# SEC Radically Revamps Regulation A - Part 3

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### Reporting and Blue Sky Issues

For many years, SEC Regulation A languished as an exemption from registration that nobody really used. Although securities issued in a Regulation A offering are not "restricted securities" and are thus freely tradable (if there is a market), the exemption was cumbersome, unfamiliar to both investors and securities practitioners, and limited to $5 million. Regulation D, particularly Rule 506, has been exponentially more important in the capital markets as a way for private companies to raise money.

Under the JOBS Act, which became law in April 2012, the SEC was directed to revise Regulation A so as to make it useable and available for offerings up to $50 million. On March 25, 2015, the Commission promulgated final rules and regulations to amend Regulation A. The new rules will become effective **June 19, 2015**. The dramatically altered Regulation A has been nicknamed "Regulation A+" but in this Alert we will simply refer to it as Regulation A.

This Alert is in three parts (**click here** for Part 1, **click here** for Part 2). **Part 3** focuses primarily on a Regulation A issuer's ongoing reporting requirements, "bad actor" disqualification, and the treatment of Regulation A offerings under state blue sky laws.

## Ongoing Reporting Requirements

Once the SEC qualifies an issuer's offering under either Tier 1 (up to $20 million) or Tier 2 (up to $50 million) of Regulation A, the issuer will be subject to a number of continuing reporting requirements depending on which tier the issuer elects to comply with.

### Tier 1

No ongoing reporting is required for Tier 1 issuers, unless they elect to be treated as Tier 2 issuers. However, Tier 1 issuers are required to disclose a summary of the offering in Part I of Form 1-Z upon the termination of an offering, which includes information about the qualification and commencement dates, the amounts of securities both offered and sold, the price and any net proceeds.

### Tier 2

Tier 2 issuers are required to file reports more frequently with the SEC. Specifically, they must file:

- An annual report on Form 1-K;
- A semi-annual report on Form 1-SA;
- Current event reports on Form 1-U; and
- Forms 1-K and 1-Z upon the termination of the offering.

### Annual Report

The annual report on Form 1-K consists of two parts. Part I is a form requiring basic information about the issuer to be filled in. Part II of Form 1-K requires a text attachment containing the disclosure document and financial statements, including financial information for the two most recently completed fiscal years (consistent with the requirements of Part II of Form 1-A). Form 1-K must be filed within 120 calendar days of the close of the issuer's fiscal year end.

### Semi-Annual Report

Semi-annual reports filed on Form 1-SA primarily consist of disclosing updated financial information and management's discussion and analysis (MD&A). Form 1-SA must be filed within 90 days of the end of the first six months of the issuer's fiscal year.

### Current Report

Form 1-U, or the "current event report," must be filed when the issuer experiences a significant event, including fundamental changes to the company, bankruptcy or receivership, changes in control, or the departure of a principal officer, among others. Similar to Form 8-K, this report must be filed within four business days after the occurrence of any triggering event.

### Other Reports

If Tier 2 issuers do not include financial statements in their qualification application, they must additionally file special financial reports on Forms 1-K and 1-SA to include audited, or in some circumstances unaudited, financial statements for the most recent fiscal year.

Lastly, upon the termination or completion of an offering, Tier 2 issuers are required to disclose a summary of the offering in Parts I of Forms 1-K and 1-Z, including information about the qualification and commencement dates, the amounts of securities both offered and sold, the price and any net proceeds.

### Termination or Suspension of Tier 2 Reporting

Tier 2 issuers may terminate or suspend their reporting requirements in a number of ways. If a Tier 2 issuer opts to register its securities under Section 12 of the Exchange Act, then its ongoing reporting obligations under Regulation A are automatically suspended, but it must now make periodic filings (Forms 10-K, 10-Q and 8-K) as required by the Exchange Act. Further, a Tier 2 issuer may suspend its ongoing reporting obligations after completing its reporting obligations for the fiscal year in which the offering was qualified with the filing of Form 1-Z. In order to do so, the Tier 2 issuer must have filed all of its ongoing reports for the shorter of: (a) the period since the issuer became subject to such reporting obligation; and (b) its three most recent fiscal years and the portion of the current year most recently preceding the filing of Form 1-Z. Further, each class of securities offered must be held by fewer than 300 persons and the offering may not be ongoing in order to suspend the issuer's reporting obligations.

