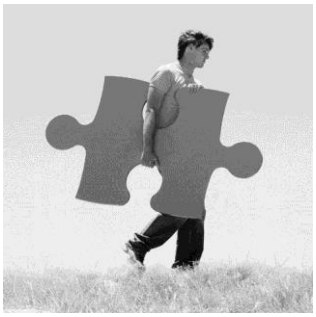
Client Alert

December 19, 2013



A+ Indeed: The SEC's Proposed Rules Amending Reg A

Overview

Yesterday, December 18, 2013, the SEC released proposed rules to carry out the rulemaking mandate of Title IV of the JOBS Act. The proposed rules both retain and modernize the current framework of Regulation A, by expanding Regulation A into two tiers. Tier 1 would preserve the current offering threshold in Regulation A, which permits an issuer to offer and sell up to $5 million in any 12-month period, including no more than $1.5 million in securities sold on behalf of selling stockholders. Tier 1 offerings would be subject to state securities review. Tier 2 would provide an exemption for offerings of up to $50 million in any 12-month period, including no more than $15 million in securities sold on behalf of selling stockholders. Offerings in both tiers are subject to the same basic requirements relating to issuer eligibility, disclosure and other matters.

The proposed rules are intended to help increase access to capital for smaller companies. The proposed rules also take into account all of the factors that were cited in the GAO Report on existing Regulation A. The proposed rules are intended to increase reliance on Regulation A. Generally, the proposed rules build on the existing framework of Regulation A. For example, the proposed rules would preserve the concept of "eligible issuer." The exemption will be available to non-reporting companies organized in the United States or Canada, and would exclude investment companies, companies delinquent in their filing requirements, and issuers subject to certain SEC orders. An issuer would be required to prepare and submit to the SEC for review an offering statement. The offering circular may be submitted confidentially to the SEC for its review. The offering circular would then be filed electronically through EDGAR. Consistent with current Regulation A, issuers would be permitted to conduct test-the-waters communications. The proposed rules would incorporate a new investment limit. The proposed rule would limit the permissible amount to be invested by any individual to the greater of 10% of the individual's net worth or annual income. In addition, the proposed rules contain certain ongoing reporting requirements. An issuer that has conducted a Regulation A offering will be required to make certain limited ongoing SEC filings.

In order to address the most significant impediment associated with current Regulation A, the proposed rule preempts state securities law review for Tier 2 Regulation A offerings (those up to $50 million). The proposed rule does so by defining a "qualified purchaser" as any offeree or purchaser in a Tier 2 offering.

Consistent with existing Regulation A, the securities sold in a Regulation A+ offering will not be "restricted securities."

Background on Regulation A

Section 3(b) of the Securities Act authorizes the SEC to adopt rules and regulations exempting securities from registration if the SEC finds that registration "is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering. . . ." One of the

exemptions that the SEC adopted pursuant to Section 3(b) of the Securities Act is Regulation A.[1] Pursuant to current Regulation A, issuers that are not SEC-reporting companies may raise up to $5 million through sales of their securities in interstate offerings, without complying with the registration requirements of the Securities Act.[2] Regulation A also provides controlling stockholders, as well as non-affiliates, with an opportunity to sell their unregistered securities. When originally enacted, Section 3(b) authorized the SEC to exempt only "small" issues involving offerings of $100,000 or less. Over time, this dollar threshold was adjusted. In 1980, the small issue exemption was increased by Congress to $5 million.[3] However, the SEC did not actually increase the threshold until 1992.[4] A Regulation A offering is not a "private" offering. In fact, it is often referred to as a "mini-registration." Regulation A incorporates a number of conditions that in certain respects resemble the registration requirements of Section 5 of the Securities Act. For example, in order for an issuer to avail itself of the Regulation A exemption, it must prepare and file an offering statement for the SEC's review and approval; deliver the offering statement to prospective investors; and file periodic reports of sales after completion of the offering. Due to the low offering threshold, and without a corresponding state blue sky exemption for securities offered in Regulation A offerings, Regulation A has not provided a viable capital-raising vehicle for smaller companies in recent years, and Rule 506, which has no offering threshold, has become the most commonly used exemption from registration.

