

Can Regulation A+ Succeed Where Regulation A Failed?

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On March 25, 2014, the Securities and Exchange Commission (SEC) adopted final amendments to Regulation A under the Securities Act of 1933, or what is now being referred to as Regulation A+.¹ While much of the existing framework of Regulation A was preserved, Regulation A+ expands the prior exemption to allow an issuer to offer and sell up to \$50 million of securities over a 12-month period in a public offering, without complying with the registration requirements of the Securities Act. Regulation A+ was adopted to implement the rulemaking mandate of Title IV of the Jumpstart Our Business Startups Act (or JOBS Act), which was signed into law in April 2012² and differs slightly from the amendments to Regulation A as proposed by the SEC in December 2013.³

This White Paper summarizes the impetus for and most important provisions of Regulation A+, as well as the possible implications of the Final Rules.

Background

Regulation A, as it existed prior to the Final Rules, provided an exemption from registration requirements of Section 5 of the Securities Act for certain smaller securities offerings of up to \$5 million by private companies. Historically, Regulation A has been rarely utilized as a capital raising tool. This lack of use is

¹ SEC Release No. 33-9741; Amendments to Regulation A; available [here](#) (the Final Rules).

² H.R. 3606, available [here](#).

³ SEC Release No. 33-9497; Proposed Rule for Small and Additional Issues Exemptions under 3(b) of the Securities Act; available [here](#) (the Proposed Rules).

widely attributed to two factors: (i) the offering costs, and burden of SEC review, relative to the dollar amounts being raised, and (ii) the necessity of complying with state blue sky laws in each state where an offering is conducted. From 2012 to 2014 only 26 Regulation A offerings were qualified by the SEC.⁴

Title IV of the JOBS Act, entitled “Small Company Capital Formation,” was intended by Congress to expand the use of Regulation A by solving some of the perceived limitations of the exemption. Section 401 of the JOBS Act amended Section 3(b) of the Securities Act by designating existing Section 3(b), the SEC’s exemptive authority for offerings of up to \$5 million, as Section 3(b)(1), and creating a new Section 3(b)(2).⁵ New Section 3(b)(2) directed the SEC to adopt rules adding a class of securities exempt from the registration requirements of the Securities Act for offerings of up to \$50 million of securities within a 12-month period.⁶

Final Rules

Eligible Issuers

In order to be eligible to issue securities pursuant to the Regulation A+ exemption, an issuer must be organized in and with its principal place of business in the United States or Canada.⁷ The Regulation A+ exemption is unavailable to:

- An issuer that is already an SEC “reporting company”;
- An issuer registered or required to be registered under the Investment Company Act of 1940 (this includes Business Development Companies);
- An issuer that is a “blank check company”;
- An issuer of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights;
- An issuer that has not filed with the SEC the ongoing reports required by Regulation A+ during the two years immediately preceding the filing of a new offering statement (or for such shorter period that the issuer was required to file such reports);
- An issuer that has been subject to an order by the SEC denying, suspending or revoking registration pursuant to Section 12(j) of the Securities Exchange Act of 1934 that was entered into within five years before the filing of the new offering statement; and
- An issuer subject to “bad actor” disqualification under Rule 262.⁸

Eligible Securities

The securities that may be offered pursuant to the Regulation A+ exemption are limited to equity securities, including warrants; debt securities and debt securities convertible into or exchangeable into equity



⁴ SEC Public Statement, “Helping Small Businesses and Protecting Investors” dated March 25, 2015, available [here](#).

