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SEC Issues Proposals to Implement "Regulation A+" Offering Exemption under the JOBS Act

Introduction

On December 18, 2013, the SEC proposed rules to implement the so-called "Regulation A+" offering exemption under the JOBS Act, which would permit unregistered public offerings of up to $50 million in any 12-month period, provided the issuer meets certain important disclosure and other requirements. Market participants may be disappointed with certain aspects of the SEC's proposals, especially the audit and ongoing reporting proposals that are noted below, even as the proposals go a long way in updating the existing offering regime under Regulation A, including by preempting from state blue sky laws new "Tier 2" offerings (offerings over $5 million, up to $50 million). On balance, however, we believe that issuers may find that Regulation A+ has real benefits that may outweigh at least some of its costs and provides yet another IPO "on-ramp" for issuers who might seek to comply with the expanded disclosure requirements proposed in this wholly re-vamped Regulation A+ as a step toward registering with the SEC as a smaller reporting company.

Regulation A+, a term we (and others) use to identify Regulation A as the JOBS Act and the SEC's proposals would amend it, builds on existing but rarely used Regulation A. Regulation A currently permits unregistered public offerings of securities up to $5 million in any 12-month period by eligible non-reporting US and Canadian companies. Eligible companies must file an offering statement (similar to a registration statement, with parts that are not required to be delivered to prospective investors) with the SEC, which must be qualified by (similar to being declared effective by) the SEC, and deliver an offering circular (a part of the offering statement, similar to a prospectus) to prospective investors at least 48 hours before mailing the confirmation of sales. Financial statements are required to be included in the offering circular, but currently need not be audited unless audited financial statements are otherwise available. Today, Regulation A securities may be offered through general advertising and solicitation and are not restricted in the hands of purchasers, unlike securities issued under the very popular Regulation D. The historical light touch by the SEC under current Regulation A is counterbalanced by subjecting Regulation A offerings to state blue sky laws, significantly limiting the attractiveness of the exemption.

SEC Proposals Implementing Regulation A+

Section 401 of the JOBS Act is intended to "jumpstart" Regulation A by expanding the exemption to cover offerings of securities up to $50 million in any 12-month period, provided that the companies relying on the enhanced exemption also file audited financial statements with the SEC on an annual basis and comply with any other rules the SEC imposes in implementing Section 401.

The proposals implement Section 401 by expanding Regulation A into two tiers: "Tier 1" for offerings of up to $5 million, including no more than $1.5 million on behalf of selling security holders (unchanged from current Regulation A), and "Tier 2" for offerings over $5 million and up to $50 million, including no more than $15 million on behalf of selling security holders.

The proposals would modernize Regulation A in respects relating to the filing and offering process that would apply to both Tier 1 and Tier 2 offerings. For example, the proposals would require that all Regulation A offering statements be filed electronically via EDGAR (paper submissions are still

permissible under current Regulation A). Additionally, the proposals would extend the "access equals delivery" model to Regulation A final offering circulars, among other proposed changes relating to prospectus delivery, and allow "electronic only" offerings to be made under Regulation A+, provided that investors consent to electronic delivery of documents and information, including the preliminary and final offering circulars.

There would be surprisingly few distinctions between Tier 1 and Tier 2 offerings under Regulation A+, other than in three main categories. There are significant differences in the financial statement and ongoing reporting requirements between Tier 1 and Tier 2 offerings, and Tier 1 offerings generally remain subject to state blue sky laws, while Tier 2 offerings are preempted.

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

Tier 1	Tier 2
Offering Limits	
Up to $5 million in any 12-month period, including up to $1.5 million offered by selling security holders	Up to $50 million in any 12-month period, including up to $15 million offered by selling security holders
Investor Purchase Limits	
None	• Securities purchased cannot exceed 10% of the greater of the investor's annual income or net worth (calculated consistent with Regulation D) • Issuers would be permitted to rely on investor representations unless aware at the time of sale that the representations are untrue (the SEC stated it is "mindful of the privacy issues and practical difficulties associated with verifying individual net income and net worth")
State Securities Law Preemption	
Only offers are not subject to state blue sky laws; all other state securities law registration and qualification requirements apply	Preempted from state blue sky laws
Eligible Issuers/Eligible Securities	
• Non-reporting US and Canadian issuers • Equity securities • Debt securities • Debt securities convertible or exchangeable into equity securities • Guarantees of the eligible securities noted above	