Regulation A Reform

Regulation A reform has been considered at various times, but it was not until 2011 and 2012 that legislative efforts to amend the exemption took shape. As discussed below, these legislative proposals, if passed, would have raised the offering threshold and modernized existing Regulation A. Ultimately, however, many of these concepts were incorporated into Title IV of the JOBS Act, titled "Small Company Capital Formation." The topic of increasing the Regulation A dollar threshold was discussed at the SEC's Government-Business Forum on Small Business Capital Formation on November 18, 2010.[5] Moreover, in 2009, the recommendation to raise the dollar threshold made it into the final report of the SEC's Government-Business Forum on Small Business Capital Formation.[6]

Statistics demonstrate that the offering threshold of Regulation A is too low and does not align with market realities.[7] Observers have, in fact, highlighted this issue for a long time, because "the cost of making the offering, including fees for attorneys and accountants and printing costs consume an inordinate percentage of the proceeds of the offering."[8] The threshold has not been increased for almost twenty years.[9] Regulation A has not provided a viable capital-raising vehicle for smaller companies principally due to the low dollar threshold and the burdens associated with state "blue sky" compliance. In connection with a hearing before the House Committee on Financial Services on December 8, 2010, regarding amending the Regulation A offering threshold to $30 million, William R. Hambrecht, Chairman and CEO of WR Hambrecht + Co., stated that, "according to public records, since 2005 there have only been 153 Regulation A filings and of those 153, an astoundingly low number of 13 have

1. Securities Act Release No. 66, 1933 WL 28878 (Nov. 1, 1933).
2. Regulation A consists of Rules 251 through 263. 17 C.F.R. §§ 230.251–.263, hereinafter cited by rule number.
3. *See* Pub. L. No. 96-477, § 301, 94 Stat. 2275, 2291 (1980).
4. *See* Small Business Initiatives, Securities Act Release No. 6949, 1992 WL 188930 (July 30, 1992).
5. *See* 29th ANNUAL SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION, RECORD OF PROCEEDINGS (Nov. 18, 2010) (statement of David Hirschmann, President and CEO of the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce).
6. *See* 2009 ANNUAL SEC GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION 17 (2009).
7. *See* Statement of William R. Hambrecht, Chairman & Chief Exec. Officer, WR Hambrecht + Co. ("According to public records, since 2005 there have only been 153 Reg A filings and of those 153, an astoundingly low number of 13 have actually priced.").
8. *Hearing on Capital Formation Before the S. Subcomm. on Small Business*, 95th Cong. 589 (1978) (statement of Sen. Lowell Weicker).
9. *See A Proposal to Increase the Offering Limit Under SEC Regulation A: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 3 (2010) (statement of Rep. Anna Eshoo, Member of Congress, Cal.) ("The main problem is that hardly anybody uses it. Currently, there is little incentive to support the small initial public offerings under Regulation A. In fact, the current regulations are a disincentive, burdening a $5 million offering with $1 million to $2 million in underwriting expenses. So that is a pretty good reason why people aren't using it.").

actually priced."[10] Representative Barney Frank, who chaired the hearing, noted that the proposal to amend Regulation A should not be "a partisan or terribly controversial one."

In March 2011, legislation was introduced that would have increased the Regulation A offering threshold. This legislation would have amended Section 3(b) of the Securities Act by requiring the SEC to increase the aggregate offering amount to $50 million for exempt offerings of securities. The legislation also would have amended Section 18(b)(4) of the Securities Act by including the securities sold in a Regulation A offering in the definition of "covered security," preempting offerings from state blue sky review. The legislation was met with strong bipartisan support. Ultimately, certain of the changes contemplated in this proposed legislation were incorporated into the JOBS Act.

Title IV of the JOBS Act

Title IV of the JOBS Act does not amend existing Regulation A. Instead, Section 401 of the JOBS Act amends Section 3(b) of the Securities Act by adopting a new section (b). Pursuant to the new Section 3(b)(2), the SEC is authorized to promulgate rules or regulations creating an exemption that is substantially similar to the existing Regulation A for offerings of up to $50 million. The JOBS Act also included certain mandatory provisions.

Section 402 of the JOBS Act requires that the Comptroller General must conduct a study on the impact of blue sky laws on offerings made under Regulation A. Within three months of enactment of the Act, the Comptroller General must deliver the report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate. The study titled "Factors that May Affect Trends in Regulation A Offerings" was delivered in July 2012.[11] The study notes that there are a number of factors that have contributed to the lack of utility of the Regulation A exemption, and highlights the time and expense associated with state blue sky compliance. The study concludes that without preemption of the state blue sky requirements, Regulation D may continue to be used in favor of Regulation A.