⁵ Proposed Rules at I.A

⁶ *Id.*

⁷ Final Rules at II.B.1.; Securities Act Rule 230.251(b)(1)

⁸ Final Rules at II.B.1.; Securities Act Rule 230.251(b)(2)-(8)

interests, including guarantees of such securities.⁹ Asset-backed securities have been specifically excluded from the Final Rules.¹⁰

Offering Limitations and Secondary Sales

The Regulation A+ exemption consists of two tiers of offerings:

- Tier 1 offerings of up to \$20 million in any 12-month period, with not more than \$6 million consisting of offers by selling security-holders that are affiliates of the issuer
- Tier 2 offerings of up to \$50 million in any 12-month period, with not more than \$15 million consisting of offers by selling security-holders that are affiliates of the issuer¹¹

Issuers conducting offerings of up to \$20 million can elect whether to proceed under Tier 1 or Tier 2.¹²

When calculating the offering limit for convertible or exchangeable securities, the Final Rules require issuers to aggregate the price of all securities for which qualification is currently being sought, including the securities underlying any rights to acquire that are convertible, exercisable or exchangeable within the first year after qualification or at the discretion of the issuer.¹³

For both tiers, all selling security holders are limited to no more than 30% of the aggregate of an initial offering or subsequent Regulation A+ offerings for the first 12 months after the initial offering.¹⁴ After the first 12 months, the limit on secondary sales falls away for non-affiliates only.¹⁵

Investment Limitation

Regulation A+ introduces an investment limitation for Tier 2 offerings. The investment limitation will not apply to accredited investors and will not apply if the securities being offered are to be listed on a national securities exchange at the consummation of the offering.¹⁶ A non-accredited investor, however, may not purchase more than 10% of the greater of the investor's annual income or net worth, to be calculated as provided in the accredited investor definition under Rule 501 of Regulation D.¹⁷ An issuer must make investors aware of this investment limitation and may rely on an investor's representation of compliance, unless the issuer knew, at the time of sale, that such representation was untrue.¹⁸

Integration

Under the Final Rules, offerings pursuant to Regulation A+ will not be integrated with:



⁹ Final Rules at II.B.2.; Securities Act Rule 230.261 (c)

¹⁰ Final Rules at II.B.2.

¹¹ Final Rules at II.A.; Securities Act Rule 230.251(a)(1) and 251(a)(2)

¹² Final Rules at II.A.

¹³ Final Rules at II.B.3.a.; Securities Act Rule 230.251

¹⁴ Final Rules at II.A.; Securities Act Rule 230.251(a)(3)

¹⁵ *Id.*

¹⁶ Final Rules at II.B.4. Securities Act Rule 230.251 (d)(2)(C)

¹⁷ *Id.*

¹⁸ Final Rules at II.B.4.; Securities Act Rule 230.251 (d)(2)(D)

- 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 255(c);
 - Made pursuant to Rule 701 under the Securities Act;
 - Made pursuant to an employee benefit plan;
 - Made pursuant to Regulation S;
 - Made pursuant to Section 4(a)(6) of the Securities Act; or
 - Made more than six months after the completion of the Regulation A+ offering.¹⁹

An offering made in reliance on Regulation A+ will 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.²⁰ Moreover, where an issuer abandons a contemplated Regulation A+ offering²¹, the issuer must wait at least 30 calendar days to avoid integration with a subsequent registered offering or else be subject to integration.²²

Liability for Material Misstatements or Omissions

Sellers of Regulation A+ securities will have the risk of Section 12(a)(2) liability in respect of offers or sales made by means of an offering statement or oral communications that include a material misleading statement or omission. Section 12(a)(2) of the Securities Act provides the buyers of securities an express remedy for material misstatements or omissions made by “any seller” in connection with the offer or sale of the issuer’s securities involving a prospectus or oral communications.

This liability risk is not present in offerings made under Rule 506 of Regulation D. Disappointed investors in a Rule 506 offering cannot sue, under the federal securities laws, for negligent misrepresentation (that is, lack of due care or due diligence). As a result of a 1995 Supreme Court decision, *Gustafson v. Alloyd*,²³ which held that the liability provisions of Section 12(a)(2) of the Securities Act do not extend to a private sale, investors in Rule 506 offerings may assert federal claims only under section 10(b) and Rule 10b-5 under the Exchange Act, which require that the investor prove actual intent to defraud, or reckless indifference to the truth of the representations made in the offering. The practical effect of *Gustafson* has been to make it much harder for lawsuits to be maintained by investors in Rule 506 offerings.