Tier 1	Tier 2
Disqualification Provisions	
• 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 five previous years denying, suspending or revoking the registration of a class of securities under Exchange Act Section 12(j) • Companies that have failed to file with the SEC the ongoing reports required by the proposed Regulation A rules during the two years preceding the filing of a new Regulation A offering statement • "Bad actor" disqualification provisions would be substantially conformed to those in new Rule 506(d) of Regulation D	
SEC Filing Requirements/Confidential Submission Provisions	
• Offering statements and other Regulation A filings, including ongoing periodic reports required to be filed for Tier 2 offerings, must be filed electronically on the EDGAR system • Offering statements remain subject to review and comment by the SEC staff • Confidential, electronic filing of draft offering statements would be permitted for issuers whose securities have not been previously sold pursuant to a qualified offering statement under Regulation A or an effective registration statement, provided all non-public submissions are filed as exhibits to the offering statement not less than 21 calendar days before qualification of the offering statement (similar to emerging growth company confidential submission process)	
Financial Statement Disclosures	

• Financial statements for the two most recently completed fiscal year ends (or from time of existence if less than two years)
  ◦ Balance sheet as of a date within 90 days of filing the offering (currently, the requirement is to file a balance sheet as of only the most recently completed year)
  ◦ Income statement, cash flow statement, statement of stockholders' equity for the two fiscal years and stub period between last fiscal year and date of most recent balance sheet
  ◦ Financial statement of significant acquired businesses and pro forma information regarding significant business combinations
• Where audited financial statements are provided, auditor need not be registered with the PCAOB	

• No audit requirement, except where audited financial statements have already been prepared • No requirement to follow Regulation S-X except for transactions involving an acquired business or subsidiary guarantors	• Financial statements must be prepared in accordance with US GAAP (or Canadian issuers may instead follow IASB IFRS) and audited in accordance with PCAOB auditing standards and auditor requirements, including independence, quality control and ethics • Issuers must follow financial statement requirements of 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	

• Regulation A offering statements would be required to be electronically filed via EDGAR and contain substantive narrative and financial information about the issuer, including an MD&A discussion and would receive the same level of SEC staff review as registration statements
• **Part I:** Represents substantive changes to current Part I by requiring disclosure concerning (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 whether any disclosure regarding disqualifying activities is disclosed, (4) 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, (6) unregistered securities issued or sold within the prior year
• **Part II:** Proposals would eliminate the Model A narrative disclosure option but retain disclosure options Model B, updated to require certain different disclosures, and following Part I of Form S-1. Part II offering statement disclosures would be required to cover:
  • Basic information about the issuer and the offering, including underwriting information
  • Material risks
  • Material differences between the public offering price and the effective cash cost for shares acquired by insiders during the past year
  • Plan of distribution
  • Use of proceeds
  • Business operations for the past three fiscal years, or inception (whichever is longer)
  • Material physical properties
  • MD&A covering the two most recently completed fiscal years
  • Information about directors, executive officers and significant employees, including five-year business experience background, legal proceedings, family relationships within the management group
  • Executive compensation for the most recent year for the three highest paid officers or directors
  • Beneficial ownership of voting securities by executive officers, directors and 10% owners
  • Related person transactions
  • Material terms of the securities being offered	

Tier 1	Tier 2
Ongoing Reporting Obligations	

No new ongoing reporting requirements, other than the requirement to report sales after the termination or completion of the offering within 30 days after such completion or termination (via EDGAR on new reporting forms)	• Annual reporting, due within 120 calendar days of the issuer's fiscal year end, via EDGAR on new Form 1-K would be required:
	  • **Part I:** Basic issuer information, similar to Part I for an Offering Circular
	  • **Part II:** Would cover: business operations for the prior three fiscal years, related person disclosures, beneficial ownership reporting, information about directors, executive officers and significant employee, executive compensation disclosures, MD&A, two years of audited financial statements
	• Bi-annual (mid-year) reporting, due within 90 calendar days after the issuer's second fiscal quarter, consisting primarily of financial statements and MD&A
	• Current reports, within four business days of any of the following events: material transactions that would result in a "fundamental" changes 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 5% or more of outstanding equity securities
	• "Special financial reports" including audited financial statements for the issuer's last completed fiscal year, due within 120 days after the qualification of the offering statement if such statement did not include audited financial statements – the SEC explains that the purpose of this report would be to "close lengthy gaps in financial reporting between the financial statements included in the offering statement on Form 1-A and the issuer's first periodic report due after the qualification of the offering statement"
	• Reporting of sales upon termination or completion of the offering would be required similar to that for Tier 1 offering