Regulation A and Proposed Changes

The availability of Regulation A is conditioned upon meeting certain substantive and procedural requirements.[12] The principal requirement relates to the dollar size of the offering. If that requirement is met, the issuer must file the appropriate forms with the SEC. Failure to comply with either the dollar limit or the filing requirements results in the loss of the exemption and a violation of Section 5 under the Securities Act.

Eligible Issuers

The Regulation A exemption is available for any U.S. or Canadian entity that (i) has its principal place of business in the United States or Canada[13] and (ii) is not subject to reporting obligations under Section 13 or Section 15(d) of the Exchange Act immediately before the offering.[14] The following issuers are "ineligible" to offer or sell securities under Regulation A:

10. *See A Proposal to Increase the Offering Limit Under SEC Regulation A: Hearing Before the H. Comm. on Fin. Servs.*, 111th Cong. 32 (2010) (prepared statement of William R. Hambrecht, Chairman & Chief Exec. Officer, WR Hambrecht + Co.).
11. *See* study available at http://www.gao.gov/assets/600/592113.pdf.
12. *See generally* Rules 251–63, 17 C.F.R. §§ 230.251–.263.
13. Rule 251(a)(1). An issuer that is a corporation, an unincorporated association, or a trust must be incorporated or organized "under the laws of the United States or Canada, or any State, Province, Territory or possession thereof, or the District of Columbia."
14. Rule 251(a)(2). The requirement that the issuer must be a non-reporting company was added to Regulation A in 1992. *See* Small Business Initiatives, Securities Act Release No. 6949, 1992 WL 188930 (July 30, 1992).

(1) any issuer that is a development stage company that either has no specific business plan or purpose, or has indicated that its business plan is to merge with an unidentified company or companies;[15]

(2) any investment company registered or required to be registered under the Investment Company Act of 1940;[16] and

(3) any entity issuing fractional undivided interests in oil or gas rights, or similar interests in other mineral rights.[17]

Rule 262 of Regulation A also contains certain bad actor provisions, identifying specific types of improper conduct undertaken by an issuer or certain affiliated parties that will disqualify the issuer from being able to avail itself of Regulation A.[18] The proposed rule would retain but revise the bad actor provisions.

The proposed amendments would make the exemption unavailable to: issuers that have not filed with the SEC the ongoing reports required by the proposed rules during the two years immediately preceding the filing of a new offering statement; and issuers that are or have been subject to an SEC order denying, suspending, or revoking the registration of a class of securities under the Exchange Act.

Eligible Securities

The securities that may be offered under Regulation A are limited to equity securities, debt securities and debt securities convertible into or exchangeable into equity interests, including any guarantees of such securities. The proposed rule would exclude asset-backed securities.

Offerings by Selling Security Holders

Currently, Regulation A may be used by an issuer to conduct a primary offering of its securities with the proceeds to be used by the issuer, as well as to conduct a secondary offering of securities on behalf of selling security holders.[19] There are a few limitations built into Rule 251(b) as it relates to secondary offerings of securities on behalf of selling security holders. First, no affiliate resales are permitted if the issuer has not had net income from continuing operations in at least one of its last two fiscal years. Second, Rule 251(b) limits the offering amount to $1.5 million offered by all selling security holders. Continuous or delayed offerings may be made pursuant to Regulation A if permitted by Rule 415.[20] An offering circular for a continuous offering must be updated to include, among other things, updated financial statements, twelve months after the date the offering statement was qualified.[21]

The proposed rule would continue to permit use of the exemption for sales on behalf of selling security holders as discussed in the "Overview" above. Sales by selling security holders would be aggregated with sales of securities under Regulation A by the issuer. The proposed rule would eliminate the prohibition on affiliate resales unless the issuer has had net income from operations in at least one of the last two fiscal years.

15. Rule 251(a)(3). The term "development stage company" is not defined in Regulation A or Rule 405. However, the adopting release makes clear that Rule 251(a)(3) is intended to disqualify only "blank check" companies. *See* 1992 WL 188930, at *3.
16. Rule 251(a)(4).
17. Rule 251(a)(5). Note that Rule 251(a)(5) does not prevent companies in the oil and gas industry from using Regulation A for offerings of, for example, their common stock or bonds.
18. *See* Rules 262(a), (b), and (c).
19. *See* Rule 251(b).
20. Rule 251(d)(3).
21. Rule 253(e)(2).

Investment Limitation

Currently, Regulation A does not contain a limit on the amount of securities that may be purchased by an investor. However, to address potential investor protection concerns, the proposed rule would impose an investment limit for Tier 2 offerings. An investor in a Tier 2 offering would be required to limit purchases to no more than 10% of the greater of the investor's annual income and net worth.

