SEC Releases Proposed Rule Amendments to Regulation A

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On December 18, 2013, the Securities and Exchange Commission released its proposed rule amendments to Regulation A, which were required by Section 401 of the JOBS Act. Among the changes, the proposed rules create two tiers of exemptions and increase the offering limit from $5 million to $50 million. The proposed rules, often referred to as "Regulation A+," are intended to increase access to capital for smaller issuers and to modernize the existing regulations.

Noting that Regulation A is seldom utilized, the SEC observes in the proposing release: "In recent years Regulation A offerings have been rare in comparison to offerings conducted in reliance on other Securities Act exemptions or on a registered basis. From 2009 through 2012, there were 19 qualified Regulation A offerings for a total offering amount of approximately $73 million. During the same period, there were approximately 27,500 offerings of up to $5 million (i.e., at or below the cap on Regulation A offering size) for a total offering amount of approximately $25 billion, claiming a Regulation D exemption, and 373 offerings of up to $5 million for a total amount of approximately $840 million, conducted on a registered basis."

The proposed rules were published in the Federal Register on January 23, 2014 and consequently the comment period expires on March 24, 2014.

Regulation A Exemptions

The proposed rules provide for two tiers of exemptions:

- **Tier 1** would be available for public offerings of up to $5 million (including up to $1.5 million in securities offered by the issuer's security holders) during any 12-month period; and
- **Tier 2** would be available for public offerings of up to $50 million (including up to $15 million in securities offered by the issuer's security holders) during any 12-month period.

The Tier 1 size limitations are the same as those that currently apply under Regulation A. As discussed below, the disclosure obligations and other requirements applicable to each Tier would differ.

Issuer Eligibility Requirements

Under both the current and proposed rules, an eligible issuer must be a company organized in, and have its principal place of business within, the United States or Canada.

In addition, the following issuers are *not* eligible to rely on Regulation A:

- Companies subject to reporting requirements of Section 13 or 15(d) of the Exchange Act;
- Companies registered or required to be registered under the Investment Company Act of 1940;
- Development stage companies with no specific business plan or purpose, and blank-check companies planning to engage in a merger or acquisition with an unidentified company or companies; and
- Companies issuing fractional undivided interests in oil or gas rights or similar interests in other mineral rights.

The proposed rules expand the categories of ineligible issuers to also include the following:

- Issuers that have not complied with the reporting requirements contained in the proposed rules and filed ongoing reports during the two years preceding the filing of a new offering statement; and
- Issuers that have been subject to an SEC order denying, suspending or revoking the registration of a class of securities under the Exchange Act, which order was entered within the five years prior to filing.

The SEC has not yet proposed any restrictions or requirements based on the issuer's size.

Bad Actor Disqualification

Under the proposed rules, Rule 262, which sets forth disqualification provisions under Regulation A, would be revised to substantially conform with new Rule 506(d) which disqualifies "bad actors" from relying on the Regulation D exemption. The SEC noted that this uniform disqualification standard between Regulation A and Regulation D should simplify diligence.

Eligible Securities and Investment Limitations

Under the proposed rules, issuers relying on Regulation A may sell equity securities, debt securities, and debt securities convertible or exchangeable into equity interests, including any guarantees of such securities. The proposed rules would exclude asset-backed securities.

For purposes of investor protection, the SEC also proposes limiting the amount an investor may purchase in a Tier 2 offering to no more than 10% of the greater of such investor's annual income or net worth. The annual income and net worth calculations will be based on the accredited investor definitions under Rule 501 of Regulation D.

Integration

The current rules contain a safe harbor from integration for the following:

- Prior offers or sales of securities; and
- Subsequent offers and sales of securities that are:
    - registered under the Securities Act, except as provided in Rule 254(d) (which creates a safe harbor for issuers who have a *bona fide* change of intention and decide to register securities under the Securities Act before filing the Regulation A offering statement);
    - made in reliance on Rule 701 of the Securities Act;
    - made pursuant to an employee benefit plan;
    - made in reliance on Regulation S ("offshore offerings"); or
    - made more than six months after the Regulation A offering is complete.

