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April 17, 2018

Regulation A+ Continues To Grow

The new Regulation A/A+, which went into effect on June 19, 2015, is now three years old and continues to develop and gain market acceptance. In addition to ongoing guidance from the SEC, the experience of practitioners and the marketplace continue to develop in the area. Nine companies are now listed on national exchanges, having completed Regulation A+ IPO's, and several more trade on OTC Markets. The NYSE even includes a page on its website related to Regulation A+ IPO's. As further discussed herein, most of the exchange traded companies have gone down in value from their IPO offering price, which I and other practitioners attribute to the lack of firm commitment offerings and the accompanying overallotment (greenshoe) option.

On March 15, 2018, the U.S. House of Representatives passed H.R. 4263, the Regulation A+ Improvement Act, increasing the Regulation A+ Tier 2 limit from $50 million to $75 million in a 12-month period. In September 2017 the House passed the Improving Access to Capital Act, which would allow companies subject to the reporting requirements under the Exchange Act to use Regulation A, a change the entire marketplace is advocating for. See HERE. On June 8, 2017, the U.S. House of Representatives passed the Financial Creating Hope and Opportunity for Investors, Consumers and Entrepreneurs Act (the "Financial Choice Act 2.0"), which also included a provision increasing the Tier 2 offering limit to $75 million. See HERE. The SEC has included Regulation A amendments on its long-term legislation action list as of December 2017.

This firm has been deep in the Regulation A space. A February 2018 *Audit Analytics* report named our firm one of the top three Regulation A firms in the country, and we are working on multiple new offerings that have yet to be filed. Furthermore, we are working on Regulation A+ offerings that will include an equity security in the form of a token based on blockchain or distributed ledger technology, an exciting new development in the field.

This blog will provide a comprehensive overview of Regulation A+, including updates based on experience and guidance in the industry.

Summary of Regulation A/A+

I've written about Regulation A+ on numerous occasions, including detailing the history and intent of the rules. Title IV of the JOBS Act, which was signed into law on April 5, 2012, set out the framework for the new Regulation A and required the SEC to adopt specific rules to implement the new provisions. The new rules came into effect on June 19, 2015. For a refresher on such history and intent, see my blog HERE.

Importantly, as discussed further below, Tier 2 of Regulation A (Regulation A+) preempts state blue sky law, and securities issued in a Regulation A+ offering are "covered securities." In addition to the federal government, every state has its own set of securities laws and securities regulators. Unless the federal law specifically "preempts" or overrules state law, every offer and sale of securities must comply with both the federal and the state law. There are 54 U.S. jurisdictions, including all 50 states and 4 territories, each with separate and different securities laws. Even in states that have identical statutes, the states' interpretations or focuses under the statutes differ greatly. On top of that, each state has a filing fee and a review process that takes time to deal with. It's difficult, time-consuming and expensive.

However, as I will discuss below, this does not include preemption of state law related to broker-dealer registration. Five states (Florida, New York, Texas, Arizona and North Dakota) do not have "issuer exemptions" for public offerings such as a Regulation A offering. Companies completing a Regulation A offering without a broker-dealer will need to register as an "issuer dealer" in those states. Although each state has differing requirements, they all require certain uniform information and the process has not been overly cumbersome.

Two Tiers of Offerings

Regulation A is divided into two offering paths, referred to as Tier 1 and Tier 2. A Tier 1 offering allows for sales of up to $20 million in any 12-month period. Since Tier 1 does not preempt state law, it is really only useful for offerings that are limited to one but no more than a small handful of states. Tier 1 does not require the company to include audited financial statements and does not have any ongoing SEC reporting requirements. Tier 1 is generally not used for an initial going public transaction. Tier 1 is most often used by existing public companies that are not subject to the SEC reporting requirements.

Both Tier I and Tier 2 offerings contain minimum basic requirements, including issuer eligibility provisions and disclosure requirements. Resales of securities by affiliate selling security holders are limited to no more than $6,000,000 for a Tier 1 offering and $15,000,000 for a Tier 2 offering. Resales of securities by non-affiliate selling security holders are limited to 30% of the aggregate offering amount for the company's first Regulation A offering or subsequent offering that is completed within one year of the first offering. Although no company has yet completed a second Regulation A offering after the one-year period, such offering would not have a limit on non-affiliate resales.