Integration of Offerings

Rule 251 of Regulation A provides for certain integration safe harbors. Rule 251(c) provides that offers or sales made in reliance on Regulation A will not be integrated with:

(1) prior offers or sales of securities; or

(2) subsequent offers or sales of securities that are:

(i) registered under the Securities Act, except as provided in Rule 254(d);

(ii) made in reliance on Rule 701;

(iii) made pursuant to an employee benefit plan;

(iv) made in reliance on Regulation S; or

(v) made more than six months after the completion of the Regulation A offering.

Rule 251(c)(1) provides certainty from integration with respect to *any* offers or sales of securities. For example, an issuer could make a private offering under Section 4(a)(2) or Regulation D prior to commencing a Regulation A offering without risking integration of the private offering with the Regulation A offering. For offerings made subsequent to the Regulation A offering, the Rule 251(c)(2) safe harbor period begins at the latest "six months after completion of the Regulation A offering;"[22] however, depending on how the offering is structured, as enumerated by Rules 251(c)(2)(i)–(iv), it may begin immediately subsequent to completion of the Regulation A offering. In addition, a note to Rule 251(c) provides that, if the integration safe harbor is unavailable, offers and sales still may not be integrated with a Regulation A offering, subject to the particular facts and circumstances.

The proposed rule would preserve the integration safe harbors and add to the list of specific safe harbor provisions subsequent offers or sales made in crowdfunded offerings. The proposed rule also would address abandoned offerings by providing that where an issuer decides to register an offering after soliciting interest in a contemplated, but abandoned, Regulation A offering, any offers made pursuant to Regulation A would not be subject to integration with the registered offering, unless the issuer engaged in solicitations of interest in reliance on Regulation A to persons other than QIBs and institutional accredited investors in test-the-waters communications. An issuer that had solicited a broader group of offerees would be subject to a 30-calendar day cooling off period between the last such solicitation of interest in the Regulation A offering and the SEC filing.

Exchange Act Threshold

The proposed rule would not exempt securities sold pursuant to Regulation A from the Section 12(g) Exchange Act threshold. This would require that an issuer monitor closely the number of holders for Exchange Act purposes,

22. Rule 251(c)(2)(v).

which may be difficult given that securities sold pursuant to Regulation A are not considered "restricted securities" and may be transferred freely.

Securities Act Liability

Sellers of Regulation A securities would have Section 12(a)(2) liability in respect of offers or sales made by means of an offering circular or oral communications that include a material misleading statement or material misstatement of fact. An exempt offering pursuant to Regulation A is excluded from the operation of Section 11 of the Securities Act. Regulation A offerings are, however, subject to the antifraud provisions under the federal securities laws.

Offering Disclosures

An issuer that seeks to rely on Regulation A must file and qualify an offering statement.[23] The offering statement is intended to be a disclosure document that provides potential investors with information that will form the basis for their investment decision. In July 1992, as part of its Small Business Initiative, the SEC adopted significant amendments to Regulation A. These amendments imposed requirements for the offering circular, which had the effect of creating more similarities between an offering circular and a prospectus used in a registered offering. However, an offering circular is generally less detailed. Rule 253(a) provides that an offering circular must include the narrative and financial information required by Form 1-A.[24] Rule 252(a) also requires that "any other material information necessary to make the required statements, in the light of the circumstances under which they are made, not misleading" be included.

Part II of Form 1-A sets forth the specific information required to be disclosed and provides two formats for the offering circular: (A) all corporate issuers may use Model A of Part II of Form 1-A and disclose the information required by the form; and (B) all other issuers, and any issuer that so chooses (including corporate issuers), may use either Part I of Form S-1, except for the financial statements required by Form S-1, or Model B of Part II of Form 1-A.[25] Depending on the type of issuer, the required disclosure content must follow either Model A, which follows a "question-and-answer" format, or Model B, which is generally similar to an S-form registration statement, or Part I of Form S-1. Financial statements for the preceding two fiscal years must be filed as part of the offering statement and included in the offering circular under both models.[26] Unless an issuer has prepared audited financials for other purposes, the financial statements to be filed under Regulation A need not be audited.[27] The financial statements must be prepared in accordance with generally accepted accounting principles (GAAP) in the United States. Regulation A filings are not currently made via the SEC's electronic filing system (EDGAR).

