JACKO LAW GROUP, PC

Legal Risk Management Tip
July 2015

AMENDED REGULATION A: A "NEW" FINANCING OPTION

Every adviser, broker, and securities attorney has uttered these words to a client hundreds of times: all securities offered in the United States must be registered or qualified under an exemption from registration. Until March 25, 2015, new and seasoned companies alike had two workable options under this rubric: a private offering or going public. However, the recently adopted amendments to the seldom-used Regulation A have created a middle ground and a more flexible option for companies to raise capital.

On June 19, 2015, the Securities and Exchange Commission's ("SEC") final rules for the new and improved Regulation A became effective and brought a rarely used offering avenue into the modern age. Colloquially referred to as "Reg A+", the newest installment of changes under the Jumpstart Our Business Startups ("JOBS") Act allows non-reporting companies to raise as much as $50 million in a twelve-month period. Unlike private offerings under Regulation D, which was arguably the most popular option for smaller issuers to raise capital, Reg A+ allows the issuer to offer its securities to the general public.[1]

New Rules (In a Nut Shell)
Formerly, an exemption from registration under Regulation A was limited to offering of securities of up to $5 million in a twelve-month period, including no more than $1.5 million in securities offered by issuer's security-holders. The offerings under Reg A+ have two tiers: Tier 1 allows offerings of up to $20 million in a twelve-month period, and Tier 2 allows offerings of up to $50 million in a twelve month period. The issuer and its affiliates may sell up to $6 million of securities in a Tier 1 offering, and up to $15 million in a Tier 2 offering.

All sales by security-holders are limited to 30 percent of a particular offering during the twelve months following the offering. For Tier 2 offerings, there is an additional restriction that limits any purchases of securities by a non-accredited investor to no more than the greater of 10 percent of the investor's annual income or net worth. Also, an issuer seeking $20 million or less in capital may rely on the Tier 2 option, but should consider the implications discussed in more detail below.

Similar to its predecessor, Tier 1 offerings must satisfy state registration and qualification requirements. This may be a major consideration for an issuer, which intends to offer its securities in several states; especially states with the tougher review standards. The North American Securities Administrators Association ("NASAA") offers a coordinated review service to issuers with plans to offer their securities for sale in multiple states.[2] Unlike its counterpart, Tier 2 offerings are exempt from state registration and qualification requirements, but are subject to more stringent disclosure and ongoing reporting requirements.

---

[1] The adopting release and final rules may be found at: http://www.sec.gov/news/pressrelease/2015-49.html.
[2] Information on the coordinated review may be found at: http://www.nasaa.org/industry-resources/corporation-finance/coordinated-review/.

Another new requirement is an electronic filing of offering materials on the SEC's EDGAR system, including the new offering statement, Form 1-A, and two years of financial statements (or from inception, if the company is less than two years old). Issuers may submit the offering for non-public SEC staff review before filing, and, as is later discussed, use specific solicitation materials while the filing is under review. The offering statement shall remain private during SEC staff's review, but must be made public 21 days after it is qualified.

According to the SEC staff, the estimated time to complete Form 1-A is 608 hours, but the issuer should allot extra time and resources to prepare exhibits, gather supporting documents, satisfy state-related registration and qualification requirements, and for additional communication with the SEC staff, state regulator(s), and NASAA examiners, if the issuer intends to use the coordinated review process.

Reg A+ exemption is available only to issuers organized and with a principal place of business in the United States and Canada, and is not available to SEC reporting companies, Registered Investment Companies, special purpose entities, shell/shelf companies, and issuers disqualified under the "Bad Actor" rule.[3] The exemption is also not available to: issuers of asset-backed securities or fractional undivided interests in oil, gas, or other mineral rights; issuers whose security registration has been revoked under the Exchange Act, section 12(j)[4] within the past five years; and issuers that have not filed ongoing reports during the preceding two years.

Tier 2-Specific Provisions

Audited Financials
Tier 2 offerings require the issuer to prepare two years of audited financial reports (or from inception, if the company is less than two years old) in accordance with the Generally Accepted Accounting Principles ("GAAP") or the Public Company Accounting Oversight Board ("PCAOB") rules. These will be used to comply with the issuers disclosure obligations – as part of the initial offering statement and registration statement – and to comply with the issuer's ongoing reporting requirements. An issuer must file annual, semiannual, and current event reports.