Under the proposed rules, the SEC would maintain and expand upon this current safe harbor. The proposed rules would provide that subsequent offers or sales of securities made pursuant to the proposed rules for "crowdfunding" transactions under Title III of the JOBS Act would not be subject to integration. In addition, registered but abandoned Regulation A offerings would not be subject to integration unless the issuer solicited interest from persons other than qualified institutional buyers (QIBs) and institutional accredited investors.

Section 12(g)

In the proposed rules, the SEC declined to exempt Regulation A offerings from the requirements of Section 12(g) of the Exchange Act. Section 12(g) requires an issuer with total assets in excess of $10 million and a class of equity securities held of record by either 2,000 persons (or 500 non-accredited investors) to register such class of securities. Thus, unlike securities issued in "crowfunding" offerings, which are exempted from inclusion when counting the number of holders of an issuer's securities for purposes of Section 12(g), the issuance of securities in Regulation A+ offerings could be the catalyst for requiring Exchange Act registration.

Offering Process

Currently, Regulation A offering statements must be filed in paper form. The proposed rules would provide that the offering statement

(Form 1-A) and other materials must be filed electronically via EDGAR.

Under the proposed rules, Form 1-A would maintain its existing three-part structure:

- **Part I** - Notification
- **Part II** - Offering Circular
- **Part III** - Exhibits

Part I contains certain basic information, including details about the issuer and the offering. The information in Part I would be available on EDGAR but issuers would not be required to otherwise distribute to investors.

The proposed rules set forth significant changes to Part II. The current Model A, which takes the form of a Q&A, would be eliminated in the proposed rules. Model B, described as "a somewhat scaled version of Form S-1," has been retained with modifications. Part II contains two parts – a narrative disclosure and financial statements. Audited financial statements must be provided for Tier 2 offerings.

The proposed rules would eliminate the delaying notation process (and the possibility of automatic effectiveness) and provide that an offering statement can only be qualified by order of the SEC.

Another change to the current rules is that draft offering statements may be submitted on a confidential, non-public basis. Issuers and broker-dealers must deliver a preliminary offering circular to prospective purchasers at least 48 hours in advance of the sale when a preliminary offering circular is used during the prequalification period.

Testing the Waters

Issuers would continue to be permitted to "test the waters" (i.e., evaluate interest in an offering prior to filing an offering statement) under the proposed rules. The SEC declined to adopt the more restrictive standard of Section 5(d) of the Securities Act under which the issuer may only communicate with QIBs and institutional accredited investors. Accordingly, the proposed rules do not restrict the audience for purposes of testing the waters.

The SEC also specified that issuers may use testing the waters solicitation materials both before and after filing an offering statement. If used after an offering statement is filed, a current preliminary offering circular must be included or an EDGAR link to such circular must be provided (or comparable notice on how an investor can obtain a copy of the circular). In addition, under the proposed rules, testing the waters materials must be submitted or filed as an exhibit when the offering statement is submitted for non-public review or filed, rather than at or before the time of first use. Finally, the proposed rules also specify that sales made under Regulation A are contingent upon the qualification of the offering statement, not delivery of a final offering circular.

Ongoing Reporting Requirements

Under the proposed rules, the SEC eliminated the requirement to file a Form 2-A to report sales and termination of sales every six months after qualification and within 30 days after the end of an offering. Instead, issuers will need to file Part I of a Form 1-Z (which generally contains the same information that is disclosed on a Form 2-A) via EDGAR only after the termination or completion of the offering.

The proposed rules contain the following additional requirements for issuers of Tier 2 offerings:

- Form 1-K (summary information on recently completed offering and annual reports);
- Form 1-SA (semiannual updates); and
- Form 1-U (current events).

Tier 2 issuers also must provide notice of suspension of their ongoing reporting obligations on Part II of Form 1-Z. All filings must be submitted via EDGAR.

State Securities Laws

Under the current rules, Regulation A offerings are subject to state securities laws and qualification requirements ("blue sky laws") unless a state-level exemption applies. Under the JOBS Act, offers and sales to "qualified purchasers" now are exempt from blue sky laws. Accordingly, "qualified purchasers" are defined in the proposed rules to include all *offerees* and all *purchasers* in a Tier 2 offering. Tier 1

offerings would continue to be subject to state blue sky laws.

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