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CLIENT ALERT

Regulation A+: Time for an Upgrade

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On March 25, 2015, the SEC approved the long anticipated Final Rules to implement Title IV of the JOBS Act, or as it is being colloquially called, "Regulation A+." The SEC has published the adopting release for the Final Rules here, and the Final Rules will become effective 60 days after publication in the Federal Register. We will provide a more detailed analysis in an upcoming Client Alert, but we wanted to provide a brief summary of our initial reactions to Regulation A+ (for our report last year on the Proposed Rules for Regulation A+, please see here).

As background, the existing Regulation A is rarely used by issuers. With the adoption of Regulation A+, the SEC hopes to provide a viable additional mechanism for capital raising to private placements using Regulation D and an Initial Public Offering using a Registration Statement on Form S-1. Time will tell whether this is the case, but the increase from the existing Regulation A in the amount of capital which can be raised using Regulation A+ and access to a broader investor base than under Regulation D, combined with additional reporting requirements that are less rigorous and costly than those imposed upon traditional reporting companies and the preemption of state securities law registration, may achieve the right balance to make Regulation A+ a tool which issuers consider using.

Access to Capital: Regulation A+ will provide two tiers for companies to raise capital. Tier 1, for offerings of securities of up to $20 million in a 12-month period, with not more than $6 million in offers by selling security-holders that are affiliates of the issuer; and Tier 2, for offerings of securities of up to $50 million in a 12-month period, with not more than $15 million in offers by selling security-holders that are affiliates of the issuer. Tier 1 gives companies a slight increase in the amount that can be raised from that contained in the existing Regulation A. Although additional reporting requirements arise (see below), in an effort to boost capital raising, Tier 2 gives companies a chance to raise significant amounts of capital from a dispersed investor group than is typical under a Regulation D private placement. In addition, as is the case with Emerging Growth Companies filing for an IPO, issuers will be able to "test the waters", including if such issuers make confidential submissions of offering circulars to the SEC for review. However, issuers will have to submit or file solicitation materials as an exhibit when the offering statement is either submitted for non-public review or filed, similar to as is required for Emerging Growth Companies, except that such solicitation materials will become publicly available as a matter of course. Furthermore, limited secondary sales will be permitted, allowing for some liquidity for securityholders, which itself can promote earlier investment into issuers.

The Final Rules will also provide an exemption from Exchange Act Section 12(g) for securities issued in a Tier 2 offering for so long as the issuer remains subject to, and is current in (as of its fiscal year end), its Regulation A+ periodic reporting obligations and meets other requirements. This will ease the regulatory burden on issuers using the regulation. However, short-Form 8-A 1934 Act registration will be possible, and thus it is conceivable that a company could use Regulation A+ to raise sufficient capital to become listed on a national securities exchange. Also, the SEC stated that it is considering encouraging the development of venture exchanges as a way to provide liquidity for smaller issuers, and are contemplating their use for Regulation A+ securities as part of that consideration.

Reporting Requirements: Although Tier 2 allows for more significant amounts of capital to be raised than is currently the case under Regulation A, there will be more reporting and disclosure requirements associated with such offerings. Tier 2 will require companies to include audited financials in offering materials as well as additional reporting requirements which will be at a lower cost than a public company. One step forward is that all offering statements under Regulation A+ will be available on EDGAR. Tier 2 issuers will also have to file annual and semi-annual reports on EDGAR, as well as current event reports which will need to be filed within four business days after the occurrence of a triggering event for the following events: fundamental changes; bankruptcy or receivership; material modification to the rights of security holders; changes in the issuer's certifying accountant; non-reliance on previous financial statements or a related audit report or completed interim review; changes in control of the issuer; departure of the principal executive officer, principal financial officer, or principal accounting officer; and unregistered sales of 10 percent or more of outstanding equity securities.

State Preemption: Regulation A+ also provides that all investors in Tier 2 offerings will be "qualified purchasers," and therefore, the regulation will preempt any state securities law registration and qualification requirements for securities offered or sold in such offerings. In doing so, it is hoped that this will create an easier regulatory path to conducting financings as issuers will only have to comply with one regulatory regime. However, the SEC does believe that state securities regulators will continue to play a vital role in the supervision of Regulation A+ securities. Specifically, state regulators will still have the jurisdiction to investigate and bring enforcement actions with respect to fraudulent securities transactions, the ability to require issuers to file with the states any document filed with the SEC, solely for notice purposes and the assessment of fees, together with a consent to service of process and any required fee, and the power to enforce the filing and fee requirements by suspending the offer or sale of securities within a given state for the failure to file or pay the appropriate fee.

The preemption which will arise for Tier 2 offerings should be contrasted with the result that occurs when public reporting companies that are not listed on a national securities exchange conduct an offering as in such circumstance there is no state preemption. State securities regulators such as the California Department of Business Oversight do impose qualification requirements for such offerings, but will now be faced with a set of offerings over which there will be preemption. The fact that the SEC has decided to preempt state securities regulation of Tier 2 offerings did garner some debate, but the SEC ultimately concluded that it will preserve efficiencies in capital raising. As for Tier 1 offerings, those remain subject to the dual system of Federal and state oversight, although the recently developed coordinated review process which NASAA has put in place should work to improve efficiencies on those offerings as well.

We hope that the new rules when available go far enough to allow companies to access capital in areas that they were not able to under the current rules; however, it is too soon to tell whether Regulation A+ is an upgrade in name only from Regulation A. For the time being, we are continuing to advise emerging company clients which are raising capital to proceed with Regulation D private placements as we look to see how markets develop for Regulation A+ offerings.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

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