Testing the Waters
After it files its offering statement, but before the SEC qualifies it, a Tier 2 issuer may use a Preliminary Offering Circular to "test the waters" and use outlets like social media to gauge the public interest in its securities.[5] The issuer must include a copy of the Preliminary Offering Circular as an exhibit to the offering statement and should be aware that the circular is subject to anti-fraud laws and may not contain any false or misleading statements.

Additionally, the Preliminary Offering Circular and any communication concerning the offering must contain a link to the issuer's offering statement on SEC's EDGAR website. The issuer must also instruct the potential investor that the company is not accepting any money or orders

[3] *See* 17 C.F.R. 230.262.
[4] *See* 15 U.S.C. § 78l(j).
[5] *See* 17 C.F.R. 230.255.

until the SEC qualifies the offering statement and that any expressed interest in the security does not compel the investor to purchase the security once the offering statement is qualified.

Before the SEC staff qualifies the offering, issuers may continue to "test the waters" under Tier 1 and 2 offerings. However, in practice, this will most likely be limited to Tier 2 offerings because most states, whose rules still govern Tier 1 offers, impose limitations on, or prohibit such practices.

Lastly, and perhaps most importantly, after the SEC qualifies an offering statement, any communication with potential investors regarding the security or the offering must come from a registered broker-dealer.

Exchange Act, Section 12(g) Registration Requirements

An issuer with assets exceeding $10 million and 2,000 security-holders of record, or 500 security-holders who are not accredited or who did not receive their securities under a compensation plan, must register its securities with the SEC and comply with the periodic reporting requirements under the Securities Exchange Act, section 12(g).[6]

A Tier 2 issuer may avoid the mandatory registration requirements of section 12(g) if it: 1) engages a registered transfer agent; 2) remains subject to, and current on, the Tier 2 reporting obligations; and 3) has a public float of less than $75 million as of the last day of its most recent semiannual period, or, in the absence of a public float, revenues of less than $50 million as of its most recently completed fiscal year.

Listing on a National Exchange

Tier 2 offerings allow the issuer to list its securities on a national exchange. To list its securities, the issuer must file Form 8-A registration statement concurrently with the Form 1-A offering statement. An issuer has to provide additional disclosures in its offering statement and include a set of audited financial statements. According to the SEC, Form 8-A should take approximately 3 hours to complete, but the issuer should allot more time to the preparation of exhibits to the registration statement and the gathering of supporting documents. Of course, there is also the ongoing expense and public scrutiny of being a reporting company.

Conclusion

In deciding whether Tier 1 or Tier 2 offering is more appropriate for your company, the issuer should consult with a qualified securities attorney. Regulation D may still be the best option for new companies, while Reg A+ may be more appropriate for seasoned issuers that have done one or more Regulation D offerings. Even if Reg A+ is a good option for you, Tier 1 or 2 may be more or less appropriate depending on the issuer's long-term strategy and immediate capital needs.

An issuer should also consider the costs and time commitments of conducting a background investigation on its principals to comply with the "Bad Actor" rule, preparing its financials

---

[6] *See* 15 U.S.C. § 78l(g).

(especially if these have to be audited), ensuring it is in compliance with corporate formalities,[7] and cleaning up its capitalization table. Lastly, do not forget that only a registered broker-dealer may communicate with potential investors and sell your securities once the SEC staff qualifies the offering statement, and give thought to who will act as the transfer agent and custodian for the offering.

For more information on Regulation A+, the final rules, or advice on capital raising generally, please contact us at (619) 298-2880 or at info@jackolg.com.

Author: Aleksandr Yarmolinets, Esq., Securities and Corporate Counsel; Editor: Michelle L. Jacko, Esq., Managing Partner, Jacko Law Group, PC. JLG works extensively with investment advisers, broker-dealers, investment companies, hedge funds, banks and corporate clients on securities and corporate counsel matters.

[7] In certain situations, Delaware's General Corporations Law allows companies to ratify certain defective corporate acts and stock. *See* Del.Corp.Law, §§ 204 and 205. A conversion to a Delaware entity may avail an issuer of an opportunity to correct some early-stage oversights and present the issuer's securities as a stronger investment.