For offerings up to $20 million, an issuer can elect to proceed under either Tier 1 or Tier 2. Both tiers will allow companies to submit draft offering statements for non-public SEC staff review before a public filing, permit continued use of solicitation materials after the filing of the offering statement and use the EDGAR system for filings.

Tier 2 allows a company to file an offering circular with the SEC to raise up to $50 million in a 12-month period. Tier 2 preempts state blue sky law. A company may elect to either provide the disclosure in Form 1-A format or the disclosure in a traditional Form S-1 when conducting a Tier 2 offering. The Form S-1 format is a precondition to being able to file a Form 8-A to register under the Exchange Act. Either way, the SEC review process is a little shorter, and a company can market in a way that it cannot with a traditional IPO. However, we have noticed that as more and more issuers are using the process, the reviewers have become busier and the review time has extended accordingly.

Both Tiers of Regulation A have specific company eligibility requirements, investor qualifications and associated per-investor investment limits. Also, the process is not inexpensive. Attorneys' fees, accounting and audit fees and, of course, marketing expenses all add up. A company needs to be organized and ready before engaging in any offering process, and especially so for a public offering process. Even though a lot of attorneys, myself included, will provide a flat fee for parts of the process, that flat fee is dependent on certain assumptions, including the level of organization of the company.

In a CD&I, the SEC confirmed that a company may withdraw a Tier 2 offering after qualification but prior to any sales or the filing of an annual report, by filing an exit report on Form 1-Z, and thereafter be relieved of any further filing requirements.

Eligibility Requirements

Regulation A is available to companies organized and operating in the United States and Canada. A company will be considered to have its "principal place of business" in the U.S. or Canada for purposes of determination of Regulation A eligibility if its officers, partners, or managers primarily direct, control and coordinate the company's activities from the U.S. or Canada, even if the actual operations are located outside those countries.

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The following issuers are ***not*** eligible for a Regulation A offering:

- Companies currently subject to the reporting requirements of the Exchange Act;
- Investment companies registered or required to be registered under the Investment Company Act of 1940, including BDC's. However, a company that operates investments that are exempt from the registration requirements under the 1940 Act would qualify, such as REIT's and companies that transact in certain loans such as small business loans, student loans, auto loans, and personal loans.
- Blank check companies, which are companies that have no specific business plan or purpose or whose business plan and purpose is to engage in a merger or acquisition with an unidentified target; however, shell companies are not prohibited, unless such shell company is also a blank check company. A shell company is a company that has no or nominal operations; and either no or nominal assets, assets consisting of cash and cash equivalents; or assets consisting of any amount of cash and cash equivalents and nominal other assets. Accordingly, a start-up business or minimally operating business may utilize Regulation A;
- Issuers seeking to offer and sell asset-backed securities or fractional undivided interests in oil, gas or other mineral rights;
- Issuers that have been subject to any order of the SEC under Exchange Act Section 12(j) denying, suspending or revoking registration, entered within the past five years. Accordingly, a company that is deregistered for delinquent reporting would not be eligible for Regulation A;
- Issuers that became subject to Regulation A reporting requirements, such as through a Tier 2 offering, and did not file required ongoing reports during the preceding two years; and
- Issuers that are disqualified under the Rule 262 "bad actor" provisions.

A company that was once subject to the Exchange Act reporting obligations but suspended such reporting obligations by filing a Form 15 is eligible to utilize Regulation A. A company that voluntarily files reports under the Exchange Act is not "subject to the Exchange Act reporting requirements" and therefore is eligible to use Regulation A. A wholly owned subsidiary of an Exchange Act reporting company parent is eligible to complete a Regulation A offering as long as the parent reporting company is not a guarantor or co-issuer of the securities being issued.

Unfortunately, in what is clearly a legislative miss, companies that are already publicly reporting – that is, are already required to file reports with the SEC – are not eligible. OTC Markets has petitioned the SEC to eliminate this eligibility criterion, and pretty well everyone in the industry supports a change here, but for now it remains. For more information on the OTC Markets' petition and discussion of the reasons that a change is needed in this regard, see my blog HERE. Also, as discussed at the beginning of this blog, the House has now passed the Improving Access to Capital Act, which would allow companies subject to the reporting requirements under the Exchange Act to use Regulation A.

Regulation A can be used for business combination transactions, but is not available for shelf SPAC's (special purpose acquisition companies).

