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Access to Capital for Small Businesses: SEC Adopts Final Rules to Implement "Regulation A+" Offering Exemption Under the JOBS Act

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New SEC rules will help smaller companies access capital. Dentons examines what these new rules will mean for businesses and investors.

Introduction

The new Regulation A offering exemption, which the SEC recently adopted under Title IV of the JOBS Act, has taken effect. The new rules, also known as "Regulation A+," permit unregistered public offerings of up to US$50 million in any 12-month period by eligible US and Canadian companies.

Regulation A+ reflects Congress' determination to facilitate access to capital for smaller companies. As set out in greater detail in the chart below, the new rules permit unregistered public offerings under two tiers: "Tier 1" for offerings of up to US$20 million, including no more than US$6 million on behalf of selling security holders and "Tier 2" for offerings of up to US$50 million, including no more than US$15 million on behalf of selling security holders. For offerings of up to US$20 million, the issuer can elect whether to proceed under Tier 1 or Tier 2.

SEC rule changes implementing Regulation A+

The new rules contain several changes compared to the version of the Regulation A+ rules which the SEC first proposed in 2013. Compared to the 2013 proposal, the final rules:

- Raise the upper limit for Tier 1 offerings from US$5 million to US$20 million
- Limit sales by selling security holders to less than 30 percent of the issuer's initial and subsequent offerings for the 12-month period following its initial offering
- Exempt from limits on Tier 2 investor purchases those sales made to "accredited investors" as well as any sale of securities that will be listed on a national exchange upon qualification
- Permit an issuer in Tier 2 offerings to audit its financial statements in accordance with either US Generally Accepted Auditing Standards (GAAS) or Public Company Accounting Oversight Board (PCAOB) auditing standards
- Increase the threshold of unregistered shares that may be sold from five percent to 10 percent or more of outstanding equity before such shares constitute a "fundamental change" for the purposes of Form 1-U
- Exempt securities issued under Tier 2 from the requirements under Section 12(g) of the Securities Exchange Act of 1934 (the Exchange Act), provided that the issuer uses a registered transfer agent, is current in filing required reports, and has a public float of less than US$75 million or annual revenues of less than US$50 million
- Permit an issuer making an offering under Tier 2 to register the class of securities under the Exchange Act by filing only a short form Exchange Act registration statement on Form 8-A concurrently with the qualification of the Regulation A offering statement

Regulation A+ builds on the existing Regulation A promulgated under the Securities Act of 1933. Both the Tier 1 and Tier 2 exemptions from registration draw from the provisions of the old Regulation A, such as the eligibility of issuers and securities, certain disclosure requirements and the civil liability provisions of Sections 12(a)(2) and 17 of the Securities Act. Similar to Regulation A, both tiers under Regulation A+ exclude from integration prior offers or sales of securities and certain subsequent offers or sales of securities, including in particular crowdfunding offerings under the recently adopted Section 4(a)(6) of the Securities Act. Additionally, Regulation A+, like Regulation A, permits the use of solicitation materials before filing an offering statement.

The new rules also modernize the older version of Regulation A, which was rarely used, with respect to the SEC filing and offering process for both Tier 1 and Tier 2 offerings. Regulation A+ now requires electronic filing via EDGAR of offering materials, extends the "access equals delivery" model to final offering circulars and allows "electronic only" offerings. Importantly, securities issued under either tier are not considered "restricted securities" within the meaning of Rule 144 under the Securities Act, and therefore investors who are not affiliated with the issuer may freely resell them under the Securities Act.

Ongoing reporting

The two-tier Regulation A+ regime moves away from a "one size fits all" approach that characterized Regulation A. Regulation A originally required issuers, regardless of offering size, to file ongoing reports on the now rescinded Form 2-A every six months after qualification and within 30 calendar days following termination. Under Regulation A+, issuers that conduct offerings under Tier 1 have no ongoing reporting requirements other than to file an exit report on Form 1-Z upon termination of the offering. Issuers that conduct offerings under Tier 2 must file annual reports on Form 1-K, semiannual reports on Form 1-SA, current reports on Form 1-U, special financial reports, and exit reports on Form 1-Z. In addition, issuers of Tier 2 offerings, unlike Tier 1 offerings, must file audited financial statements prepared in accordance with US GAAP (or International Financial Reporting Standards, as issued by the International Accounting Standards Board, in the case of Canadian issuers).