As a consequence, Regulation D offerings will continue to have a significant advantage over Regulation A+ offerings in terms of risk of liability.

Resale of Securities Sold under Regulation A+

The securities sold in a Regulation A+ offering will not be considered “restricted securities” under Securities Act Rule 144. As a result, sales of the securities by persons who are not affiliates of the issuer



¹⁹ Final Rules at II.B.5.; Securities Act Rule 230.251(c)

²⁰ Final Rules at II.B.5.

²¹ Before qualification, but after soliciting interest in such offering to persons other than QIBs and institutional accredited investors.

²² Final Rules at II.B.5.; Securities Act Rule 230.255(e)

²³ 513 U.S. 561, 569 (1995)

will not be subject to transfer restrictions. This creates an opportunity for establishment of trading markets in Regulation A+ securities, although the issuer's securities may not be listed or quoted on a securities exchange without registration under Section 12 of the Exchange Act. Affiliates will continue to be subject to Rule 144, however, even if the underlying Regulation A+ securities are not restricted.

Treatment Under Section 12(g)

The Final Rules provide a limited exemption for securities sold pursuant to Regulation A+ from the calculation of "holder of record" for purposes of the Section 12(g) Exchange Act threshold where the issuer is subject to, and is current (as of its fiscal year end) in its Regulation A+ periodic reporting obligations.²⁴ In order for the conditional exemption to apply, issuers must engage the services of a transfer agent registered with the SEC and meet requirements similar to those in the "smaller reporting company" definition.²⁵ An issuer that exceeds the thresholds set forth in the "smaller reporting company" definition will have a two-year transition period before it is required to register its class of securities pursuant to Section 12(g).²⁶

Offering Statement

Electronic Filing

Regulation A+ offering statements and all other documents required to be submitted or filed with the SEC in conjunction with a Regulation A+ offering, such as ongoing reports, must be filed with the SEC electronically on EDGAR.²⁷ Additionally, the Final Rules adopt an "access equals delivery" model for Regulation A+ final offering statements.²⁸ If a preliminary offering statement is used to offer securities to potential investors and the issuer is not yet subject to Tier 2 periodic reporting requirements, the issuer and participating broker-dealer will be required to deliver the preliminary offering statement to potential investors at least 48 hours in advance of sale.²⁹

Non-Public Submission of Draft

The Final Rules allow for non-public submission of draft offering statements by issuers of Regulation A+ securities who have not previously sold securities pursuant to a qualified offering statement under Regulation A+ or an effective registration statement. All non-public draft offering statements must be submitted via EDGAR and must then be filed publicly, along with any correspondence from the SEC relating to such submission, not less than 21 calendar days before qualification of the offering statement.³⁰

 ²⁴ Final Rules at II.B.6.

²⁵ The conditional exemption in the Final Rules is limited to issuers that have a public float of less than \$75 million, determined as of the last business day of its most recently completed semiannual period, or, in the absence of a public float, annual revenues of less than \$50 million, as of the most recently completed fiscal year.

²⁶ Final Rules at II.B.6.

²⁷ Final Rules at II.C.1.; Securities Act Rule 230.251(f)

²⁸ *Id.*

²⁹ Final Rules at II.A.; Securities Act Rule 230.251(d)(2)(B)

³⁰ Final Rules at II.C.2.; Securities Act Rule 230.252(d)

Form and Content

Issuers are required to file an offering statement on Form 1-A, consisting of three parts: Part I (Notification), Part II (Offering Circular) and Part III (Exhibits).³¹

Part I requires disclosure of certain basic information regarding the issuer, its eligibility, the offering details, the jurisdictions where the securities will be offered and sales of unregistered securities.³²

