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New Regulation A+ Rules Provide Access to Capital Markets and Alternative IPO Route to Smaller Issuers

WHITE PAPER

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Introduction

Tier 1 of the new Regulation A+ provides smaller issuers with the ability to raise up to $20 million through sales to an unlimited number of accredited and non-accredited investors, with no limits on the amount that non-accredited investors may invest. With no requirement to file audited financial statements or ongoing periodic reports, Tier 1 can be an efficient alternative to Regulation D for many issuers. ongoing periodic reports, Tier 1 can be an efficient alternative to Regulation D for many issuers.

Tier 2 of the new Regulation A+ allows issuers with a need to raise larger amounts of capital to access the capital markets without being subject to all of the costs of conducting an IPO and the associated ongoing Exchange Act reporting obligations. Like Tier 1 offerings, Tier 2 issuers may offer and sell securities to an unlimited number of accredited and non-accredited investors; however, non-accredited investors in Tier 2 offerings may only invest 10 percent of the greater of their annual income or net worth. While Tier 2 issuers are required to have their financial statements audited and must file some ongoing periodic reports, the Regulation A+ disclosure requirements do not rise to the level of Exchange Act reporting.

Tier 2 issuers also have the ability to voluntarily list their securities for trading on a national securities exchange, but thereafter, the issuer would be subject to the Exchange Act's more detailed reporting requirements.

History of Regulation A

Prior to the 2012 enactment of the Jumpstart Our Business Startups Act (JOBS Act), then-Section 3(b) of the Securities Act of 1933 (Securities Act) and Securities Act Rules 251 through 263 (Regulation A) provided an exemption from Securities Act registration. The exemption applied to offerings of up to $5 million in any 12-month period, including no more than $1.5 million in secondary sales by selling security-holders, by U.S. and Canadian issuers that are not:

- Reporting companies
- Investment companies
- Blank check companies
- Issuers of fractional undivided interests in oil or gas rights
- Issuers disqualified by Regulation A's "bad actor" provisions

Securities issued under Regulation A were not considered "covered securities" under Section 18(b) of the Securities Act and were subject to state registration and qualification requirements. For that reason, and the $5 million/12-month cap, Regulation A has not been a widely used exemption.

JOBS Act Impact on Regulation A

Section 401(a) of the JOBS Act amended Section 3(b) of the Securities Act and required the Securities and Exchange Commission (SEC) to adopt rules that would allow for the issuance of up to $50 million in securities over a 12-month period and would require issuers to file annual audited financial statements. The amendments to Section 3(b) of the Securities Act also require the SEC to review Regulation A every two years to determine whether the maximum aggregate offering amount under Regulation A should be increased. On March 25, 2015, the SEC adopted final rules to implement the new exemption that will take effect on June 19, 2015.

Scope of Exemption

The SEC's new rules, often referred to as "Regulation A+," provide for two new tiers of offerings under Regulation A and preserve parts of existing Regulation A with some modifications.

Eligible Issuers

The new rules preserve the existing exclusions from eligibility for certain issuers under Regulation A, and add two new exclusions from eligibility:

- Issuers that are, or have been within five years before the filing of the offering statement, subject to any order of the Commission to suspend or revoke any registration statement filed by the issuer; and
- Tier 2 issuers that are required to, but have not, filed the ongoing periodic reports required following a Tier 2 offering under Regulation A+ during the two years immediately preceding the filing of a new offering statement.

Eligible Securities
Under old Regulation A, a company could issue equity securities, debt securities and debt securities convertible or exchangeable into equity interests, including any guarantees of such securities. The new rules maintain these eligible securities, but clarify that all securities convertible or exchangeable into equity interests are eligible under Regulation A+ while explicitly excluding asset-backed securities, as defined in Regulation AB.