The proposed rule would retain Form 1-A's current structure, Part I (the Notification), Part II (the Offering Circular), and Part III (Exhibits), but would make various revisions to the form. Currently, Part II of Form 1-A provides issuers with three options for narrative disclosure (Model A, Model B, and Part 1 of Form S-1). The proposed rule would eliminate Model A and preserve and update Model B. Model B requires disclosures of basic information about the issuer; material risks; use of proceeds; an overview of the issuer's business; an MD&A type discussion; disclosures about executive officers and directors and compensation; beneficial ownership information; related party transactions; a description of the offered securities; and two years of financial statements. The disclosure requirements would continue to be scaled. For Tier 1 offerings, audited financial statements would be required only to the extent they were prepared for other purposes. For Tier 2 offerings, audited financial statements are required. For Tier 1 offerings, the auditors of financial statements must meet the

23. *See* Rules 252(e) and (g).
24. Rule 253(a).
25. *See* Form 1-A, Part II. 17 C.F.R. § 239.90.
26. *See* Form 1-A, Part F/S. If the issuer has been in business for less than two years, financial statements for that shorter period are required. *Id.*
27. *Id.*

independence standards but need not be PCAOB-registered. For Tier 2 offerings, audited financial statements must be audited in accordance with PCAOB standards.

The proposed rule would revise the qualification process for Regulation A offerings and require that an offering statement could only be qualified by an SEC order, so that the SEC Staff has an opportunity to review and comment on the offering statement before it becomes effective. The proposed rule would require offering statements to be submitted through EDGAR. An issuer or broker-dealer would be required to deliver only a preliminary offering circular to prospective purchasers at least 48 hours in advance of sale when a preliminary offering circular is used to offer securities. A final offering circular would continue to be required to accompany or precede any written communications that constitute an offer in the post-qualification period. Reliance on electronic delivery would require that investors consent to electronic delivery.

The proposed rule would permit confidential submission of offering statements for first time offerings under Regulation A. The initial confidential submission and subsequent confidential amendments and SEC correspondence regarding the submissions would be required to be publicly filed as exhibits to the offering statement not less than 21 calendar days before qualification of the offering statement. Timing of the public filing would not be tied to the commencement of a "road show."

Continuous Offerings

The proposed rule would continue to permit continuous or delayed offerings in certain instances, such as for offerings offered or sold on behalf of selling security holders, securities offered under employee benefit plans, and securities issued upon the exercise of options, warrants, or rights, etc.

Offering Communications

An issuer engaged in a Regulation A offering has substantial flexibility regarding offering communications. This is especially true if one compares the types of communications permitted under Regulation A with the limitations on issuer communications in connection with most private placements. No sale of securities can be completed without the use of an offering circular; however, an issuer may solicit retail investors, including investors that are not accredited investors. In addition, an issuer may test the waters prior to preparing and filing offering materials. This is an important advantage associated with a Regulation A offering. In the pre-filing period, before the issuer files an offering statement, Rule 254(a) allows an issuer to publish or deliver to prospective purchasers a written document or to make scripted radio or television broadcasts to determine whether there is interest in a contemplated securities offering.[28] An issuer must comply with specified requirements in connection with any test-the-waters communications, including the use of certain disclaimers on any offering materials used for this purpose.

The proposed rule would not modify the types of investors that may be contacted in test-the- waters communications. However, the proposed rule would permit issuers to use test-the-waters materials both before and after the issuer files the offering statement, subject to compliance with disclaimer and filing requirements. The proposed rule would require that an issuer submit or file solicitation material with the SEC.

Ongoing Reporting Requirements

Currently, Regulation A does not require that issuers file ongoing reports with the SEC, other than a Form 2-A to report sales or termination of sales made under Regulation A. The proposed rule would rescind Form 2-A. The proposed rule would require that Tier 1 issuers provide certain information about their Regulation A offerings on a new form, Form 1-Z. Issuers in Tier 2 offerings would be subject to an ongoing reporting regime. Similar to the

28. Rule 254(a).

ongoing reporting regime that the SEC proposed in connection with issuers that conduct crowdfunded offerings, Tier 2 issuers would be required to file:

- annual reports on Form 1-K;
- semi-annual reports on Form 1-SA;
- current reports on Form 1-U; and
- special financial reports on Form 1-K and Form 1-SA.

The Form 1-K would require disclosures relating to the issuer's business and operations for the preceding three years (or since inception if in existence for less than three years); related party transactions; beneficial ownership; executive officers and directors; executive compensation; MD&A; and two years of audited financial statements. The semiannual report would be similar to a Form 10-Q, although it would be subject to scaled disclosure requirements.

