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Management Alert

SEC Adopts Final Amendments to Regulation A

By Michael Dunn

On March 25, 2015, the Securities and Exchange Commission (the "SEC") adopted final amendments to Regulation A ("Reg. A") pursuant to Title IV of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"). Reg. A was adopted in 1936 as a rule under the Securities Act of 1933, as amended (the "Securities Act"), in order to assist small businesses with accessing the capital markets by providing a "mini-registration" for offerings up to $5 million that did not involve the more fulsome registration and reporting obligations of a public securities offering.

Offerings under the amended Reg. A will be organized into two tiers. Tier 1 offerings will be subject to an annual offering limit of $20 million and will largely be subject to the same rules and regulations under existing Reg. A. Tier 2 offerings under Reg. A will be subject to an annual offering limit of $50 million and require more extensive disclosure and ongoing reporting. Elements of the current Reg. A that would remain the same for offerings under both tiers of amended Reg. A are that the securities issued may be sold publicly by means of a general solicitation, the securities issued will be freely tradable subject to certain restrictions, the civil liability provisions of Section 12(a)(2) of the Securities Act will apply to Reg. A offerings, and the issuer may engage in "testing the waters" activities similar to existing Rule 254 that permits Reg. A issuers to solicit interest prior to the filing of the offering statement with the SEC.

The new rules will be effective 60 days from the date that the rules are published in the federal register.

Eligible Issuers

- The following issuers are excluded from using Reg. A:
  - » Issuers that are or have been subject to any order of the SEC terminating registration of a class of securities pursuant to Section 12(j) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), entered within five years before the filing of the offering statement.
  - » Issuers that have not filed with the SEC the ongoing reports required by Reg. A during the two years immediately preceding the filing of an offering statement.
  - » Issuers that are not organized under the laws of and with their primary place of business in the U.S. or Canada.
  - » Issuers that are subject to the ongoing reporting requirements of Section 13 or 15(d) of the Exchange Act (reporting companies).
  - » Issuers that are registered or required to be registered under the Investment Company Act of 1940 (investment companies) and business development companies ("BDCs").
  - » Blank check companies.
  - » Issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights.

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Eligible Securities

- Reg. A may only be used to issue the following types of securities:
  - Equity;
  - Debt;
  - Debt convertible into equity; and
  - Any guarantees of the above securities.
- In addition, Reg. A explicitly excludes asset backed securities, citing that they are governed under Regulation AB under the Securities Act which was not in effect at the time old Reg. A was effected, and thus have their own workable regulatory regime.

Issuer Limitations

- Offerings under Reg. A will be organized into two tiers.
  - **Tier 1** has an annual offering limit of $20 million, including no more than $6 million on behalf of selling securityholders, and is, with a few exceptions (such as allowing for electronic filings of the Form 1-A and "access equals delivery" with respect to the offering statement), subject to the same regulations of the old Reg. A.
  - **Tier 2** has an annual offering limit of $50 million, including no more than $15 million on behalf of selling securityholders.
  - Issuers may elect to conduct their offering under either Tier 1 or Tier 2.
  - For purposes of the $6 million and $15 million limits under Tier 1 and Tier 2, respectively, "selling securityholders" are individuals or entities that own the class securities being offered and are participating in the sale of such securities alongside the issuer, such as employees, officers or founders who received securities prior to the offering and wish to sell them.
- Importantly, the SEC has provided guidance consistent with old Reg. A that the following offerings will not be integrated with a Reg. A offering:
  - Prior offers or sales of securities; or
  - Subsequent offers and sales of securities that are:
    - registered under the Securities Act, except as provided in Rule 254(d) which provides a safe harbor to conduct a registered public offering after soliciting interest pursuant to Reg. A;
    - compensatory awards made in reliance on Rule 701 under the Securities Act;
    - other compensatory awards made pursuant to an employee benefit plan in reliance on other exemptions under the Securities Act;
    - made in reliance on Regulation S; or
    - made more than six months after completion of the Reg. A offering.
- Additionally, Reg. A offerings will not be integrated with subsequent offerings made under proposed Regulation Crowdfunding ("Reg. CF"), the JOBS Act Title III crowdfunding provisions proposed in October 2013.
- The SEC also provided guidance that an offering made in reliance on Reg. A should not be integrated with another exempt offering made by the issuer, provided that each offering complies with the requirements of the exemption that is being relied upon for the particular offering. Thus, concurrent Reg. A, Reg. D and/or Reg. CF offerings would be permissible.