State securities law

Regulation A+ distinguishes between Tier 1 offerings and Tier 2 offerings in the preemption of US state securities laws. Securities offerings under former Regulation A required full compliance with state securities laws. Under the JOBS Act, securities offered or sold to "qualified purchasers" are exempt from state law registration and qualification requirements. Regulation A+ brings within the definition of "qualified purchasers" persons to whom securities are offered or sold in a Tier 2 offering. Accordingly, Tier 2—but not Tier 1—offerings preempt state securities laws, other than antifraud provisions. The SEC expects Tier 1 offerings to be more local in nature, and therefore they remain appropriate for state jurisdiction. Securities sold in both Tier 1 and Tier 2 offerings remain subject to state securities laws with respect to resales.

Investor protection

The SEC implemented investor protection policies in Regulation A+. Investors in an individual Tier 2 offering are limited to investing no more than 10 percent of their net worth or annual income (or no more than 10 percent of the greater of annual revenue or net assets at fiscal year end for non-natural persons), except such limits do not apply to accredited investors or to securities that will be listed on a national exchange upon qualification. To improve access to information for all investors, the SEC under Regulation A+ requires companies to disclose financial information as part of their offering. The SEC also borrowed provisions from Regulation D to protect investors by disqualifying companies that are "bad actors" from using Regulation A+.

Regulation A+ subjects issuers to greater liability for fraud compared to private offerings conducted under Securities Act Section 4(a)(2), Rule 506 or Rule 144A. Offers and sales of securities under both Regulation A+ and the private offering exemptions subject issuers to liability for fraud under Section 10(b) of the Exchange Act which requires a plaintiff to prove scienter before imposing liability for any material misstatement or omission in the offering process. Offerings under Regulation A+ subject issuers to additional liability under Sections 12(a)(2) and 17 of the Securities Act, under which liability may be based on merely negligent conduct rather than the higher standard of scienter.

The following chart summarizes the main provisions of Regulation A+ under each tier of the final rules, including with respect to issuer eligibility and disclosures:

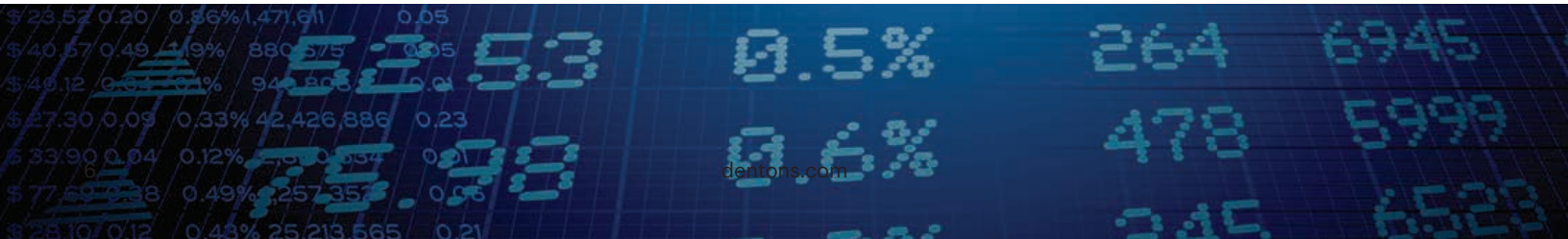
Tier 1	Tier 2
Offering limits	
Up to US$20 million in any 12-month period, including up to US$6 million offered by selling security holders	Up to US$50 million in any 12-month period, including up to US$15 million offered by selling security holders
Investor purchase limit	
None	• Securities purchased (a) for natural persons, cannot exceed 10 percent of the greater of the investor's annual income or net worth and (b) for non-natural persons, cannot exceed 10 percent of the greater of annual revenue or net assets at fiscal year end • No investment limit for "accredited investors," as defined in Regulation D, or for sales of securities that will be listed on a national securities exchange • Issuers may rely on investor representations unless the issuer was aware at the time of sale that the representations were untrue
State securities law preemption	
State securities laws apply	State securities laws preempted (other than anti-fraud provisions)

Eligible issuers / eligible securities

- Non-reporting US and Canadian issuers
- Equity securities (including warrants)
- Debt securities
- Debt securities convertible or exchangeable into equity securities
- Guarantees of eligible securities

Disqualified entities

- Exchange Act reporting companies
- Non-US and non-Canadian companies
- Investment companies, including business development companies
- Blank check companies and special purpose acquisition companies
- Issuers of fractional undivided interests in oil, gas or similar mineral rights
- Issuers subject to an order within the previous five years denying, suspending or revoking the registration of a class of securities under Section 12(j) of the Exchange Act
- Companies that have failed to file with the SEC ongoing reports required by the final Regulation A rules during the two years preceding the filing of a new Regulation A offering statement
- Companies subject to "bad actor" disqualification under provisions substantially similar to those in Regulation D