Tier 2 issuers would be permitted to terminate or suspend their ongoing reporting obligations on a basis similar to the provisions for suspension or termination of reporting requirements for Exchange Act filers. A Tier 2 issuer that has filed all required ongoing reports for the shorter of: (1) the period since the issuer became subject to such reporting obligations, or (2) its most recent three fiscal years and the portion of the current year preceding the date of filing Form 1-Z (termination or exit form) to suspend reporting obligations at any time after completing reporting for the fiscal year in which the offering statement was qualified, if the securities of each class to which the offering statement relates are held of record by fewer than 300 persons and offers or sales made in reliance on a qualified offering statement are not ongoing. Reporting requirements pursuant to Regulation A would be automatically suspended if an issuer registers a class of securities under Section 12 of the Exchange Act.

National Securities Exchanges

The proposing release indicates that a review of the mandatory ongoing reports would be sufficient to satisfy a broker-dealer's obligations under Exchange Act Rule 15c2-11 to review information about an issuer in connection with publishing quotations on any facility other than a national securities exchange.

Unfortunately, the proposed rule does not address any measures that would facilitate listing of securities offered pursuant to Regulation A on a national securities exchange. The proposing release notes that an issuer would still be required to file a Form 10 to do so.

Character of the Securities Sold in a Regulation A Offering

The securities sold in a Regulation A offering are not considered "restricted securities" under the Securities Act. As a result, the securities are not subject to any transfer restrictions and may be offered and sold to retail investors. This is important to an issuer that would like an active trading market to develop for its securities following completion of a Regulation A offering. However, the issuer's securities may not be listed or quoted on a securities exchange, and, as a result, there may not be a liquid market for the securities.

State Securities Law Requirements

As discussed above, one of the most significant concerns regarding the use of the current Regulation A exemption has been the requirement to comply with state securities laws. Historically, there was no coordinated review process by the states for Regulation A offerings. Although NASAA has now proposed a coordinated review process for Regulation A offerings, the details have not been finalized. The proposed rule provides that securities offered in Tier 1 offerings will remain subject to state review. However, securities offered in Tier 2 offerings will not be subject to state review if the securities are sold to "qualified purchasers" or, as provided by statute in the JOBS

Act, listed on a national securities exchange. The proposed rule would define the term "qualified purchaser" in a Regulation A offering to include: all offerees in a Tier 2 offering and all purchasers in a Tier 2 offering. Given that the proposed rule imposes an investment limitation, enhanced disclosure requirements, and new ongoing reporting requirements, investor protection concerns have been addressed adequately.

FINRA Review

For any public offering of securities, FINRA Rule 5110 prohibits FINRA members and their associated persons from participating in any manner unless they comply with the filing requirements of the rule.[29] Rule 5110 also contains rules regarding underwriting compensation. Rule 5110(b) requires that certain documents and information be filed with and reviewed by FINRA, and these filing and review requirements apply to securities offered under Regulation A.[30]

Why Use Regulation A?

Many clients have asked us why an issuer might choose to rely on Section 3(b)(2) if the issuer could rely on Rule 506 of Regulation D. An exempt offering, including, for example, a Regulation D offering, may still be subject to several limitations that may not be appealing to an issuer, and a registered public offering may still be too time-consuming and costly. Using the new Section 3(b)(2) provisions to offer securities can provide an issuer with an offering format that is similar to a registered offering with certain accompanying advantages, but may be more efficient. It might be especially appealing for an issuer to consider this type of offering as a precursor to an IPO. An issuer will be required to prepare and furnish certain offering disclosures in connection with a Section 3(b)(2) offering, while there are no information requirements associated with a Rule 506 offering. However, in practice, most issuers will prepare some disclosure materials to share with prospective investors, even in a Rule 506 offering. An issuer may want to preserve the opportunity to approach investors that are not accredited, and may do so in connection with a Section 3(b)(2) offering. Securities sold in a Rule 506 offering will be "restricted securities" that are subject to transfer restrictions. This tends to limit the market for the securities. An investor may have a preference for purchasing securities that are not "restricted securities" and that may be freely transferred.

A non-reporting company may choose to undertake a Section 3(b)(2) offering or a Regulation D offering and remain below the shareholder threshold for required Exchange Act reporting. If it were to do so, a market for its securities may or may not develop. A non-reporting company that undertakes a Section 3(b)(2) offering may also use the offering as an IPO.