### All Filings Must Be Electronic

All reporting obligations under Regulation A must be made electronically using the SEC's EDGAR filing system.

## Character of Securities and Intersection with the Exchange Act

Securities issued under Regulation A are not "restricted." As a consequence, they are freely tradable, assuming a market exists. This will occur if the issuer lists the securities on a national exchange, thereby registering under Section 12 of the Exchange Act. In that event, the issuer will become subject to the requirements of the relevant stock exchange, as well as those applicable under the Exchange Act (e.g., periodic reporting, the Williams Act, the federal proxy rules, and the short-swing profits recapture rules).

Offerings qualified under Tier 2 of Regulation A may be registered under the Exchange Act through a simplified process. If the Tier 2 issuer makes the disclosures required of Form S-1 when filing Part II of Form 1-A, then the issuer need only file Form 8-A in order to list its securities on a national exchange, rather than the much more burdensome Form 10.

## Broker-Dealer "Current Information"

Under Exchange Act Rule 15c2-11, broker-dealers have an obligation to review information relating to an issuer when publishing quotations for certain over-the-counter equity securities. For Tier 2 companies filing periodic reports, the information published on EDGAR in connection with a Regulation A offering or as part of its ongoing reporting requirements satisfies the "current information" criteria under Rule 15c2-11, and broker-dealers may thus rely on it when making corresponding publications. However, information satisfying Rule 15c2-11 does not constitute "current information" for purposes of Rule 144 and Rule 144A.

## Bad Actor Disqualification

The bad actor disqualification provisions of Regulation A are consistent with those found in Rule 506 of Regulation D in order to foster greater uniformity among the rules. Regulation A includes provisions for the disqualification of felons and other "bad actors" and has aligned its triggering events and covered person provisions with those found in Rule 506(d). Covered persons under Regulation A include managing members of limited liability companies, compensated solicitors of investors, underwriters, executive officers and other officers participating in the offering, and the beneficial owners of 20% or more of the issuer's outstanding voting equity securities.

## Coordination with State Securities Laws

Significantly, Regulation A preempts state securities laws for offerings made under Tier 2 while preserving states' rights to regulate Tier 1 offerings and to require notice of Tier 2 filings made with the SEC for fee collection or enforcement (anti-fraud) action. The preemption of state securities laws for Tier 2 issuers has created some controversy, however, concerning the SEC's authority to promulgate the regulations in this fashion.

Section 18(b)(4)(D) of the Securities Act enables the SEC via regulation to preempt state securities laws for offerings "offered or sold to a qualified purchaser." Further, the SEC may define what constitutes a "qualified purchaser" differently for different types of securities.

In Regulation A, the SEC defines "qualified purchaser" as either an accredited investor or an investor whose investment is limited to no more than 10% of the greater of his or her income or net worth for natural persons or 10% of the greater of annual revenue or net assets for non-natural persons. This definition, limited to Tier 2 offerings, has the effect of preempting state securities laws. Tier 2 offerings will remain subject to limited state securities oversight, which may include the investigation of fraudulent securities transactions and enforcement of related actions; the requirement that issuers file with the state copies of documents that were filed with the SEC and the assessment of associated fees; and the enforcement of suspension actions if filing fees are unpaid.

The avoidance of substantive "blue sky" regulation is expected to make Tier 2 an attractive option for many issuers.

The Tier 2 definition of "qualified purchaser" does not apply to Tier 1 offerings. Thus, Tier 1 issuers are still subject to state regulation and oversight. The SEC takes the view that the smaller Tier 1 offerings are more likely to be of local nature and the state therefore has an enhanced interest in the supervision of solicitation materials and offering process.

Regulation A appears to strike a balance between encouraging capital formation and maintaining oversight of securities offerings, with emphasis focused at the local level for Tier 1 offerings and at the national level for Tier 2 offerings. Companies interested in utilizing Regulation A for securities offerings should seek the advice of counsel to ensure compliance with initial and ongoing regulatory requirements.

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