Offering Limitations and Secondary Sales
Under the new rules, there are two tiers of Regulation A+ offerings, with different offering limitations and limits on secondary sales by selling stockholders:

Tier 1: Offerings of up to $20 million in a 12-month period

- Secondary sales by all selling security-holders are limited to no more than 30 percent of the aggregate offering price of the issuer's initial Regulation A+ offering and to 30 percent of any subsequent Regulation A+ offerings for the first year following the initial Regulation A+ offering.
- Secondary sales by security-holders that are affiliates of the issuer in any offering made after the first year following the issuer's initial Regulation A offering are limited to $6 million in a 12-month period.

Tier 2: Offerings of up to $50 million in a 12-month period

- Sales by all selling security-holders are limited to no more than 30 percent of the aggregate offering price of the issuer's initial Regulation A offering and to 30 percent of any subsequent Regulation A offerings for the first year following the initial Regulation A offering.
- Secondary sales by security-holders that are affiliates of the issuer in any offering made after the first year following the issuer's initial Regulation A offering are limited to $15 million in a 12-month period.

Under both tiers, issuer sales, affiliate secondary sales, and non-affiliate secondary sales must be aggregated for purposes of calculating the $20 million or $50 million maximum offering amount (as applicable). An issuer may choose to conduct an offering under $20 million under either Tier 1 or Tier 2, and would be required to conduct such an offering under Tier 2 if, for example, there will be secondary sales by selling security-holders in excess of $6 million.

Investment Limitation
The rules provide that unless the securities will be listed for trading on a national securities exchange once they have been qualified by the SEC under Regulation A+, purchasers in Tier 2 offerings must either be:

- accredited investors, as defined in Rule 501(a) of Regulation D; or
- limited to purchasing not more than 10 percent of the greater of the non-accredited investor's annual income or net worth.

Issuers must inform non-accredited investors of the limitation on the amount that may be invested. Investors are not required to provide personal documentation to an issuer, and issuers are not required to take reasonable steps to verify an investor's compliance with the investment limitations. Issuers may rely on an investor's representation of compliance with the investment limitation, unless the issuer knows at the time of the sale that the representation is false.

Integration

- For purposes of determining whether an issuer has met or exceeded the $20 million Tier 1 or $50 million Tier 2 maximum offering amount in a 12-month period, Regulation A offerings will not be integrated with prior offers or sales of securities; or subsequent offers or sales of securities that are:
  - offerings registered under the Securities Act;
  - made pursuant to a compensatory benefit plan under Securities Act Rule 701;
  - made pursuant to an employee benefit plan;
  - made pursuant to Regulation S, which governs sales made outside the U.S.;
  - made pursuant to crowdfunding offers and sales conducted pursuant to Section 4(a)(6) of the Securities Act; or
  - made more than 6 months after completion of the Regulation A offering.

Treatment under Section 12(g)

Exchange Act Section 12(g) provides that issuers with total assets exceeding $10 million at the end of the fiscal year and a class of equity securities held of record by 2,000 or more persons or 500 or more non-accredited investors must register such class of securities with the SEC within 120 days of the end of the fiscal year and become subject to the quarterly and annual reporting requirements of the Exchange Act.

Tier 2-qualified securities are exempt from Section 12(g) as long as the issuer remains subject to and current in its ongoing periodic reporting obligations under Regulation A+, uses a transfer agent that is registered with the SEC, and:

- has a "public float" (as defined in the rule) for its common equity securities of less than $75 million, determined as of the last business day of its most recently completed second quarter; or
- does not have a public equity float because it only has publicly held debt securities, but has annual revenues of less than $50 million, as of its most recently completed fiscal year.

There is a two-year transition period for an issuer that exceeds the public float or revenue limits, has assets exceeding $10 million at the end of its fiscal year, and has equity securities held of record by 2,000 or more persons or 500 or more non-accredited investors.

Offering Statement

An issuer in a Regulation A+ offering must file an offering statement with the SEC and deliver a preliminary or final version of the offering statement to potential investors at the time of any offers and sales.

Qualification

A Regulation A+ offering statement is "qualified" by a "notice of qualification" issued by the SEC's Division of Corporation Finance in a manner similar to a registration statement being declared effective by the SEC. The new rules eliminate the immediate qualification of an offering statement, and all offering statements are now subject to review by the Division of Corporation Finance.