The new Section 3(b)(2) exemption should be flexible enough to facilitate a contemporaneous listing on a securities exchange for an issuer that elects to become a reporting company following completion of its Section 3(b)(2) offering. An emerging company may be able to satisfy the market capitalization and public float requirements of a securities exchange upon completion of its Section 3(b)(2) offering. Currently, if an issuer were to seek to list its securities on a national securities exchange in conjunction with, or following the completion of, a Section 3(b)(2) offering, it would be required to prepare and file with the SEC a registration statement on Form 10. Many of the comment letters submitted to the SEC on Title IV of the JOBS Act have suggested that the SEC modify the approach to Exchange Act registration for those issuers that choose to use a Section 3(b)(2) offering as an IPO. Now, of course, an issuer that qualifies as an emerging growth company also would be able to avail itself of the Title I on-ramp approach. A traditional IPO, even with the accommodations now made available to emerging growth companies by Title I, may not be a realistic alternative for smaller companies. Many investment banks will only undertake an IPO if it is of a certain size, and smaller companies may still seek to undertake IPOs in which they offer up to $50 million in securities. For smaller IPOs of the sort that were once common in the United States, Regulation A may prove the only realistic approach.

29. *See* FINRA Rule 5110.
30. *See* NASD Notice to Members 92-28 (May 1992); *see also* NASD Notice to Members 86-27 (Apr. 1986).

Costs and Flexibility

The costs associated with external advisors, such as counsel and auditors, also will be lower in connection with a Regulation A offering. Also, management time devoted to the preparation of the offering circular will be less. The review process undertaken by SEC staff is generally shorter than the review and comment process in connection with a full registration. A registration statement on Form S-1 would always be subject to complete review by the SEC staff in connection with an issuer's IPO. Timing is often the most important determinant of success for an offering. Inability to initiate an offering during a favorable "market window" may result in the issuer not being able to conduct an offering at all. Regulation A may provide flexibility to the issuer in this respect.

No Limitation on Offerees

Regulation A does not impose any limitations on offerees. In contrast to Rules 505 and 506 of Regulation D, Regulation A does not limit the number of offerees or investors that can participate in an offering, nor does it impose any requirement that offerees be accredited or sophisticated investors.

Nature of Securities

Securities offered and sold pursuant to Regulation A are offered publicly and are not "restricted securities." The securities are freely tradable in the secondary market (assuming that there is a secondary market) after the offering. As a practical matter, the securities likely will trade on the Pink Sheets or in the over-the-counter market unless the issuer has taken steps to list the class of securities on an exchange. No holding period applies to the holder of securities purchased in a Regulation A offering. Because an issuer may remain a non-reporting company after completion of a Regulation A offering, there may not be an active secondary market. If a smaller company chooses to list a class of securities on a major exchange, it will become subject to Exchange Act reporting. Certain institutional investors have limitations on the amount that they may invest in "restricted securities." These restrictions generally would not apply to investments in securities issued pursuant to Regulation A.

Testing the Waters, Advertising, and General Solicitation

The ability to test the waters in connection with a Regulation A offering may make a Regulation A offering more appealing (if the dollar threshold is increased) than a Regulation D offering, even with the relaxation of the prohibition on general solicitation for certain offerings made pursuant to Regulation 506.

Looking Ahead

In proposing the rule amendments to Regulation A, the SEC has moved the United States one step closer to realizing the potential of the JOBS Act. In the next 60 days, the Staff of the SEC likely will be receiving comment letters focusing on a number of different issues and reflecting any number of different points of view. We expect that the proposed amendments may be modified here and there, but likely will become final in substantially the form in which they were proposed. If that occurs, we expect that, over time, the amended Regulation A has the potential to become an important capital raising alternative for growing companies in the United States for which the IPO "on ramp" may be too steep a climb, or too costly an alternative.

The first chart below compares the current Regulation A requirements and the proposed Tier 1 and Tier 2 Regulation A exemptions. The second chart below updates the comparison of exempt offering methodologies to reflect the proposed rules.