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Investor Limitations

- **Tier 1** – no limit to the amount an investor may invest, save the aggregate offering cap.
- **Tier 2** – there is no limit on the amount that accredited investors may invest in any Tier 2 offering, and there are no limits for any investors if the securities in a Tier 2 offering will be listed on a national securities exchange. Otherwise, non-accredited investors in a Tier 2 offering are limited to purchasing no more than 10% of the greater of such investor's annual income or net worth for individuals or 10% of the greater of revenues or net assets for the most recent fiscal year for entities, in each case measured in accordance with Reg. D.
- There is no accreditation requirement or knowledge or sophistication requirement for either Tier 1 or Tier 2 investors, the general public may invest.

The investor limits for Tier 2 offerings demonstrate the tension between the Congressional mandate for greater flexibility in capital raising and the SEC's concerns regarding fraud in the marketplace and protecting investors. In proposing these limits for Tier 2 offerings, which mirror the limits under proposed Reg. CF for investors with net worth or annual net income in excess of $100,000, the SEC is attempting to provide a uniform approach to investor protection across all of the newly proposed offering exemptions mandated by the JOBS Act.

Testing the Waters

As is the case with existing Rule 254 under Reg. A, the new amendments permit issuers to "test the waters" or solicit interest in a potential offering with the general public either before or after the filing of the offering statement, so long as any solicitation materials used after publicly filing the offering statement are preceded or accompanied by a preliminary offering circular or contain a notice informing potential investors where and how the most current preliminary offering circular can be obtained. This requirement could be satisfied by providing the uniform resource locator ("URL") where the preliminary offering circular or the offering statement may be obtained on EDGAR. The solicitation materials used to test the waters would not have to be filed until the offering statement is submitted to the SEC for review, but at such time the test the waters materials would have to be filed with the offering statement and would be publicly available.

Qualification, Communications, and Offering Process

Prior to the consummation of an offering, the issuer must submit an offering statement on Form 1-A to the SEC which must then be qualified by the SEC prior to any sale of the securities. Whereas old Reg. A required a paper filing of the offering statement, amended Reg. A requires electronic filing through EDGAR.

Reg. A permits the non-public submission of offering statements and amendments for review by the SEC before filing such documents with the SEC, so long as all such documents are publicly filed not later than 21 calendar days before qualification. This relief mirrors the provision under the JOBS Act that permits emerging growth companies to submit IPO registration statements to the SEC for confidential review.

The new rules also require issuers and intermediaries prior to the offering statement being qualified to deliver a preliminary offering statement to prospective purchasers at least 48 hours in advance of a sale. Once an offering statement is qualified, all offers must be preceded or accompanied by a final offering statement. In addition, the new rules permit issuers and intermediaries to satisfy their final offering statement delivery requirements under an "access equals delivery" model when the final offering circular is filed and available on EDGAR, meaning that not later than two business days after completion of the sale, the issuer or the intermediary, as applicable, must provide the purchasers with a copy of the final offering circular or a notice that the sale occurred pursuant to a qualified offering statement that includes the URL leading to the final offering statement.

Issuers may file offering statement supplements after qualification of the offering statement in certain circumstances in lieu of post-qualification amendments, including to provide the types of information that may be excluded from a prospectus under Rule 430A, such as final pricing information. Issuers also may qualify additional securities in reliance on Reg. A by filing a post-qualification amendment to a qualified offering statement.

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Continuous or Delayed Offerings

The new amendments to Reg. A also provide for the following types of continuous or delayed offerings substantially consistent with delayed or continuous offerings permitted under Rule 415 of the Securities Act, subject to, in the case of Tier 2 offerings, the issuer being current in its annual and semiannual reporting obligations:

- securities offered or sold by or on behalf of a person other than the issuer or its subsidiary or a person of which the issuer is a subsidiary (i.e., offerings by selling securityholders);
- securities offered and sold pursuant to a dividend or interest reinvestment plan or an employee benefit plan of the issuer;
- securities issued upon the exercise of outstanding options, warrants, or rights;
- securities issued upon conversion of other outstanding securities;
- securities pledged as collateral; or
- 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.