Electronic Filing; Delivery Requirements

An offering statement must be filed via EDGAR, the SEC's electronic filing system, and there is no associated filing fee. If a preliminary offering statement has been filed and an issuer uses it to offer securities prior to qualification, the issuer is not required to deliver a copy of the final offering statement to investors when the sale of the securities is consummated, as long as the final offering statement is filed and available to investors on EDGAR.

This "access equals delivery" method of delivering the final offering statement requires that the preliminary offering statement include a notice that the issuer may satisfy its delivery obligations for the final offering statement electronically. The issuer must also notify the investor no later than two business days after the completion of the sale of the following: (i) that the sale occurred pursuant to a qualified offering statement; (ii) the URL where the final offering statement may be obtained on EDGAR; and (iii) where a request for a copy of the final offering statement may be sent. However, if both an initial offer and final sale are made after the offering statement is qualified, the issuer is required to provide the investor with a copy of the final offering statement at the time of the initial offer.

Electronic-only offerings may be conducted by the issuer, eliminating the need to provide investors with paper copies of documents and information. If this method is chosen, the issuer and its participating intermediaries must obtain investors' consent to receive electronic delivery, or must otherwise be able to evidence receipt of electronically delivered documents.

Non-Public Submission of Draft Offering Statements

Regulation A+ issuers may submit a draft offering statement to the SEC for non-public review prior to filing the offering statement publicly on EDGAR. However, the Freedom of Information Act applies to these submissions and unless the issuer requests confidentiality pursuant to Securities Act Rule 83, the SEC may be required to make the offering statement public prior to its public filing on EDGAR. The offering statement will not be qualified until it has been publicly filed on EDGAR for at least 21 days.

Form and Content
Under the revised rules, Regulation A offering statements must be filed on Form 1-A, which consists of the following three parts:

- **Part I** – Captures key information about the issuer and its offering using a simple online form (similar to Form D) with drop-down menus, check boxes and buttons, and text boxes. Issuers must provide:
  - information about the issuer's identity, industry, number of employees, financial statements and capital structure, and contact information;
  - information regarding its eligibility to rely on Regulation A;
  - certification that the offering is not disqualified because of a "bad actor" event;
  - summary information about the offering, including, among other information, whether it is a Tier 1 or Tier 2 offering, the amount and type of securities offered, and any proposed secondary sales;
  - jurisdictions where the securities will be offered; and
  - disclosure about unregistered issuances or sales of securities within the last year.
- **Part II** – A text file containing the body of the offering statement and financial statements. Issuers must provide:
  - basic information about the issuer, the offering, underwriters, and underwriting discounts and commissions;
  - risk factors;
  - the dilutive effect of the offering;
  - the plan of distribution for the offering and disclosure regarding secondary sales by selling security-holders;
  - the issuer's planned use of the proceeds of the offering;
  - information about the business operations of the issuer for the past three years or since inception;
  - a description of material property owned or leased by the issuer;
  - management's discussion and analysis of financial condition and results of operations;
  - group-level executive compensation disclosure for the most recent year for the three highest paid executive officers or directors (Tier 2 requires individual compensation disclosure);
  - beneficial ownership of voting securities by officers, directors and 10 percent owners;
  - related party transaction disclosure;
  - material terms of the securities being offered; and
  - any events that would have triggered disqualification of the offering under the "bad actor" rules (see below), except that the events occurred prior to the effective date of the new rules.
- **Financial Statements**
  - Financial statements must be prepared in accordance with U.S. GAAP or, for Canadian Issuers, either U.S. GAAP or International Financial Reporting Standards.
  - Tier 2 issuers are required to file audited financial statements. The auditor must be independent under Rule 2-01 of Regulation S-X, but is not required to be registered with the Public Company Accounting Oversight Board (PCAOB). Financial statements must be audited either in accordance with U.S. generally accepted auditing standards or the PCAOB's auditing standards. If the issuer is conducting a Tier 2 Regulation A offering and plans to simultaneously list the securities on a national securities exchange, the financial statements must be audited in accordance with PCAOB auditing standards and by an auditor that is registered with the PCAOB.
  - Issuers may, consistent with the treatment of emerging growth companies, choose to delay the implementation of new accounting standards to the extent such standards provide for delayed implementation by non-public companies. The issuer's choice must be disclosed at the time it files the offering statement and the choice must apply to all standards.