Part II requires disclosure of information “akin to what is required of smaller reporting companies in a prospectus for a registered offering”³³, including, among other things, basic information about the issuer, summary of risk factors, plan of distribution, use of proceeds, discussion and analysis of the issuer’s liquidity and capital resources and results of operations, certain executive compensation disclosure, related party transactions and a description of the securities being offered.³⁴ As an alternative, an issuer can choose to comply with Part I of Form S-1.³⁵

Both Tier 1 and Tier 2 issuers are required to file balance sheets and other required financial statements as of the two most recent fiscal year ends (or such shorter time as such issuer has been in existence). Tier 2 issuers are required to file audited financial statements, while Tier 1 issuers may file unaudited financial statements, provided that such issuer has not already obtained audited financial statements for other purposes. All U.S. issuers are required to prepare financial statement in accordance with U.S. GAAP, while Canadian issuers may prepare financial statements in accordance with U.S. GAAP or IFRS as adopted by the IASB. An issuer may elect to delay implementation of new accounting standards to the same extent as private companies, if such election is disclosed. Financial statements must be dated not more than nine months before the date of the non-public submission, filing or qualification of an issuer’s offering statement, with the most recent annual or interim balance sheet not older than nine months. If interim financial statements are required, they must cover a period of at least six months.³⁶

With the exception of allowing for incorporation by reference of exhibits that were previously filed on EDGAR, Part III remains unchanged from the previous rule.³⁷

The Final Rules provide for certain additional disclosure items applicable to Tier 1 offerings, including a higher related party transaction disclosure threshold, and permit the disclosure of group-level, rather than individual, compensation data for the three highest paid executives or directors of the issuer.³⁸

Qualification

Offering statements must be “qualified” by the SEC before sales of securities may be made pursuant to Regulation A+. Offering statements are declared qualified by a “notice of qualification” issued by the SEC

 ³¹ Securities Act Rule 230.252

³² see Part I to Form 1-A

³³ Final Rules at II.C.3.b.(1).(c).

³⁴ Final Rules at II.C.2.c.; see Part II to Form 1-A

³⁵ Final Rules at II.C.3.; see Part II to Form 1-A

³⁶ *Id.*

³⁷ see Part III to Form 1-A.

³⁸ Final Rules at II.C.3.; see Item 13 of Offering Circular, Part II of Form 1-A.

Division of Corporation Finance, which is analogous to a notice of effectiveness in a registered offering.³⁹ Issuers may withdraw an offering statement with the consent of the Director of the Division, if no securities that are subject to such offering have been sold and the offering statement is not subject to temporary suspension order by the SEC.⁴⁰

Continuous or Delayed Offerings and Supplements

Regulation A+ permits continuous or delayed offerings, which is similar to the “shelf” registration statement process, but requires an issuer to file a post-qualification amendment for any revision or update to a qualified offering statement.⁴¹ Issuers in continuous or delayed Tier 2 offerings are required to be current in their annual and semi-annual reporting obligations in order to conduct such an offering.⁴² The Final Rules provide for the following types of continuous or delayed offerings:

- Securities offered or sold on behalf of a person other than (i) issuer, (ii) its subsidiary or (iii) a person of which the issuer is a subsidiary;
- Securities offered and sold pursuant to (i) a dividend or interest reinvestment plan or (ii) an employee benefit plan;
- Securities issued upon the exercise of outstanding options, warrants or rights;
- Securities issued upon conversion of other outstanding securities;
- Securities pledged as collateral; and
- 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.⁴³

FINRA Review

Securities offered under Regulation A+ remain subject to FINRA Rule 5110, which prohibits FINRA members and their associated persons from participating in any public offering of securities unless they comply with the filing and review requirements of the rule.⁴⁴

Testing the Waters

Regulation A+ allows for an issuer to test the waters with all potential investors for interest in an offering both before and after filing an offering statement with the SEC, subject to issuer compliance with the rules on filing and disclaimers. Testing the waters materials that are used prior to filing the offering statement must be filed with the SEC as exhibits to such offering statement, once submitted. Such materials that are used after an offering statement is filed with the SEC must be accompanied by the offering statement or



³⁹ Final Rules at II.C.5.; Securities Act Rule 230.252(e)

⁴⁰ Final Rules at II.C.1.c.(3).; Securities Act Rule 230.259(a)

⁴¹ Final Rules at II.C.4.; Securities Act Rule 230.252(e)

⁴² Final Rules at II.D.5.; Securities Act Rule 230.251(d)(3).

