

## SEC ADOPTS REGULATION A+ CAPITAL RAISING ALTERNATIVE

### OVERVIEW

On March 25, 2015, the Securities and Exchange Commission (the "SEC") pleasantly surprised the business community by adopting rules significantly expanding the ability of companies to offer securities without registration under the Securities Act of 1933 (the "Securities Act"). The new rules, which have been dubbed "Regulation A+" by industry insiders, will become effective on or near May 25, 2015. We are excited and pleased by the new rules and are looking forward to utilizing this new opportunity on behalf of our clients. Set forth below is a summary of the key provisions of Regulation A+.

### TWO OFFERING TIERS AUTHORIZED

Regulation A+ creates two tiers of offerings: (i) Tier 1 for offerings of securities up to \$20 million in any 12-month period, of which no more than \$6 million can be sold by affiliated security holders; and (ii) Tier 2 for offering of securities up to \$50 million in any 12-month period, of which no more than \$15 million can be sold by affiliated security holders. Both Tier 1 and Tier 2 offerings have minimum basic requirements, including issuer eligibility provisions and disclosure requirements, which are discussed in more detail below. Also, Tier 2 offerings require ongoing reporting requirements and added disclosures. For offerings up to \$20 million, an issuer can elect to proceed under either Tier 1 or Tier 2.

### STATE LAW PREEMPTION OF TIER 2 OFFERINGS

Briefly, by way of background, Regulation A did not previously exempt state registration and qualification of securities, which greatly limited its utility. Regulation A+, however, preempts state registration and qualification requirements for Tier 2 offerings but not for Tier 1 offerings. States will continue to have the ability to review Tier 1 offerings. However, the North American Securities Administrators Association ("NASAA") recently introduced a coordinated review program for Regulation A offerings to facilitate the filing of Regulation A offerings in multiple U.S. states.

### FREELY TRADABLE SECURITIES

Securities sold under the Regulation A+ exemption, both Tier 1 and Tier 2, will not be subject to transfer restrictions and are not restricted under Rule 144. This is important to an issuer that would like an active trading

market to develop for its securities following completion of a Regulation A+ offering.

### GENERAL SOLICITATIONS

General solicitations are allowed for both Tier 1 and Tier 2 Regulation A+ offerings, and issuers are permitted to discuss and advertise their offerings in multiple ways, including via social media.

### TESTING THE WATERS

Regulation A+ allows for pre-qualification solicitations of interest in an offering commonly referred to as "testing the waters." All solicitation material must be submitted to the SEC as an exhibit of the offering statement submitted to the SEC. Issuers can use "test the waters" solicitation materials both before and after the initial filing of the offering statement. In the event that materials are issued after the filing of an offering circular, the materials must include a current preliminary circular or information on where one can be obtained. "Test the waters" solicitations may be made both orally and in writing. A Regulation A+ company can reach out to retail and non-accredited investors. After the public filing but before SEC qualification, a company may use its preliminary offering circular to make written offers. Of course, all "test the waters" materials are subject to the antifraud provisions of federal securities laws.

### FIXED OFFERING PRICE

Securities sold under the Regulation A+ exemption, both Tier 1 and Tier 2, must be sold at a fixed price.

### ISSUER ELIGIBILITY AND CERTAIN OFFERING RESTRICTIONS

The new Regulation A+ exemption, both Tier 1 and Tier 2, will be available to issuers organized in and having their principal place of business in the United States or Canada. The following issuers will be "ineligible" to offer or sell securities under Regulation A+:

- an issuer that is an SEC-reporting company;
- a blank check company;
- any investment company registered or required to be registered under the Investment Company Act of 1940;
- any entity issuing fractional undivided interests in oil or gas rights, or similar interests in other mineral rights;

- Issuers that have been subject to any order of the SEC under Exchange Act Section 12(j) entered within the past five years;
- issuers that are disqualified under the “bad actor” rules; and
- issuers that become subject to Exchange Act reporting requirements such as through a Tier II offering and do not file required ongoing reports during the preceding two years.

In addition to the restrictions on sales from affiliate security holders, sales by selling security holders in an issuer’s initial Regulation A+ offering and any subsequently qualified Regulation A+ offering within the first 12-month period following the date of qualification of the initial Regulation A+ offering will be limited to no more than 30% of the aggregate offering price.

### **INVESTOR QUALIFICATIONS**

Investors in a Tier 1 offering will not have to meet any particular federal standards, but offers and sales will continue to be subject to state law requirements that may impose their own limitations. Investors in Tier 2 offerings will either have to qualify as an “accredited investor” under Rule 501(a) of Regulation D or be subject to a limit on the amount of securities purchased to no more than: (a) 10% of the greater of annual income or net worth (for natural persons); or (b) 10% of the greater of annual revenue or net assets at fiscal year-end (for non-natural persons). This limit will not apply to purchases of securities that will be listed on a national securities exchange upon qualification. Investors can self-certify by making representations and warranties as to their income and net worth for purposes of determining compliance with the foregoing investment limit, thereby freeing issuers from extensive documentation reviews and verification procedures.

### **ELIGIBLE SECURITIES**

The securities that may be offered under Regulation A+ are limited to equity securities, including warrants, debt securities, and debt securities convertible into or exchangeable into equity interests, including any guarantees of such securities. The final rule excludes asset-backed securities.

### **OFFERING STATEMENTS**

Issuers conducting offerings under Regulation A+ will be required to file offering statements with the SEC and to have the offering statements “qualified” by the SEC before sales may be made.

The rules require use of new modified Form 1-A. Form 1-A consists of three parts: Part I – Notification, Part II – Offering Circular and Part III – Exhibits.