- The financial statements must include:
  - balance sheets as of the end of the two most recently completed fiscal years;
  - statements of income, cash flows and stockholders' equity for each of the two fiscal years preceding the date of the most recent balance sheet and any interim period between the end of the most recent fiscal year and the date of the most recent balance sheet;
  - financial statements of significant acquired or to-be-acquired businesses; and
  - pro forma information relating to significant business combinations.
- **Part III** – Text file attachments containing signatures, an exhibit index, and exhibits to the offering statement.

Continuous or Delayed Offerings and Offering Circular Supplements
Regulation A offerings may be conducted, in some cases, on a continuous or delayed basis to promote flexibility and efficiency and to reduce unnecessary offering costs. Issuers must be current in any applicable ongoing periodic reporting requirements at the time of a sale.

Solicitation of Interest (Testing the Waters)

Under the new rules, issuers will be permitted to solicit indications of interest in a potential offering, or "test the waters" with all potential investors and use solicitation materials both before and after the offering statement is filed. A preliminary offering statement must accompany any soliciting materials used after the offering statement is filed (this requirement may be satisfied by providing the URL where the preliminary offering statement may be obtained), and the materials must be updated to the extent that they or the preliminary offering statement become materially inadequate or inaccurate. Soliciting materials must be filed as exhibits to the offering statement and must include a legend stating that sales are contingent upon the qualification of the offering statement.

Issuers should keep in mind that testing the waters is not the same as offering the securities pursuant to a general solicitation. General solicitation permits advertising of the offering itself to the general public; testing the waters only allows the issuer to directly notify specific investors and obtain their indications of interest in a potential offering. No money or other consideration may be solicited, and if sent, may not be accepted. No sales may be made or commitments to purchase accepted until the offering statement is qualified, and a prospective purchaser's indication of interest is non-binding. The soliciting materials must include a disclaimer to that effect.

The use of soliciting materials for testing the waters remains subject to state oversight in Tier 1 offerings. Because Tier 1 offerings do not impose an investment limitation on non-accredited investors, Tier 1 purchasers are not considered "qualified purchasers" for purposes of preemption of state securities laws.

Ongoing Periodic Reporting

Continuing Disclosure Obligations

- Tier 1 issuers must file the summary information required by Part I of new SEC Form 1-Z via EDGAR within 30 days after termination or completion of an offering, which includes:
  - the date the offering was qualified and commenced;
  - the amount of securities sold in the offering;
  - the price of the securities;
  - the portions of the offering that were sold on behalf of the issuer as well as any selling security-holders;
  - any fees associated with the offering; and
  - the net proceeds to the issuer.
- Tier 2 issuers must file ongoing periodic reports via EDGAR using alternate forms that are intended to have a lower cost of compliance than the annual and quarterly reports required of issuers with securities registered under the Exchange Act. The reports include
  - When the offering is terminated or completed, summary information required by Part I of Form 1-Z or Part I of Form 1-K