Tier 1	Tier 2

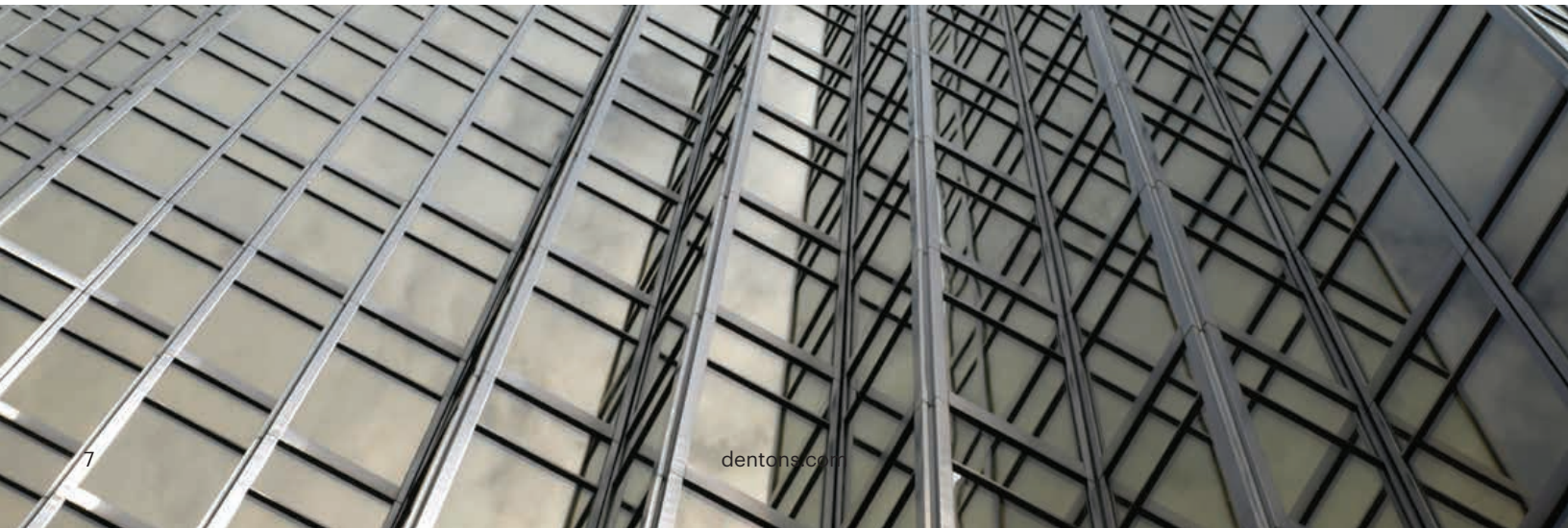
SEC filing requirements / confidential submission provisions

- The issuer must file electronically via EDGAR the offering statement, ongoing reports required for Tier 2 offerings and other Regulation A filings
- Offering statements remain subject to review and comment by the SEC staff prior to use
- The new rules permit confidential filing of draft offering statements if:
  - The issuer has not previously sold securities pursuant to a qualified offering statement under the new Regulation A or an effective registration statement
  - The non-publicly submitted offering statement is substantially complete upon submission and submitted electronically via EDGAR, and
  - The issuer files all non-public submissions as exhibits to the offering statement not less than 21 calendar days before qualification of the offering statement

Financial statement disclosures

- US GAAP compliant financial statements (IFRS permitted for Canadian issuers) as of the two most recently completed fiscal year ends (or for such shorter time that the issuer has existed)
- Financial statements must be dated not more than nine months before submission, filing or qualification. Interim financial statements, if required, must cover a period of at least six months
- Financial statements of certain non-issuer entities, such as significant acquired businesses and subsidiary guarantors, in form and content following the requirements set out in Part F/S of Form 1-A and pro forma information regarding significant business combinations
- Issuer may delay the implementation of new accounting standards to the extent such standards provide for delayed implementation by non-public business entities, but the issuer must disclose its election of such delay at the time the issuer files the offering statement and must apply the same choice to all standards

Tier 1	Tier 2
• No audit requirement, but issuer must label unaudited financial statements as unaudited • Issuer must provide audited financial statements if the issuer has already prepared these in accordance with US GAAS or PCAOB auditing standards, and the auditor followed Regulation S-X or AICPA auditor independence standards • No requirement for issuer's financial statements to comply with Regulation S-X except as guidance to identify non-issuer entities required to submit financial statements, where the form and content of such financial statements conforms to Part F/S of Form 1 A	• Issuer must provide audited financial statements audited in accordance with US GAAS or PCAOB auditing standards, and the auditor must follow Regulation S-X auditor independence standards • PCAOB-registered auditor not required • Issuer must comply with Article 8 of Regulation S-X as if issuer were a "smaller reporting company"