Part I calls for certain basic information about the issuer and the offering, and is primarily designed to confirm and

determine eligibility for the use of the Form and a Regulation A+ offering in general. Part I will include issuer information, issuer eligibility, application of the bad actor disqualification and disclosure, jurisdictions in which securities are to be offered, and unregistered securities issued or sold within one year.

Part II is the offering circular and is similar to the prospectus in a registration statement. Part II requires disclosure of basic information about the issuer and the offering, including material risks, dilution, plan of distribution, use of proceeds, description of the business operations, description of physical properties, discussion of financial condition and results of operations (MD&A), identification of and disclosure about directors, executives and key employees, executive compensation, beneficial security ownership information, related party transactions, description of offered securities, and two years of financial information. The required information in Part II of Form 1-A is scaled down from the requirements in Regulation S-K applicable to Form S-1. Issuers that had previously completed a Regulation A offering and had thereafter been subject to and filed reports with the SEC could incorporate by reference from these reports in future Regulation A+ offering circulars. All financial statements for Regulation A+ offerings must be prepared in accordance with GAAP. Financial statements of a Tier I issuer are not required to be audited unless the issuer has obtained an audit for other purposes. Audited financial statements are required for Tier II issuers. Audit firms for Tier 2 issuers must be independent and PCAOB-registered.

Part III requires an exhibits index and a description of exhibits required to be filed as part of the offering statement.

### **CONFIDENTIAL SUBMISSION OF OFFERING STATEMENTS**

The rules permit an issuer to submit an offering statement to the SEC on a confidential basis. Confidential submissions will allow a Regulation A+ issuer to get the process under way while soliciting interest of investors using the “test the waters” provisions without negative publicity risk if it alters or withdraws the offering before qualification by the SEC. The confidential filing, SEC comments, and all amendments must be publicly filed as exhibits to the offering statement at least 21 calendar days before qualification.

### **CONTINUOUS OFFERINGS**

The final rule would continue to permit continuous or delayed offerings in certain instances, such as for offerings offered or sold on behalf of selling security holders, securities offered under employee benefit plans, securities pledged as collateral, securities issued upon conversion of other outstanding securities or upon the exercise of options, warrants, or rights, etc. Issuers will

be permitted to use offering statement supplements and updates to provide certain information.

#### **EXCHANGE ACT THRESHOLD EXEMPTION**

Exchange Act Section 12(g) requires that an issuer with total assets exceeding \$10,000,000 and a class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited register with the SEC, generally on Form 10, and thereafter be subject to the reporting requirements of the Exchange Act. The new Regulation A+ exempts securities in a Tier II offering from the Section 12(g) registration requirements if the issuer meets all of the following conditions:

- the issuer utilizes an SEC-registered transfer agent;
- the issuer remains subject to the Tier II reporting obligations;
- The issuer is current in its Tier II reporting obligations, including the filing of an annual and semiannual report; and
- the issuer has a public float of less than \$75 million as of the last business day of its most recently completed semiannual period or, if no public float, had annual revenues of less than \$50 million as of its most recently completed fiscal year end.

Moreover, even if a Tier II issuer is not eligible for the Section 12(g) registration exemption as set forth above, that issuer will have a two-year transition period prior to being required to having to register under the Exchange Act, as long as during that two-year period, the issuer continues to file all of its ongoing Regulation A+ reports in a timely manner with the SEC.

#### **ONGOING REPORTING REQUIREMENTS**

While there will be no ongoing reporting regime for Tier 1 offerings, Tier 1 issuers will be required to provide information about sales and to update certain issuer information by filing a Form 1-Z exit report with the SEC not later than 30 calendar days after termination or completion of an offering. Tier 2 issuers will be subject to an ongoing reporting regime. Specifically, Tier 2 issuers will be required to file:

- annual reports on Form 1-K;
- semi-annual reports on Form 1-SA;
- current reports on Form 1-U;
- special financial reports on Form 1-K and Form 1-SA; and
- exit reports on Form 1-Z.

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The ongoing reporting for Tier 2 companies is less demanding than the reporting requirements under the Securities Exchange Act of 1934.

#### **TERMINATION OR SUSPENSION OF TIER 2 DISCLOSURE OBLIGATIONS**

Tier 2 issuers would be permitted to terminate or suspend their ongoing reporting obligations on a basis similar to the provisions for suspension or termination of reporting requirements for Exchange Act filers.

#### **INTEGRATION OF OFFERINGS**

A Regulation A offering will not be integrated with:

1. prior offers or sales of securities; or
2. subsequent offers or sales of securities that are:
  - i. registered under the Securities Act, except as provided in Rule 255(e);
  - ii. made in reliance on Rule 701;
  - iii. made pursuant to an employee benefit plan;
  - iv. made in reliance on Regulation S;
  - v. made pursuant to Section 4(a)(6) of the Securities Act [crowdfunded offerings]; or
  - vi. made more than six months after the completion of the Regulation A offering.

As a result, one could envision an issuer making a private offering under Section 4(a)(2) or Regulation D prior to commencing a Regulation A offering without risking integration of the private offering with the Regulation A offering. An offering made under Regulation A should not be integrated with another exempt offering, provided that each exempt offering complies with the requirements for the exemption that is being relied upon for that particular offering.

#### **ADDITIONAL INFORMATION**

As mentioned, we are excited and pleased by the new rules and are looking forward to utilizing this new opportunity on behalf of clients. Regulation A+ should increase issuers' access to capital that can drive innovation, nurture growth, create new jobs and foster wealth creation, while giving investors more choices and greater access to investment opportunities. Regulation A+ may also offer an attractive alternative to conducting a private placement pursuant to Regulation D for companies seeking to raise capital.

The foregoing article is issued for informational purposes only and is not intended to be construed or used as general legal advice. Please contact one of the attorneys listed above if you have questions regarding this information.