	Regulation A Exempt Public Offering	**Tier 1 of Proposed Regulation A**	**Tier 2 of Proposed Regulation A**
Offering Limit	Up to $5 million within the prior 12-month period.	Up to $5 million in a 12-month period.	Up to $50 million in a 12-month period.
SEC Filing Requirements	Must file with the SEC a Form 1-A, which is reviewed by the SEC Staff.	Must file with the SEC a Form 1-A, which must be reviewed and declared effective.	Must file with the SEC a Form 1-A, which must be reviewed and declared effective.
Blue Sky Requirements	Blue sky law compliance is required, without, in many cases, the possibility for a more streamlined "registration by coordination" process.	Blue sky law compliance is required.	Exempt from state law review, for offerings to qualified purchasers or where securities are listed on a national securities exchange.
Limitations on Investors	No limits on investors, except to the extent imposed under state laws.	No limits.	No limits on offerees. Investment limit applicable.
Restrictions on Resale of Securities	No restrictions on the resale of securities, except to the extent that the securities are held by affiliates.	No restrictions on the resale of securities.	No restrictions on the resale of securities.
Offering Communications	An issuer may "test the waters" to determine if there is interest in a proposed offering prior to filing the Form 1-A. Sales literature may be used before the filing of the Form 1-A, after filing, and following qualification.	An issuer may test the waters with all investors. Solicitation materials must be filed with the SEC.	An issuer may test the waters with all investors. Solicitation materials must be filed with the SEC.
Financial Statement Requirements	A current balance sheet, as well as income statements for a period of two years, as well as any interim period. Financial statements must be prepared in accordance with GAAP but do not have to conform to Regulation S-X and, in most cases, do not have to be audited.	• Audited financial statements only if prepared for other purposes. If audited, then must be audited by an independent accountant, but not required to be PCAOB-registered. • Current balance sheet, income statement for two years, as well as any interim period.	• Audited financial statements required, reviewed by an independent accountant and prepared in accordance with PCAOB standards.
Disqualification Provisions	Felons and bad actors disqualified from the offering in accordance with Securities Act Rule 262.	Felons and bad actors disqualified; Rule 262 updated.	Felons and bad actors disqualified; Rule 262 updated.
Ongoing Reporting	No reporting required after the offering, other than to disclose the use of proceeds.	A termination report required.	Yes. A Tier 2 issuer will be subject to filing requirements, including a requirement to file: periodic reports; semi-annual reports; and an annual report, until obligations are terminated or suspended.

Type of Offering	Dollar Limit	Manner of Offering	Issuer and Investor Requirements	Filing Requirement	Restriction on Resale	Blue Sky Exemption
Section 3(a)(11)	None.	No limitation other than to maintain intrastate character of offering.	All issuers and investors must be resident in state. No limitation on number.	None.	Rests within the state (generally a one-year period for resales within state).	Need to comply with state blue sky laws by registration or state exemption.
Section 4(a)(2)	None.	No general solicitation or general advertising.	All issuers and investors must meet sophistication and access to information test so as not to need protection of registration.	None.	Restricted securities.	Need to comply with state blue sky laws.
Rule 504 Regulation D	$1 million within prior 12 months.	No general solicitation or general advertising unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sales to accredited investors with general solicitation.	No requirements.	File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted unless registered in a state requiring use of a substantive disclosure document or sold under state exemption for sale to accredited investors with general solicitation.	Need to comply with state blue sky laws by registration or state exemption.
Rule 505 Regulation D	$5 million within prior 12 months	No general solicitation or advertising.	Unlimited accredited investors and 35 non-accredited investors.	File Form D with the Commission not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted securities.	Need to comply with state blue sky laws.
Rule 506 Regulation D	None.	No general solicitation or advertising under Rule 506(b). General solicitation and general advertising permitted under Rule 506(c), provided all purchasers are accredited investors.	Under Rule 506(b), unlimited accredited investors and 35 non-accredited investors. Under Rule 506(c), all purchasers must be accredited investors.	File Form D with SEC not later than 15 days after first sale. Filing not a condition of the exemption.	Restricted securities.	No need to comply with state blue sky laws.
Tier 1 Regulation A	$5 million within prior 12 months, but no more than $1.5 million by selling security holders.	"Testing the waters" permitted before filing Form 1-A. Sales permitted after Form 1-A qualified.	Eligible Issuer No investor requirement.	File test-the-waters documents, Form 1-A, any sales material and report of sales and use of proceeds with the Commission.	None; freely resalable.	Need to comply with state blue sky laws.

Tier 2 Regulation A	$50 million within the prior 12 months, but no more than $15 million by selling security holders.	"Testing the waters" permitted before filing Form 1-A. Sales permitted after Form 1-A qualified.	Eligible Issuer No investor requirement; however, investors are subject to an investment limit.	File test-the-waters documents, Form 1-A, any sales material and report of sales and use of proceeds with the Commission. Issuer subject to ongoing reporting requirements.	None; freely resalable.	No need to comply with state blue sky laws for offerings to "qualified purchasers."

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