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The New “Reg A+” Opens Doors for Private Companies to Raise Capital

On March 25, 2015, the Securities and Exchange Commission approved the final rules to adopt amendments to Regulation A, which will go into effect 60 days after the rules are published in the Federal Register. The amendments to create “Reg A+” were a mandate of Title IV of the JOBS Act and provide private U.S. and Canadian companies with the ability to raise up to \$50 million of equity securities in a 12-month period, which securities are freely transferable and exempt from the registration requirements of the Securities Act of 1933, as amended. As discussed below, although companies who take advantage of this new alternative for raising capital will be subject to certain eligibility, disclosure and reporting requirements, Reg A+ is a vast improvement over the prior Reg A, which was rarely used due to its small \$5 million threshold amount coupled with burdensome disclosure and blue sky filing requirements.

WHICH COMPANIES CAN USE REG A+ AND WHAT TYPES OF SECURITIES CAN THEY ISSUE?

Reg A+ is available to private companies having a principal place of business in the U.S. or Canada and which are not subject to SEC reporting requirements. The final rules specifically exclude (i) blank check companies, (ii) investment companies, (iii) issuers who issue fractional undivided interests in oil or gas rights or similar interests in other mineral rights, (iv) issuers subject to “bad actor” disqualification rules,

(v) issuers who have had the registration of a class of securities revoked by the SEC, and (vi) issuers who were required but failed to file ongoing reports required to be filed under Reg A during the two year period immediately preceding the filing of a new offering statement.

Companies can issue equity securities (including warrants), debt securities and debt securities convertible into or exchangeable into equity interests, including any guarantees of such securities.

WHAT IS THE MAXIMUM AMOUNT THAT A COMPANY CAN RAISE IN A REG A+ OFFERING?

Reg A+ provides for two tiers of offerings, each with its own maximum offering amount, limitations (including limitations on the participation of selling security-holders) and disclosure requirements.

Under a **Tier 1** offering, a company may raise up to \$20 million in a 12-month period, consisting of not more than \$6 million in offers by selling security-holders who are affiliates of the issuer.

Under a **Tier 2** offering, a company may raise up to \$50 million in a 12-month period, consisting of not more than \$15 million in offers by selling security-holders who are affiliates of the issuer. A company that elects to conduct a Tier 2 offering is also subject to the following additional requirements:

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- The financial statements included in the Form 1-A offering statement must be audited by an independent auditor, and if the company plans to concurrently list securities on a national securities exchange, the audit must be by a PCAOB-registered firm in accordance with PCAOB standards;
- In addition to filing an exit report (also required under a Tier 1 offering), the company must file annual, semiannual, current event and special financial reports until the company either registers a class of securities under Section 12 of the Securities Exchange Act of 1934, as amended, or, subject to certain additional requirements, the securities of each class to which the offering statement relates are held by fewer than 300 persons and there are no ongoing sales; and
- Non-accredited investor purchases in Tier 2 offerings are limited to no more than 10% of the greater of the investor’s annual income or net worth.

In addition to the above, sales by all selling security-holders (whether or not affiliates of the issuer) in both Tier 1 and Tier 2 Reg A offerings are limited to no more than 30% of a company’s initial offering and any subsequent Reg A offerings during the following 12-month period.

WHAT DO COMPANIES NEED TO FILE WITH THE SEC?

All companies conducting a Reg A offering, whether under Tier 1 or Tier 2, are required to file and “qualify” an offering statement on Form 1-A with the SEC. Form 1-A is intended to be a disclosure document for potential investors to use in evaluating the offering

and making their investment decision. Accordingly, the disclosure requirements for Form 1-A are similar to those required for a Registration Statement on Form S-1 and the process of “qualification” of the Form 1-A is similar to “effectiveness” for a registration statement. Under both Tier 1 and Tier 2 offerings the issuer is permitted to submit the Form 1-A offering statement to the SEC for a confidential non-public review. Although a company does not automatically become an SEC reporting company upon filing a Form 1-A offering statement, it would become an SEC reporting company if the offering resulted in greater than 2,000 shareholders. Additionally, if a company conducts a Tier 2 offering and provides disclosure in Part II of its Form 1-A that follows the requirements of Part I of Form S-1, it is permitted to concurrently file a Form 8-A to list its securities on a national securities exchange.

ARE THE STATE SECURITIES LAWS REQUIREMENTS AS BURDENSOME UNDER REG A+ AS THEY WERE UNDER THE ORIGINAL REG A?

Under the original formulation of Reg A state securities laws were not preempted by federal law and the requirement to comply with the securities laws of many states was often far too burdensome for companies to manage given the relatively low maximum permitted offering amount of \$5 million. The SEC addressed this issue in Reg A+ and now Tier 2 offerings made to “qualified purchasers” (defined in the final rule to mean “any person to whom securities are offered or sold pursuant to a Tier 2 offering of this Regulation A”) will preempt state securities laws.

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Tier 1 offerings will continue to be subject to state securities requirements, but the SEC is currently working to collaborate with state regulators to make the two layers of securities regulation more efficient. In addition, the NASAA has also introduced a coordinated review process for Reg A offerings. In the final rules the SEC notes that it will observe issuers’ experiences with a coordinated state securities review process and amend Reg A where changes would be helpful.

ARE WE LIKELY TO SEE A BOOM IN REG A+ OFFERINGS IN THE MARKETPLACE?

Companies which choose to remain private may see Reg A+ as a viable alternative to a traditional Reg D offering because purchasers can be non-accredited investors, the issued securities are not restricted and the company can conduct general solicitations without the concerns of complying with Rule 506(c) and any related investor push-back surrounding the verification requirements. In addition, a company that conducts a Tier 2 offering will be subject to ongoing public disclosure requirements that may have the added

benefit of attracting future investors that otherwise would not be aware of the company. For companies who seek to have listed securities, they may see Reg A+ as a mini-IPO or reverse merger alternative because of the ability to conduct a Reg A offering and concurrently list securities on a national securities exchange.

As stated by the SEC Chair, Mary Jo White, in the press release announcing the new rules, the SEC intends for Reg A+ to “provide an effective, workable path to raising capital that also provides strong investor protections.” While these amendments to Reg A continue to provide for strong investor protections through the offering and ongoing disclosure requirements, it remains to be seen whether this new avenue for capital raising will gain traction and whether companies will find that the cost of the disclosure requirements and the remaining uncertainty surrounding state securities requirements, in the case of a Tier 1 offering, outweigh the ability to raise up to \$20 million (Tier 1) or \$50 million (Tier 2) in a 12-month period.

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