- Annual reports on Form 1-K within 120 days of the issuer's fiscal year end, consisting of the information about the issuer required by Part I and the following Part II information:
  - business operations for the last three years, or since inception;
  - prescribed related party transaction disclosures;
  - beneficial ownership of voting securities by executive officers, directors and 10 percent owners;
  - identity and business biographies of directors, executive officers and significant employees and disclosure of their involvement in certain legal proceedings;
  - executive compensation data for the most recent fiscal year for each of the three highest paid executive officers or directors;
  - management's discussion and analysis of financial condition and results of operations comparing the current and previous fiscal years; and
  - two years of audited financial statements.
- Semi-annual reports on Form 1-SA within 90 days after the end of the issuer's second fiscal quarter, consisting primarily of interim financial statements and management's discussion and analysis of financial condition and results of operations, discussing material changes from the end of the preceding fiscal year to the date of the interim balance sheet and the most recent year-to-date period and the corresponding year-to-date period of the preceding fiscal year;
- Current event reports on form 1-U within four business days after the issuer experiences one or more of the following:
  - entry into, or termination of, a material definitive agreement resulting in a fundamental change in the nature of an issuer's business;
  - 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 of the financial statements;
  - changes in control of the issuer;
  - departure of the CEO, CFO or principal accounting officer;
  - the unregistered sale of 10 percent or more of outstanding equity securities; or
  - optionally, other events not required by the form
- If eligible, notice of suspension of ongoing reporting obligations on Form 1-Z. A Tier 2 issuer may file Form 1-Z to immediately suspend its obligation to file ongoing periodic reports at any time after completing reporting for the fiscal year in which its offering statement was qualified if it has filed all required reports for the shorter of (i) the period since the issuer became subject to such reporting obligations; or (ii) its most recent three fiscal years and any portion of the current year, provided that:
  - the issuer must have fewer than 300 record holders of each class of securities to which the offering statement relates;
  - offers and sales of the securities may not be ongoing; and
  - banks and bank holding companies may immediately suspend their ongoing periodic reporting obligation any time after completing reporting for the fiscal year in which the issuer's offering statement was qualified if it has fewer than 1,200 (not 300) record holders.

Exchange Act Registration of Regulation A+ Securities

Unlike a registration statement that has been declared effective by the SEC, the qualification of a Regulation A+ offering statement does not require an issuer to comply with the annual and quarterly reporting requirements of the Exchange Act. Regulation A+ qualified securities are, however, eligible to be listed on a national securities exchange pursuant to Section 12 of the Exchange Act. If a Regulation A+ issuer lists

its securities on a national securities exchange or conducts a registered public offering of any other class of its securities, it will become subject to the annual and quarterly reporting requirements of the Exchange Act, but would be treated as an emerging growth company for disclosure purposes.

Securities can be registered under Section 12 by filing a general form (Form 10) or a short-form (Form 8-A) registration statement. A Regulation A+ issuer that would otherwise be ineligible to use the short-form registration statement may use Form 8-A if it completes Part II of its offering statement following the format called for by a registration statement on Form S-1, which allows the issuer to avoid having to repeat the offering statement disclosure in a Form 10.

Bad Actor Disqualification

The SEC has adopted rules to disqualify certain felons and other "bad actors" from using Regulation A+, similar to those adopted in July 2013 in connection with the use of general solicitation in Regulation D offerings.

The issuer's managing members (if the issuer is a limited liability company), compensated solicitors of investors, underwriters, executive officers and other officers participating in the offering, and beneficial owners of 20 percent or more of the voting equity securities of the issuer are subject to these "bad actor" disqualifications. Several actions would qualify these individuals as "bad actors" under the rules, including certain criminal law violations, fraudulent acts and regulatory violations.

Relationship with State Securities Law

Tier 1 offerings under Regulation A+ will be subject to both SEC and state blue sky pre-sale review. Tier 2 offerings under Regulation A+ are considered offers and sales to qualified purchasers under Section 18(b)(3) of the Securities Act, and so the securities offered are "covered securities" and state securities laws are preempted from requiring the registration of a covered security. Each state, nevertheless, may require a notice filing and related fee in order to conduct a Tier 2 Regulation A+ offering in such state.

What This Means To You

Regulation A+ offers a number of benefits to issuers, including more flexibility for smaller issuers and the capability for other issuers to raise larger amounts of capital. Intended to be more useful than its predecessor, Regulation A+ provides filing alternatives for smaller issuers and offers less complicated reporting for others.

Our Securities team closely follows the regulations that impact businesses looking to raise capital. If you have any questions about Regulation A+ or how it affects your business, please contact Steve Barrett at 423.757.5905 or Jeff Haughey at 303.749.7231.