Eligible Securities

Regulation A is limited to equity securities, including common and preferred stock and options, warrants and other rights convertible into equity securities, debt securities and debt securities convertible or exchangeable into equity securities, including guarantees. If convertible securities or warrants are offered that may be exchanged or exercised within one

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year of the offering statement qualification (or at the option of the issuer), the underlying securities must also be qualified and the value of such securities must be included in the aggregate offering value. Accordingly, the underlying securities will be included in determining the offering limits of $20 million and $50 million, respectively.

Recently our firm, and several others that I am aware of, are using Regulation A to create equity digital tokens using blockchain technology. For my most recent blog on that subject, see HERE.

Asset-backed securities are not allowed to be offered in a Regulation A offering. REIT's and other real estate-based entities may use Regulation A and provide information similar to that required by a Form S-11 registration statement.

General Solicitation and Advertising; Solicitation of Interest ("Testing the Waters")

Other than the investment limits, anyone can invest in a Regulation A offering, but of course they have to know about it first – which brings us to marketing. All Regulation A offerings will be allowed to engage in general solicitation and advertising, at least according to the SEC. Tier 1 offerings are also required to comply with applicable state law related to such solicitation and advertising, including any prohibitions of same.

Marketing in the Prequalification Period

Regulation A allows for prequalification solicitations of interest in an offering, commonly referred to as "testing the waters." Issuers can use "test-the-waters" solicitation materials both before and after the initial filing of the offering statement, and by any means. A company can use social media, Internet websites, television and radio, print advertisements, and anything they can think of prior to qualification of the offering. Marketing can be oral or in writing, with the only limitations being certain disclaimers and antifraud. Although a company can and should be creative in its presentation of information, there are laws in place with serious ramifications requiring truth in the marketing process. Investors should watch for red flags such as clearly unprovable statements of grandeur, obvious hype or any statement that sounds too good to be true – as they are probably are just that.

When using "test-the-waters" or prequalification marketing, a company must specifically state whether a registration statement has been filed and if one has been filed, provide a link to the filing. Also, the company must specifically state that no money is being solicited and that none will be accepted until after the registration statement is qualified with the SEC. Any investor indications of interest during this time are 100% non-binding – on both parties. That is, the potential investor has no obligation to make an investment when or if the offering is qualified with the SEC and the company has no obligation to file an offering circular or if one is already filed, to pursue its qualification. In fact, a company may decide that based on a poor response to its marketing efforts, it will abandon the offering until some future date or forever.

Solicitation material used before qualification of the offering circular must contain a legend stating that no money or consideration is being solicited and none will be accepted, no offer to buy securities can be accepted and any offer can be withdrawn before qualification, and a person's indication of interest does not create a commitment to purchase securities.

For a complete discussion of Regulation A "test-the-waters" rules and requirements, see my blog HERE.

All solicitation material must be submitted to the SEC as an Exhibit under Part III of Form 1-A. This is a significant difference from S-1 filers, who are not required to file "test-the-waters" communications with the SEC. There is no requirement that the materials be filed prior to use—only that they be included as an exhibit to the final qualified offering circular. In a CD&I the SEC has also confirmed that the requirement under Industry Guide 5 that sales material be

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submitted to the SEC before use, does not apply to Regulation A offerings. Industry Guide 5 relates to registration statements involving interests in real estate limited partnerships.

A company can use Twitter and other social media that limits the number of characters in a communication, to test the waters as long as the company provides a hyperlink to the required disclaimers. A company can use a hyperlink to satisfy the disclosure and disclaimer requirements in Rule 255 as long as (i) the electronic communication is distributed through a platform that has technological limitations on the number of characters or amount of text that may be included in the communication; (ii) including the entire disclaimer and other required disclosures would exceed the character limit on that particular platform; and (iii) the communication has an active hyperlink to the required disclaimers and disclosures and, where possible, prominently conveys, through introductory language or otherwise, that important or required information is provided through the hyperlink.

Unlike the "testing of the waters" by emerging growth companies that are limited to QIB's and accredited investors, a Regulation A company can reach out to retail and non-accredited investors. After the public filing but before SEC qualification, a company may use its preliminary offering circular to make written offers.

Of course, all "test-the-waters" materials are subject to the antifraud provisions of federal securities laws.

Like registered offerings, ongoing regularly released factual business communications, not including information related to the offering of securities, is allowed and is not considered solicitation materials.