Offering Statement

- The issuer in any Tier 1 or Tier 2 Reg. A offering will be required to filed a Form 1-A which consists of three parts.
  - » Part I – Notification. This section of the Form 1-A will consist of an XML-based fillable form that contains disclosures regarding:
    - Issuer information
    - Issuer eligibility
    - Bad actor certification and disclosure information
    - Summary information regarding the offering and other current proposed offerings
    - Jurisdiction in which securities are being offered
    - Unregistered securities sold within one year of the offering
  - » Part II – Offering Circular. This section of the Form 1-A will be the heart of the disclosure regarding the issuer and the offering and will be uploaded as an attachment to the Form 1-A through the EDGAR system and will require disclosures of:
    - Basic information about the issuer and the offering, including identity of any underwriters and underwriting discounts
    - Material risks related to the offering and the securities
    - Material disparities between the public offering price and the costs for securities acquired by insiders in the past year
    - Plan of distribution of the securities
    - Use of proceeds
    - Business operations for the past three years (or length of existence if shorter)
    - Material physical properties

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- Discussion and analysis of issuer's liquidity, capital resources and results of operations, which may include plan of operations for the next twelve months for issuers that have no revenue from operations during the three fiscal years preceding the filing of the offering statement
- Information regarding directors, officers and significant employees
- Executive compensation
- Beneficial ownership of voting securities by officers, directors and 10% securityholders
- Transactions with related persons
- Material terms of the securities being offered
- Two years of GAAP (or IFRS if Canadian issuer) financial statements, with delayed implementation of new accounting standards if permitted by non-public business entities consistent with similar relief granted to emerging growth companies under the JOBS Act
    - **Tier 1** – must be audited only if available
    - **Tier 2** – must be audited
- Disclosure of the participation of any "bad actors" with the offering whose participation would have disqualified the issuer from relying on the exemption but for the underlying events occurring prior to the effective date of the amendments to Reg. A (similar to Rule 506(e) of Reg. D disclosure rules adopted in September 2013).
- Rather than provide the above information the issuer may provide the information required in Part I of Form S-1 or Form S-11 (if eligible to use Form S-11), but notably, the Q&A method of disclosure previously allowed under old Reg. A is no longer permitted.

» Part III – Exhibits

- Exhibits include, underwriting, placement agent, or dealer agreements, partnership or operating agreements, charter and bylaws, instruments defining the rights of securityholders, subscription agreements, voting trust agreements, material contracts, plans of acquisition, reorganization, etc., escrow agreements, letters regarding changes of certifying accountant, powers of attorney, consents (including auditor consent), legal opinion, test the waters materials, appointment for agent of service of process, and any offering statement filed confidentially.

- Under amended Reg. A, the offering statement only may be qualified by order of the SEC rather than, as previously allowed under old Reg. A, after inaction by the SEC for 20 days after filing.

While the Form 1-A disclosure permits for scaled disclosure for shorter periods of time than might otherwise be required in a Form S-1, the disclosure relief available to emerging growth companies electing to register on Form S-1 narrows that disclosure gap considerably. The considerable advantage for an offering less than $50 million that will not result in a listing on a national securities exchange is the federal preemption available for a Tier 2 Reg. A offering that would not be available for a Form S-1 that would require timely and expensive registration by coordination.

Ongoing Reporting

- **Tier 1** – Reg. A requires issuers that conduct an offering to electronically file a Form 1-Z exit report with the SEC not later than 30 calendar days after termination or completion of a qualified offering to provide information about sales in such offering and to update certain issuer information.

