration requirements. The new two-tier offering regime carries over some characteristics of existing Regulation A, such as the required filing of an offering statement and the ability to "test-the-waters." It adds new benefits, such as exemption from state "blue sky" registration requirements for Tier 2 offerings, and relaxes Exchange Act registration requirements; but it also adds new requirements, such as, for Tier 2 issuers, a uniform requirement to include audited financial statements and to file on-going periodic reports with the SEC.

Just as was the case under old Regulation A, purchasers in a Regulation A+ offering receive unrestricted shares that are freely tradable by non-affiliates under the securities laws. The absence of resale restrictions makes Regulation A more appealing than other private placement exemptions, and it is possible that it will become a popular tool for some issuers now that the maximum dollar amounts have been raised from the old $5 million threshold. However, we expect that many issuers will continue to choose the path of a traditional registered public offering, rather than a Regulation A+ offering, because a Tier 2 offering still requires the preparation and review of an offering circular and ongoing periodic reporting, albeit in a more truncated form. We expect that other issuers wishing to avoid registration will continue to rely on Rule 506 under Regulation D, which offers many of the same benefits as amended Regulation A without many of the burdens (see the table at the end of this alert for a comparison). Nonetheless, we recommend that private issuers examine new Regulation A carefully before deciding on any course of financing.

The amendments will become effective 60 days from their publication in the Federal Register.

Scope of Exemption

Offering Size

For Tier 1 offerings, there is a limit of $20 million, including no more than $6 million by a selling shareholder, during a 12-month period. For Tier 2 offerings, there is a limit of $50 million, including no more than $15 million by a selling shareholder, during a 12-month period. For both Tier 1 and Tier 2 offerings, sales by a selling shareholder in an issuer's initial Regulation A offering (and any subsequent Regulation A offerings in the next 12 months) are limited to 30% of the aggregate offering price.

Type of Issuer

Regulation A is available only to companies organized in the United States or Canada that are not required to file Exchange Act reports. Additionally, certain types of issuers, such as blank check companies, companies registered under the Investment Company Act (including business development companies or "BDCs") and issuers of asset-backed securities, are ineligible to rely on the exemption.

Additionally, the amendment updated Regulation A's disqualification rules to substantially match the "bad actor" disqualification provisions of Rule 506 under Regulation D.

Type of Purchaser

Generally, any purchaser may participate in a Regulation A offering. However, for a Tier 2 offering, a purchaser who is not an accredited investor, as defined under Regulation D, cannot purchase securities constituting more than 10% of the greater of his or her annual income and net worth (in the case of a natural person) or 10% of the greater of its annual revenue and net assets at fiscal year end (in the case of a non-natural person). This limitation will not apply if the issuer, simultaneously with its Regulation A offering, lists the class of securities offered on a national securities exchange, such as the NASDAQ or the New York Stock Exchange.

Matters Related to the Offering

Offering Statement

Issuers relying on Regulation A must continue to file an offering statement on Form 1-A. Part II of the offering statement, which is known as the offering circular and is akin to a prospectus, requires disclosure of basic information about the company, including financial statements for the last two fiscal years. For Tier 2 offerings, these financial statements must be audited. For Tier 1 offerings, audited financial statements are only required if they were prepared for other purposes and are available. The SEC must qualify the offering statement before the issuer can make sales pursuant to Regulation A. Accordingly, the offering statement is subject to review and comment by the SEC staff.

Test-the-Waters Communication

Following the amendments, Regulation A continues to permit an issuer to engage in "test-the-waters" communication prior to and following the filing of the offering statement. Unlike Section 5(d) of the Securities Act for emerging growth companies (which limits testing the waters to qualified institutional buyers and institutional accredited investors), issuers relying on Regulation A may test the waters with all potential investors. Issuers must file any test-the-waters communication as exhibits to the publicly filed offering statement but do not need to do so at or before the time of first use. Additionally, any test-the-water communication following the filing of the offering statement must include delivery of the preliminary or qualified offering circular.

Confidential Submission, Electronic Filing and Delivery Requirements

Similar to emerging growth companies, issuers relying on Regulation A for the first time may submit their offering statement for confidential review by the SEC staff. If this is done, the issuer must publicly file the offering statement at least 21 days prior to the qualification of the offering statement. The amendments to Regulation A also modernize the filing process by requiring that any confidential submission and public filing be submitted to the SEC through EDGAR. Additionally, if a preliminary offering circular or test-the-waters communication is used prior to qualification of the offering statement, then each issuer and participating broker-dealer must deliver the preliminary offering circular to the prospective purchaser at least 48 hours in advance of a sale. These delivery requirements do not apply if the issuer is, at the time of the offering, subject to Tier 2's ongoing reporting requirements, which are discussed below. Following qualification, the final or qualified offering circular must accompany or precede any written offers.

Integration

The amendments to Regulation A substantially maintain the existing integration rules applicable to Regulation A offerings. Accordingly, offers and sales prior to the Regulation A offering will not be integrated with the Regulation A offering. The following types of subsequent offers and sales will not be integrated with a Regulation A offering: (i) transactions registered under the Securities Act (other than those following certain abandoned Regulation A offerings); (ii) transactions made pursuant to an employee benefit plan, under Rule 701 or otherwise; (iii) transactions made pursuant to Regulation S; (iv) transactions more than six months after the completion of the Regulation A offering; and (v) as added by the amendments, crowdfunding transactions conducted pursuant to Section 4(a)(6) of the Securities Act.