Tier 1	Tier 2

Form and content of offering statement on Form 1-A

- Offering statements receive the same level of SEC staff review as registration statements, contain substantive narrative and financial information about the issuer, and must be qualified by the SEC before sales may be made.
- Regulation A offering statements must be filed with the SEC on Form 1-A. Form 1-A consists of these parts:
- **Part I**: Part I requires disclosure of the following: (1) the issuer, including its industry, number of employees, financial statements, capital structure and contact information; (2) issuer eligibility; (3) applicability of "bad actor" disqualification and disclosure, requiring the issuer to certify that no disqualifying events have occurred and to disclose any disqualifying activities; (4) summary information about the offering and other current or proposed offerings, including whether the issuer is conducting a Tier 1 or Tier 2 offering; (5) the jurisdictions where the offering will be made; and (6) unregistered securities issued or sold within the last year.
- **Part II**: Part II offering statement disclosures require:
  - Basic information about the issuer and the offering, including underwriting information
  - The most significant factors that make the offering speculative or substantially risky
  - Material differences between the public offering price and the effective cash cost for shares acquired by insiders during the past year
  - A plan of distribution for the offering and disclosure regarding selling security holders
  - Use of proceeds
  - Business operations for the past three fiscal years, or since inception if shorter
  - Material physical properties
  - MD&A covering the two most recently completed fiscal years and interim periods, if required
  - Information about directors, executive officers and significant employees, including five-year business experience background, legal proceedings, family relationships within the management group
  - Group-level executive compensation for the most recent year for the three highest paid executive officers or directors with Tier 2 requiring individual disclosure regarding the three highest paid executive officers or directors
  - Beneficial ownership of voting securities by executive officers, directors and 10 percent owners
  - Related person transactions
  - Material terms of the securities being offered
  - Any events that would have triggered disqualification of the offering under Rule 262 if the issuer could not rely on the provisions in Rule 262(b)(1)
- **Part III**: Part III requires exhibit information similar to the exhibits required in Form S-1.

Tier 1	Tier 2
Short-form Exchange Act registration	
• Not available	• Issuers may register securities under the Exchange Act and, assuming the issuer meets the applicable listing requirements, list the securities on a national exchange by filing only a short-form Exchange Act registration statement on Form 8-A
Ongoing reporting obligations	

• Issuers must file Form 1-Z to report sales after the termination or completion of the offering within 30 calendar days after such completion or termination	• Annual reports on Form 1-K, due within 120 calendar days of the issuer's fiscal year end
	  • **Part I**: Basic issuer information, similar to Part I for an Offering Circular
	  • **Part II**: Covers the following: business operations for the prior three fiscal years, related person disclosures, beneficial ownership reporting, information about directors, executive officers and significant employees, executive compensation disclosures, MD&A and two years of audited financial statements
	• Semiannual reports on Form 1-SA, due within 90 calendar days after the end of the first six months of the issuer's fiscal year, consisting primarily of financial statements and MD&A
	• Current reports on Form 1-U, within four business days of any of the following events: material transactions that would result in a "fundamental change" in the nature of the issuer's business; bankruptcy; material modification of shareholder rights; changes in the issuer's accountant/auditor; non-reliance on prior financial statements; changes in control; departure of PEO, PFO or PAO; and unregistered shares of 10 percent or more of outstanding equity securities
	• "Special financial reports" on Form 1-K and Form 1 SA, including audited financial statements for the issuer's last completed fiscal year (or for the life of the issuer if less than a full fiscal year), due within 120 days after the qualification of the offering statement if such statement did not include audited financial statements

Tier 1	Tier 2
	• Termination reports on Form 1-Z to report sales after the termination or completion of the offering within 30 calendar days after such completion or termination • In connection with a succession by merger, consolidation, exchange of securities, acquisition of assets, or otherwise, issuers of Tier 2 offerings who succeed issuers of a class of securities not subject to Regulation A reporting requirements must continue to file reports required of the original Tier 2 issuer, but such successor issuers may suspend or terminate their reporting obligations on the same basis as the original issuer under Rule 257(d)