Test the Waters Communications	
Permissible before and after the filing of the offering statement; issuers can solicit any type of investor	
Section 12(a)(2) Liability	
Sellers of securities under Regulation A would have liability under Section 12(a)(2) to investors for any offer or sale by means of an offering circular or oral communication that includes a material misleading statement or misstatement of fact	

Tier 1	Tier 2
Integration	
• Offerings made under Regulation A should not be integrated with another exempt offering, provided each offering complies with the relevant offering exemption requirements • Specific non-integration safe harbor for securities-based crowdfunding transactions conducted in accordance with applicable SEC rules (yet to be adopted) • 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 QIBs and accredited investors	

The proposals would further increase the utility of Regulation A+ by permitting delayed and continuous offerings in specified, limited instances, including under an employee benefit plan or for securities issuable upon the conversion of other outstanding securities, but not including by the issuer or its subsidiary. In addition, the proposals would amend Exchange Act Rule 15c2-11 to permit a Tier 2 issuer's ongoing reports filed in a Tier 2 offering to satisfy a broker-dealer's obligations to review specified information about an issuer and its security before publishing a quotation for a security in a quotation medium.

State Securities Laws

The SEC and others recognize that the current application of state securities laws to Regulation A offerings has greatly limited the utility of Regulation A to date. In light of continued concerns that state securities laws may continue to limit the utility of Regulation A, including as proposed to be expanded for Tier 2 offerings and modernized generally, the North American Securities Administrators Association (NASAA) has proposed a coordinated review program that would permit issuers to file Regulation A offering materials with the states using an electronic reporting system currently being developed by NASAA, which its examiners would review. Much work remains to be done on this review program, which is only in its early stages of development. It is even currently uncertain how many states would elect to participate in any such program.

The SEC notes that, in the absence of such a coordinated review program and revisions to current Regulation A itself, Regulation A issuers would need to continue to analyze and comply with separate and different state registration or qualification requirements, which may be different than and/or in addition to those under Regulation A, or to identify and comply with separate and different state exemptions for each state in which they intend to offer or sell securities under Regulation A. Given that Regulation A offerings may be conducted using general solicitation, the potential need for Regulation A issuers to undertake this work seems likely to continue to result in limited use of Regulation A.

The SEC proposes to address this issue and preempt certain Regulation A+ offerings from state securities law regulation by defining the term "qualified purchaser" in Securities Act Section 3(b)(2) to mean "all offerees" in any Regulation A+ transaction and "all purchasers" in a Tier 2 offering. Limited state preemption is achieved in this way because the JOBS Act added a provision exempting from state law registration and qualification requirements securities that "offered or sold to a qualified purchaser, as

defined by the Commission . . . with respect to that purchase or sale." By revising the definition as proposed, state blue sky rules would be preempted with respect to all offerees in any Regulation A+ offering, which would permit Regulation A+ issuers to use the internet and other means of widespread communication and enable the SEC to expand the "test the waters" provisions already existing under Regulation A. However, issuers in Tier 1 offerings would need to observe state blue sky laws with respect to sales of their securities. By defining "all purchasers in a Tier 2 offering" to be "qualified purchasers," Tier 2 offers and sales would be exempt from state blue sky laws.

What We Might Expect

The SEC explains that the proposals expanding the content of the offering circular for offerings made under Regulation A+ would update the current disclosure requirements under Regulation A and more closely align them with the disclosure requirements for smaller reporting companies conducting registered offerings. The SEC makes a point of stating, however, that "with the exception of the requirements for beneficial ownership, material legal proceedings, and related party transactions for certain issuers, these proposed updates should not result in an overall increase in [a Regulation A+] issuer's disclosure obligations."[1] The SEC seems to seek to support this statement by stating that "while issuers would be provided with more detailed instructions on MD&A disclosure, similar disclosure is already called for under current requirements."[2]

It is interesting that the SEC proposals are intended to align Regulation A+ offering statement disclosure more closely with that for smaller reporting companies conducting registered offerings. In January 2008, the SEC adopted rules defining "smaller reporting companies" (SRCs) as those with a public equity float of less than $75 million or, where the company had no calculable public float, revenues of less than $50 million. The purpose behind the creation of this category of issuers was to reduce their regulatory compliance costs, in part by eliminating the need for such companies to comply with certain provisions of the Sarbanes-Oxley Act and later, the Dodd-Frank Act. For SRCs, the SEC also scaled back disclosure requirements in Regulation S-K and added simplified financial reporting requirements to Regulation S-X (at the same time that it eliminated Regulation S-B). Smaller reporting companies were able to choose, on an item-by-item basis, which of these reporting accommodations they would use.