Post-qualification Marketing

Once an offering has been qualified by the SEC and a company is soliciting the purchase of the securities, and not merely an indication of interest, the company has offering circular delivery requirements. That is, the company must deliver the qualified Final Offering Circular to all purchasers and prospective purchasers. This delivery requirement can be satisfied by providing an active hyperlink to the URL where the Final Offering Circular is filed on EDGAR. Accordingly, once an offering has been qualified with the SEC, a company cannot solicit the sale of securities using print, TV, radio or other forms of advertising that do not allow for the inclusion of an active hyperlink.

Continuous or Delayed Offerings

Continuous or delayed offerings (a form of a shelf offering) are allowed only if the offering statement pertains to: (i) securities to be offered or sold solely by persons other than the issuer (however, note that under the rules, this is limited to 30% of non-affiliates for first-time offerings and by dollar limit for affiliates for any offering); (ii) securities that are offered pursuant to a dividend or interest reinvestment plan or employee benefit plan; (iii) securities that are to be issued upon the exercise of outstanding options, warrants or rights; (iv) securities that are to be issued upon conversion of other outstanding securities; (v) securities that are pledged as collateral; or (vi) securities for which the offering will commence within two days of the offering statement qualification date, will be made on a continuous basis, will continue for a period of in excess of thirty days following the offering statement qualification date, and at the time of qualification are reasonably expected to be completed within two years of the qualification date.

Under this last continuous offering section, issuers that are current in their Tier 2 reporting requirements may make continuous or delayed offerings for up to three years following qualification of the offering statement. Moreover, in the event a new qualification statement is filed for a new Regulation A offering, unsold securities from a prior qualification may be included, thus carrying those unsold securities forward for an additional three-year period. When continuously offering securities under an open Regulation A offering, a company must update its offering circular, via post-qualification amendment, to disclose material changes of fact and to keep the financial statements current.

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Where a company seeks to qualify an additional class of securities via post-qualification amendment to a previously qualified Form 1-A, Item 4 of Part I, which requires "Summary Information Regarding the Offering and Other Current or Proposed Offerings," need only include information related to the new class of securities seeking qualification.

Additional Tier 2 Requirements; Ability to List on an Exchange

In addition to the basic requirements that apply to all Regulation A offerings, Tier 2 offerings also require: (i) audited financial statements (though I note that the majority of state blue sky laws require audited financial statements, so this federal distinction does not have a great deal of practical effect); (ii) ongoing reporting requirements, including the filing of an annual and semiannual report and periodic reports for current information (Forms 1-K, 1-SA and 1-U, respectively); and (iii) a limitation on the number of securities non-accredited investors can purchase of no more than 10% of the greater of the investor's annual income or net worth.

The investment limitations for non-accredited investors resulted from a compromise with state regulators that opposed the state law preemption for Tier 2 offerings. It is the obligation of the issuer to notify investors of these limitations. Issuers may rely on the investors' representations as to accreditation (no separate verification is required) and investment limits.

A company completing a Tier 2 offering that has used the S-1 format for their offering circular may file a Form 8-A with the qualification of the Form 1-A as long as it is filed no later than 5 days following qualification, to register under the Exchange Act, and may make immediate application to a national securities exchange. A Form 8-A is a simple (generally 2-page) registration form used instead of a Form 10 for companies that have already filed the substantive Form 10 information with the SEC (generally through an S-1).

The Form 8-A will only be allowed if it is filed within five (5) days of the qualification of the Form 1-A or a post-qualification amendment to the initial qualified Form 1-A As with any SEC filings based on calendar days, where the fifth day falls on a Saturday, Sunday or federal holiday, the certification may be received on the next business day.

For registration under Section 12(g) of the Exchange Act, the 8-A becomes effective upon the later of the filing of the Form 8-A or the qualification of the Regulation A offering statement.

Where the securities will be listed on a national exchange, the accredited investor limitations will not apply. When the Form 8-A is for registration with a national securities exchange under Section 12(b) of the Exchange Act, the 8-A becomes effective on the later of the day the 8-A if filed, the day the national exchange files a certification with the SEC confirming the listing, or the qualification of the offering circular.

Upon effectiveness of the Form 8-A, the company will become subject to the full Exchange Act reporting obligations, and the scaled-down Regulation A reporting will automatically be suspended. Accordingly, upon effectiveness of the Form 8-A, a company no longer qualifies to use Regulation A as an offering method and as such, the company would need to discontinue future sales under the qualified offering circular. As a result of this, most companies file a post-qualification amendment to their Form 1-A when all sales have been completed, and then file a Form 8-A in conjunction with that post-qualification amendment.