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- **Tier 2**
  - » Annual and Semiannual Reports – Reg. A will require issuers with Tier 2 offerings to electronically file with the SEC annual reports on Form 1-K with updated audited financial statements and semiannual reports on Form 1-SA generally updating the information contained in the Form 1-Q and offering circular.
  - » Current Reports – Reg. A will require issuers with Tier 2 offerings to electronically file with the SEC current event updates on Form 1-U for the following events which are less extensive than the disclosure events under current Form 8-K but more extensive than the legacy Form 8-K disclosure rules that pre-date the 2004 amendments:
    - Fundamental changes in the business;
    - Bankruptcy or receivership;
    - Material modification to the rights of securityholders;
    - 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, principal financial officer, or principal accounting officer;
    - Unregistered sales of 10% or more of outstanding equity securities (increased from 5% under the proposed rules); and
    - Other material events not directly required by other items of Form 1-U.
  - » Special Financial Reports – Reg. A requires issuers that conduct a Tier 2 offering to, where applicable, provide special financial reports to provide information to investors in between the time the financial statements are included in Form 1-A and the issuer's first periodic report due after qualification of the offering statement. The special financial report requires audited financial statements for the issuer's most recent fiscal year (or for the life of the issuer if less than a full fiscal year) to be filed not later than 120 calendar days after qualification of the offering statement if the offering statement does not include such financial statements.
  - » Broker-Dealer Requirements – Reg. A permits the ongoing reports filed by an issuer conducting an offering to be used to satisfy a broker-dealer's obligations to review specified information about an issuer prior to publishing a quotation under Exchange Act Rule 15c2-11.
  - » Exit – Reg. A provides that issuers conducting offerings would exit the Reg. A reporting regime ongoing reporting regime:
    - When they become subject to the ongoing reporting requirements of Section 13 of the Exchange Act; and
    - At any time by filing a Form 1-Z exit report after completing reporting for the fiscal year in which the offering statement was qualified, so long as 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 Regulation A offering statement are not ongoing.
    - Issuers must include in their first annual report after termination or completion of a qualified Reg. A offering, or in their Form 1-Z exit report, information about sales in the terminated or completed offering and to update certain issuer information.

Exchange Act Section 12(g) Registration Threshold

Section 12 (g) of the Exchange Act provides that if an issuer ends its fiscal year with total assets of $10 million and a class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited investors, then the issuer will become subject to registration and reporting under the Exchange Act. Under the final amendments to Reg. A, purchasers

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in a Tier 1 Reg. A offering will be counted in the number of holders of record for purposes of Section 12(g) of the Exchange Act. However, the final rules provide for a limited, conditional exemption from Section 12(g) for Tier 2 Reg. A offerings as follows:

- The issuer must engage the services of a transfer agent registered with the SEC pursuant to Section 17A of the Exchange Act;
- The issuer must remain current in its Reg. A periodic reporting obligations; and
- The issuer must meet the requirements of a "smaller reporting company" with either a public float less than $75 million as of the last business day of its most recently completed second fiscal quarter, or, in the absence of a public float, annual revenues less than $50 million for the most recently completed fiscal year.

As long as the above conditions are met, persons who acquire securities in a Tier 2 Reg. A offering will not count toward the investor threshold under Section 12(g).

Voluntary Exchange Act Registration

Consistent with the IPO on-ramp relief for emerging growth companies under the JOBS Act, the new amendments to Reg. A also provide for a voluntary Exchange Act registration in connection with a Reg. A offering for Tier 2 issuers. Issuers conducting a Tier 2 Reg. A offering may register a class of Reg. A securities under the Exchange Act by filing a Form 8-A in conjunction with the qualification of a Form 1-A in lieu of a separate and more robust Form 10 filing. Only issuers that follow Part I of Form S-1 or the Form S-11 disclosure model in the offering circular will be permitted to use Form 8-A. An issuer registering a class of securities under the Exchange Act concurrently with the qualification of a Reg. A offering statement will become an Exchange Act reporting company upon effectiveness of the Form 8-A and, if applicable, its obligation to file ongoing reports under Reg. A will be suspended for the duration of the resulting reporting obligation under Section 13 of the Exchange Act.

"Bad Actor" Disqualification

Reg. A will disqualify an issuer from conducting an offering under Reg. A to the extent it, or its officers, directors, 20% holders, promoters, compensated solicitors and others involved with the offering are "bad actors" as defined in amended Rule 262 of the Securities Act, which mirrors the disqualification standards under Rule 506(d) of Reg. D that were adopted in September 2013.

Application of State Securities Laws

- **Tier 2** – Reg. A, provides for the preemption of state securities law registration and qualification requirements for securities offered or sold to "qualified purchasers," defined to be all offerees and purchasers in a Tier 2 offering.
- **Tier 1** – Offers conducted under Tier 1 will still be required to comply with all applicable state securities laws with respect to securities sold pursuant to Reg. A.

This client alert is intended only to provide a brief summary of the final amendments to Reg. A. The full adopting release provided by the SEC is available at http://www.sec.gov/rules/final/2015/33-9741.pdf.

If you have any questions, please contact Michael Dunn at *mdunn@seyfarth.com* or your Seyfarth attorney.

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