The SRC reporting regime has been successful, with a large number of SEC registrants filing as SRCs. As the disclosure requirements of Regulation A+ offerings, in particular Tier 2 offerings, would be more closely aligned with the SRC reporting requirements, it seems possible the Regulation A+ may serve as a roadmap for companies intending to go public as smaller reporting companies. The disclosure requirements and process for Tier 2 offering statements are in several ways parallel to registration statements for smaller reporting companies – issuers must file an offering statement that must be qualified (basically the equivalent of being declared effective) and include audited financial statements for the two most recently completed years as well as other disclosures about the issuer's business, management and risks relating to the offering; the offering statement is like an SRC registration statement, but with several additional disclosure accommodations. Tier 2 issuers are then subject to

[1] Securities Act Release No. 33-9497 (Dec. 18, 2013) at 96.
[2] Id.

annual, bi-annual and current reporting requirements that reflect meaningful disclosure accommodations from Forms 10-Q and Form 8-K, but are similar enough that issuers making Tier 2 offerings and disclosures might easily transition to the SRC reporting system should they undertake an IPO.

While Tier 1 offerings remain subject to state blue sky laws as a general matter, Tier 2 offerings are not. And all offers under Regulation A+ are not only exempt from state blue sky laws, but are also permissible before and after the issuer files an offering statement with the SEC. Furthermore, all securities issued under Regulation A+ are unrestricted and can therefore generally be resold immediately. Accordingly, while the financial statement and ongoing reporting requirements under the proposals seem to create significant hurdles for Tier 2 offerings, the proposed benefits may outweigh the costs. The SEC seems to have hope that the proposals will encourage issuers to register with the SEC and list on a national securities exchange.

In summary, while the proposals may not be what market participants were hoping or even planning for, the proposals may jumpstart Regulation A so that it might become useful for certain issuers. If the SEC adopts the proposed rules, market participants who can adapt to the exemption's new disclosure regime may have another useful tool for raising capital.

SEC Request for Comment

The SEC seeks comment on its proposals. Some of the more interesting requests for comment include:

- Whether to limit access to Regulation A on the basis of issuer size
- Whether to permit reporting companies to use Regulation A
- Whether the new Regulation A should be available to foreign issuers that have a "substantial United States nexus" in view of the JOBS Act's goal of promoting domestic job creation
- Whether all, affiliated, or other category of selling security holders be required to observe a holding period for securities offered for resale under Regulation A
- Whether Regulation A securities should, as with securities-based crowdfunding offerings under the JOBS Act, be exempt from Exchange Act Section 12(g) registration requirements, either "conditionally or otherwise"
- Whether electronic filing of Regulation A offering statements should be mandated
- Whether Tier 2 issuers should be required to provide financial statements using XBRL
- Whether the proposed periodic reports required to be filed by Tier 2 issuers should be the same as for non-accelerated filers, such that annual reports would be due 90 rather than 120 days after the fiscal year end and interim periodic reports would be due quarterly within 45 days after the end of each fiscal quarter
- Do the proposed content requirements for annual and bi-annual reports provide for the disclosure of adequate information about the issuer?
- Whether the proposed current reporting requirements for Tier 2 issuers also apply to Tier 1 issuers

- Whether Tier 2 ongoing reports should be deemed to constitute "adequate current public information" for purposes of Rule 144 and Rule 144A
- Whether Regulation A issuers that seek to commence reporting under the Exchange Act (including by listing securities on a national securities exchange) should be required to file a Form 10 or some simpler form, including potentially a Form 8-A, in order to "facilitate IPOs and encourage the listing of securities on national securities exchanges, which would provide benefits to both issuers and investors"
- How can the SEC facilitate secondary market trading in Regulation A securities? Should the SEC encourage the development of "venture exchanges" or other trading venues that would attract such issuers?
- Whether the SEC should take a different approach to preempt Regulation A offerings from state blue sky laws, including to completely preempt Tier 1 offers and sales
- Whether the SEC should expand Regulation A+ to offerings of more than $50 million in a twelve-month period

You can find the full text of the proposal at http://www.sec.gov/rules/proposed/2013/33-9497.pdf.

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