"Test the waters" communications

- Issuers may test the waters with all potential investors and use solicitation materials before and after filing the offering statement, subject to rules on filing solicitation materials and disclaimers
- Issuers must file solicitation materials as exhibits to the offering statement when the offering statement is submitted for non-public review or filed; issuers must update such solicitation materials for substantive changes
- After publicly filing an offering statement, issuers must either attach to test the waters materials the current preliminary offering circular or provide notice to investors on where to obtain the offering circular, such as providing the URL to where the investor can obtain the preliminary offering circular or offering statement
- The new rules do not require issuers to submit solicitation materials at or before the time of first use

Liability

- Liability under Section 12(a)(2) of the Securities Act for any offer or sale by means of solicitation materials, an offering circular or oral communication that includes a material misleading statement or misstatement or omission
- Liability under other anti-fraud provisions, such as Section 17 of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act

Integration

- Offerings made under Regulation A are not integrated with other registered offerings or exempt offerings, provided each such offering complies with the relevant offering exemption requirements
- Specific non-integration safe harbor for crowdfunding offerings of securities completed pursuant to Section 4(a)(6) of the Securities Act
- Specific non-integration provision regarding a registered offering that follows an abandoned Regulation A offering, provided the issuer did not solicit interest from persons other than qualified institutional buyers (QIBs) and accredited investors

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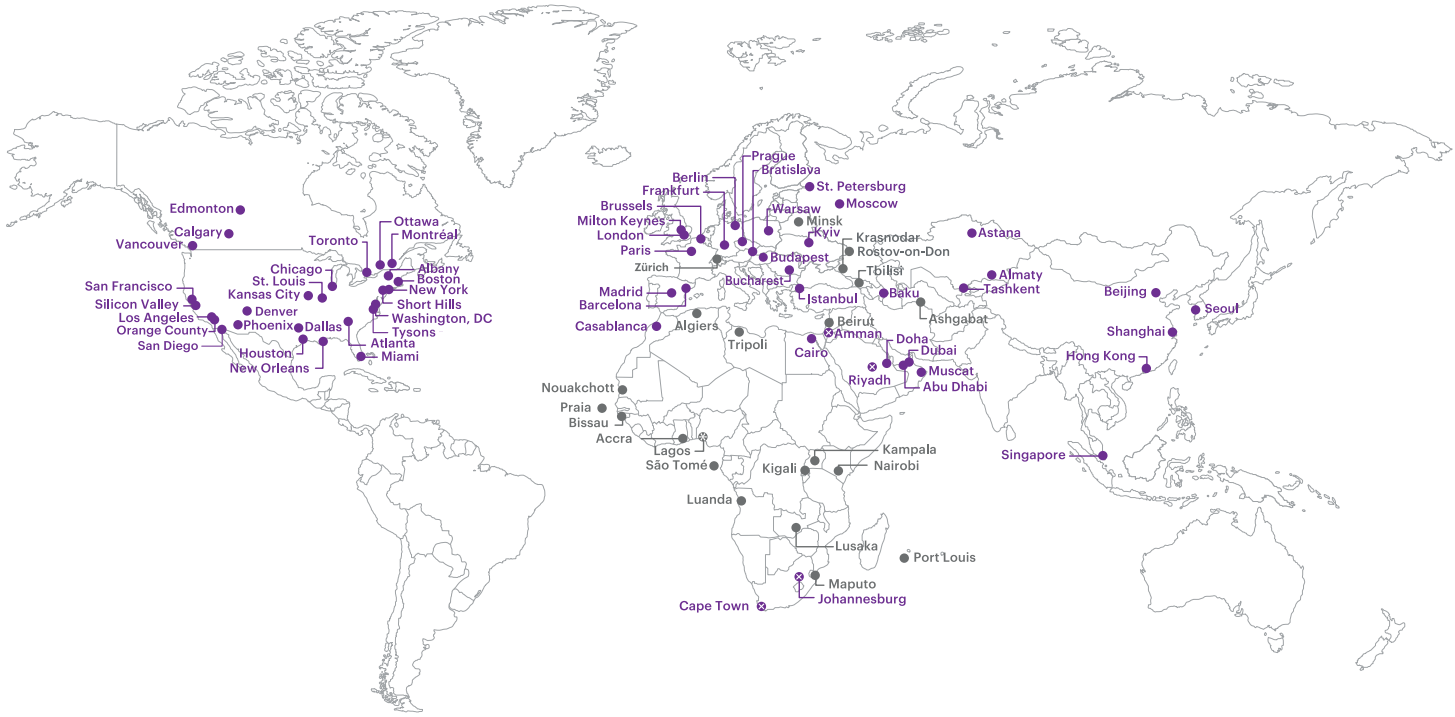

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