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Will Regulation A+ Make the Grade (by Increasing Smaller Company Access to Capital)?

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On December 18, 2013, the Securities and Exchange Commission (SEC) voted to propose amendments to Regulation A, as mandated by Section 401 of the Jumpstart Our Business Startups Act (JOBS Act). The proposals are intended to increase reliance on Regulation A, a little-used exemption from the registration requirements of the Securities Act.

Section 401 of the JOBS Act directs the SEC to adopt rules, dubbed by industry commentators as "Regulation A+," which would exempt offerings of up to $50 million of securities annually from the registration requirements of the Securities Act, an increase from the current limit under Regulation A of $5 million within a 12-month period.

Regulation A securities may be publicly offered pursuant to an offering circular that is part of a filing reviewed and "qualified" by the SEC. The securities may be offered to an unlimited number of investors, including unaccredited investors, and are not subject to holding period restrictions pursuant to Rule 144 under the Securities Act. Under current law, however, Regulation A offerings are subject to registration requirements under state "blue sky" laws, which adds a layer of complexity and expense to an already time-consuming federal filing and review process. This, together with the current exemption's low offering ceiling, has made Regulation A an unattractive way to raise capital.

Under the SEC's proposal, Regulation A would provide for a two-tier offering paradigm. "Tier 1" would consist of those offerings currently covered by Regulation A, while "Tier 2" would permit offerings of up to $50 million in a 12-month period. Offerings by existing security holders would be limited to $1.5 million for Tier 1 and $15 million for Tier 2. Importantly, the SEC has proposed to exempt all Tier 2 offerings from blue sky registration requirements. Tier 1 offerings would remain subject to state securities law review.

Proposed Regulation A+ sets forth detailed disclosure requirements, including audited financial statement requirements for Tier 2 offerings. The offering statement would be filed online and available via EDGAR and issuers could deliver final offering circulars via an "access equals delivery" model. Initial filings could be submitted for SEC review on a confidential basis. Issuers could solicit interest in the

offering before filing an offering statement via "test-the-waters" communications. Companies that had made a Tier 2 offering would be subject to an ongoing reporting system, requiring them to electronically file with the SEC annual and semiannual reports, as well as current reports of certain events. A company could exit the ongoing reporting system at any time after completing the requirements for the fiscal year in which the

offering statement was qualified, provided that the company's securities were held of record by fewer than 300 persons and offers and sales made in reliance on the offering statement were no longer occurring.

At present, Regulation A is unavailable to companies registered or required to be registered under the Investment Company Act, development stage companies that have no specific business plan or purpose or have indicated their business plan is to engage in a merger or acquisition with an unidentified company (so-called "blank check" companies and "SPACs"), and issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights. The exemption is available to Canadian as well as U.S. companies; the SEC has requested comment as to whether the exemption should be extended to non-Canadian foreign private issuers. The SEC has also requested comment as to whether currently non-reporting business development companies, shell and blank check companies and SPACs should be permitted to rely on Regulation A.

The SEC proposes to maintain Regulation A's existing eligibility requirements and to add two new categories of ineligible issuers: (i) issuers that have not filed ongoing reports required by the proposed rules during the two years immediately preceding the filing of a new offering statement, and (ii) issuers that are or have been subject to an order by the SEC denying, suspending, or revoking the registration of a class of securities pursuant to the Securities Exchange Act that was entered within five years before the filing of the offering statement. Issuers may also be disqualified from the exemption under the "bad actor" provisions of Rule 262 of Regulation A, as such provisions are proposed to be amended to be consistent with the "bad actor" disqualifications of Regulation D under the Securities Act. Another investor protection provision included in the proposal is a limitation on the amount of securities investors can purchase in a Tier 2 offering to no more than 10% of the greater of their annual income and their net worth. Issuers would be permitted to rely on representations from investors in complying with this provision.

From 2009 to 2012, a mere $73 million was raised by issuers in nineteen qualified Regulation A offerings. Will the proposed Regulation A+ result in greater usage of the exemption? The answer depends in part on whether the potential liquidity of Regulation A securities will make up for the costs of compliance. In order for Regulation A+ to succeed, the state securities law pre-emption provision must be included in the final rule and a robust market for securities issued under the exemption must develop.

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