⁴³ *Id.*

⁴⁴ FINRA Rule 5110.

include a link to the offering statement. Testing the waters materials will be subject to certain legend requirements and to the antifraud and other civil liability provisions of the federal securities laws.⁴⁵

Ongoing Reporting

Tier 1 issuers are not subject to any ongoing reporting obligations other than the obligation to provide certain information on Form 1-Z within 30 days after the completion or termination of an offering.⁴⁶

Tier 2 issuers are required to file each of the following reports with the SEC on an ongoing basis using EDGAR:

- Annual reports on Form 1-K;
- Semi-annual reports on Form 1-SA;
- Current event reports on Form 1-U; and
- Termination or completion reports on Form 1-K or Form 1-Z, respectively.⁴⁷

Form 1-K requires disclosure similar in scope to Form 1-A and covers, among other things:

- The issuer's business and operations for the preceding three years (or since inception, if in existence for less than three years);
- Related party transactions;
- Beneficial ownership of voting securities by executive officers, directors and 10 percent owners;
- Certain information regarding executive officers, directors and significant employees, including a description of business experience and involvement in certain legal proceedings;
- Certain executive compensation data for the most recent fiscal year for the three highest paid executive officers or directors;
- Management's discussion and analysis of the issuer's liquidity, capital resources and results of operations for the two most recently completed fiscal years and
- Two years of audited financial statements.⁴⁸

Forms 1-SA and 1-U are analogous to Forms 10-K and 8-K, respectively, with certain scaled disclosure requirements.⁴⁹

Tier 2 issuers will also be required to file a special financial report to cover financial periods between the most recent period included in a qualified offering statement and the issuer's first periodic report.⁵⁰

Ongoing reports filed by an issuer conducting a Tier 2 offering will satisfy a broker-dealer's obligations under Exchange Act Rule 15c2-11 to maintain current information on the issuer.⁵¹



⁴⁵ Final Rules at II.D.; Securities Act Rules at 230.255

⁴⁶ Final Rules at II.E.c. (The date the offering commenced, the total amount of securities sold, the price of the securities sold, net proceeds to the issuer, etc.)

⁴⁷ Final Rules at II.E.1.c.

⁴⁸ Final Rules at II.E.1.c.(1).(b).

⁴⁹ Securities Act Rule 230.257(b)(3)-(4)

⁵⁰ Securities Act Rule 230.257(b)(2)

A Tier 2 issuer's reporting obligations would suspend should it become subject to the ongoing reporting requirements of Section 13 of the Exchange Act, and may also be suspended at any time by filing a Form 1-Z exit report after completing reporting for the fiscal year in which an offering statement was qualified, so long as (i) the securities of each class to which the offering statement relates are held of record by fewer than 300 persons, or fewer than 1,200 persons for banks or bank holding companies and (ii) offers or sales made in reliance on a qualified Tier 2 offering statement are not ongoing.⁵²

The Final Rules allow a Tier 2 issuer that has provided disclosure in Part II of Form 1-A that follows Part 1 of Form S-1 to file a Form 8-A to list its securities on a national securities exchange. The issuer would thereafter become subject to Exchange Act reporting requirements.⁵³

Bad Actor Disqualification

The Final Rules substantially conform the bad actor qualification of Regulation A+ to those found in Rule 506 of Regulation D, including the addition of a reasonable care exception to the disqualification provisions, which prevents an issuer from losing the benefit of the Regulation A+ exemption if it is able to show that it did not know, and in the exercise of reasonable care could not have known, of the existence of a disqualification.⁵⁴