Ongoing Reporting and Exchange Act Matters

Ongoing Reporting

Following qualification of the offering statement, issuers relying on Regulation A (both Tier 1 and Tier 2) must publicly file a report providing information about the results of the offering, including the number of securities sold, the fees associated with the offering and the net proceeds to the issuer. For Tier 1 issuers, this exit report is the only ongoing reporting obligation. In contrast, Tier 2 issuers will become subject to ongoing reporting requirements similar to companies required to report under the Exchange Act. These requirements consist of an annual report on Form 1-K, a semiannual report on Form 1-SA and a current report on Form 1-U. After filing reports with respect to the year in which its offering statement was qualified, a Tier 2 issuer may suspend its reporting obligations if the class of securities that is the subject of the offering statement is held by fewer than 300 record holders and no offers or sales continue to be made pursuant to the qualified offering statement. This suspension is subject to the requirement that the Tier 2 issuer has filed all of its required reports for a certain period of time. Additionally, a Tier 2 issuer may suspend its reporting obligations under Regulation A if it becomes required to file periodic reports under the Exchange Act.

Exchange Act Matters

An issuer conducting a Tier 2 offering may wish to simultaneously register the class of securities under the Exchange Act. In this situation, the amendments permit the Tier 2 issuer to file a short-form registration statement on Form 8-A (as opposed to the longer Form 10) to register the class under the Exchange Act. However, to take advantage of the short-form registration statement, the Tier 2 issuer must provide prospectus-level disclosure (i.e., the disclosure required by Part I of Form S-1) in its offering statement.

Section 12(g) of the Exchange Act requires a company to register a class of securities if, as of the end of its fiscal year, there are at least 2,000 record holders or 500 record holders who are non-accredited investors and the company has more than $10 million in assets. The amendments to Regulation A exempt Tier 2 issuers from the Section 12(g) registration requirements under certain conditions. First, the issuer must use a transfer agent registered with the SEC. Second, the issuer must have a public float of less than $75 million, or, if there is no public float, have revenues of less than $50 million. If an issuer exceeds these thresholds as well as the Section 12(g) thresholds, then it must register under Section 12(g), subject to a two-year transition period.

State "Blue Sky" Laws

A particular impediment to the use of old Regulation A was the lack of an exemption from state "blue sky" registration requirements. Many commentators on the proposed Regulation A+ rules contended that the exemption would not be widely utilized if there was not a corresponding exemption from state "blue sky" laws. Amended Regulation A+ draws a distinction on the issue by subjecting Tier 1 offerings to full blue sky laws compliance and exempting Tier 2 offerings from blue sky law review. However, as required by Section 18 of the Securities Act, state securities regulators will continue to have the authority to require notice filings and bring enforcement action for fraudulent conduct with respect to Tier 2 offerings.

Comparison of Rule 506 and Tier 2 for Private Issuers

We expect issuers intending to raise up to $50 million to evaluate exempting their offering under Rule 506(b) or Rule 506(c) under Regulation D or the new Tier 2 under Regulation A. For each of these options, some aspects are the same, such as the exemption from state "blue sky" registration requirements and "bad actor" disqualifications. However, other aspects of the exemptions differ, and the table below summarizes the main differences.

	Rule 506(b)	Rule 506(c)	Regulation A Tier 2
Nature of purchasers	Accredited investors and up to 35 non-accredited investors who are sophisticated	Only accredited investors	No restrictions – but see below regarding investment limit
Purchasers' investment limit	No limit	No limit	Non-accredited investor cannot purchase more than 10% of greater of annual income / revenue and net worth / net assets
Restrictions on communications	General solicitation prohibited	General solicitation permitted	Test-the-water communications permitted, subject to certain conditions, and must be filed with the SEC

Disclosure document	No disclosure required if purchasers are solely accredited investors (but consider anti-fraud disclosure) Disclosure required if purchasers include non-accredited investors but disclosure document does not need to be filed with the SEC and is not subject to SEC staff review	No disclosure required (but consider anti-fraud disclosure)	Form 1-A must be filed with the SEC and is subject to SEC staff review
Integration	Prior and subsequent offers and sales may be integrated	Prior and subsequent offers and sales may be integrated	Prior offers and sales will not be integrated; some types of subsequent offers and sales also will not be integrated
Ongoing SEC filings	None, other than a Form D	None, other than a Form D	Issuer must file annual, semi-annual and current reports

Exemption from Section 12(g) of the Exchange Act	No exemption	No exemption	Exemption possible if the issuer uses an SEC-registered transfer agent, files its ongoing SEC reports (see above) and has less than $75 million of public float (or less than $50 million of revenues, if no public float)
Nature of securities sold	Restricted securities under Rule 144	Restricted securities under Rule 144	Not restricted securities under Rule 144

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A copy of the SEC's final rule amendments on Regulation A is available at the following link: http://www.sec.gov/rules/final/2015/33-9741.pdf

Related Professionals

- **Frank Zarb**
  Partner
- **Peter M. Fass**