Relationship with State Securities Laws

The Final Rules provide for the preemption of state securities law registration and qualification requirements for securities that are sold to "qualified purchasers," which are defined as any person to whom securities may be offered or sold in a Tier 2 offering, and for Tier 2 offerings that are listed on a national securities exchange.⁵⁵ States will continue to have the authority to require filing of offering materials and enforce antifraud provisions in connection with Tier 2 offerings.⁵⁶ Tier 1 offerings will remain subject to state securities law requirements.⁵⁷

Practical Application

The requirements for the new category of Tier 1 offerings remain largely in line with the previously existing rules under Regulation A, other than the increase in the maximum offering size from \$5 million to \$20 million. This increase may make raising capital under this alternative more attractive to a number of issuers, as the cost of preparing an offering can be a smaller percentage of the offering size. However, Tier 1 offerings remain subject to state securities laws and a number of public disclosure obligations, including the new requirement to include MD&A-like disclosure in an issuer's offering document.

It remains to be seen whether Tier 2 of Regulation A+ will become an effective avenue for small businesses to raise capital, or if it will remain largely unused like its predecessor rule. In the Final Rules, the SEC recognized that the potential use of Regulation A+ for Tier 2 offerings will "depend largely on how

⁵¹ Final Rules at II.E.2.

⁵² Securities Act Rule 230.257(d)

⁵³ Final Rules at II.E.3.

⁵⁴ Final Rules at II.G.3.; see also Securities Act Rule 230.262(d)

⁵⁵ Final Rules at II.H.

⁵⁶ *Id.*

⁵⁷ *Id.*

issuers perceive the trade-off between costs of qualification and ongoing disclosure requirements and the benefits to issuers from access to a broad investor base, expansion of the offering size, and preemption of state securities law registration requirements and the potential for enhanced secondary market liquidity.⁵⁸

Proponents of Regulation A+ believe that the new Tier 2 exemption will give small businesses access to capital without having to conduct an IPO or complying with the significant restrictions on resale of privately placed securities. Unlike Regulation D, securities offered pursuant to the Regulation A+ Tier 2 exemption will not be subject to restrictions on resale or limits on participation by non-accredited investors. In contrast to Rule 506 of Regulation D, companies relying on the Regulation A+ Tier 2 exemption can sell securities to an unlimited number of non-accredited investors, and the securities will not be restricted securities for purposes of the federal securities laws. Because the investors in a Regulation A+ Tier 2 offering need not be accredited, the exemption has been likened to crowdfunding, allowing issuers to reach a broader investor base.

We believe that it is likely that Regulation A+ will be used not as a standard method of capital-raising, but as a special solution to particular situations in which issuers have a need to offer to a large number of unaccredited investors, without resale restrictions, in order to accomplish purposes of the issuer that may be only partially related to capital-raising.

While a Regulation A+ offering is less expensive than a traditional IPO for issuers making offerings of less than \$50 million, the SEC anticipates that it will take 750 hours to prepare the related filings for a Regulation A+ offering.⁵⁹ Given the time and expense required to make such a filing, it is uncertain whether the expanded rules will provide enough of an incentive for companies to issue securities pursuant to this new exemption, other than in special cases as mentioned in the previous paragraph. Additionally, the expanded reporting requirements contained in Regulation A+ will require that an issuer have sufficient infrastructure in place to meet these ongoing requirements and will likely require the employment of a financial officer who is knowledgeable and experienced with SEC accounting rules, as well as adequate investor relations capacity to respond to any questions from a larger, and potentially less knowledgeable, investor group. Moreover, there is currently no developed trading market for these securities, which may limit the value of the elimination of resale restrictions.

As issuers weigh the pros and cons of Regulation A+, it remains to be seen whether this exemption will prove valuable as a means to achieve the SEC's goal of bolstering the growth and success of our nation's small businesses.

If you have any questions about the content of this white paper, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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 ⁵⁸ Final Rules at III.A.

⁵⁹ Final Rules at III.D.I.

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