In their September 14, 2017 CD&I, the SEC confirmed that an issuer may also file a Form 8-A concurrently (i.e., within five days) with the qualification of a post-qualification amendment to a Form 1-A. Financial statements in any qualified Form 1-A must be current at the time of qualification, and the same holds true for a post-qualification amendment. The SEC notes that the reason a Form 8-A may only be filed concurrently with qualification is to ensure that financial statements are current at the time a company becomes registered under the Exchange Act and subject to its reporting requirements.

The SEC has clarified the timing of an annual report on Form 10-K once an 8-A has been filed. In particular, in the event that a qualified Form 1-A did not contain an audit of the last full fiscal year, the SEC will allow the company to file its annual report within 90 days of effectiveness of a Form 8-A. A Form 8-A is usually effective as of its filing, but can be preconditioned on certain events, such as a certification of a national exchange as described above. For example, if a company with a calendar year-end qualifies a Form 1-A on March 30, 2018 and files an 8-A on April 4, 2018, it would be required to file a Form 10-K for fiscal year-end December 31, 2017 (with the 2016 comparable period) within 90 calendar days from the effectiveness of the Form 8-A.

Likewise, the SEC provided guidance on the timing of a quarterly report on Form 10-Q following effectiveness of a Form 8-A. Generally, a company must file its 10-Q within 45 days of the effectiveness of a registration statement, or on the due date of its regular 10-Q if the company was already subject to the Exchange Act reporting requirements. The SEC has confirmed that it will allow a 10-Q to be filed within 45 days of effectiveness of a Form 8-A filed in connection with a Form 1-A qualification. Moreover, a company may actually have to file two Form 10-Q's in that time period. A Form 1-A does not require (or allow for) the filing of quarterly stub periods; rather, a stub period must be for a minimum of a six-month financial period. Accordingly, it is possible that a company would need to file two Form 10-Q's for two stub periods, within 45 days of effectiveness of its Form 8-A.

For example, let's say a company with a calendar year-end qualifies a Form 1-A on August 10, 2018 and files a Form 8-A, which goes effective on the same day. The qualified Form 1-A contains an audit for fiscal year-end December 31, 2016 and 2017, but does not contain any stub period financial statements for 2018 (note that the 2017 year-end audit would not go stale for purposes of Regulation A until September 30, 2018 in this example). In this case, the company would need to file its Form 10-Q's for both quarters ending March 31, 2018 and June 30, 2018 by September 24, 2018.

Nine companies are now listed on national exchanges having completed Regulation A+ IPO's and several more trade on OTC Markets. Most of the exchange traded companies have gone down in value from their IPO offering price, which I and other practitioners attribute to the lack of firm commitment offerings and the accompanying overallotment (greenshoe) option. An overallotment option, often referred to as a greenshoe option because of the first company that used it, Green Shoe Manufacturing, is where an underwriter is able to sell additional securities if demand warrants same, thus having a covered short position. A covered short position is one in which a seller sells securities it does not yet own, but does have access to.

A typical overallotment option is 15% of the offering. In essence, the underwriter can sell additional securities into the market and then buy them from the company at the registered price exercising its overallotment option. This helps stabilize an offering price in two ways. First, if the offering is a big success, more orders can be filled. Second, if the offering price drops and the underwriter has oversold the offering, it can cover its short position by buying directly into the market, which buying helps stabilize the price (buying pressure tends to increase and stabilize a price, whereas selling pressure tends to decrease a price).

The federal securities laws only allow overallotment options in "firm commitment offerings. In a firm commitment offering, the underwriter firmly commits to buying a certain number of shares" from the company and then resells those shares into the market, either directly or through a syndicate of other underwriters. As of now, all Regulation A offerings have been on a "best-efforts basis." In a best-efforts offering, the underwriter does not commit to any sales but merely uses its best efforts to sell the offering into the market (either directly or through a syndicate).

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As Regulation A grows in use and popularity, and attracts more institutional players and higher-quality deals, I would expect firm commitment offerings and the use of the overallotment option. In a Regulation A offering, the overallotment would need to be considered in determining the maximum allowable offering amounts ($20 million for Tier 1 and $50 million for Tier 2).

Integration

The final rules include a limited-integration safe harbor such that offers and sales under Regulation A will not be integrated with prior or subsequent offers or sales that are (i) registered under the Securities Act; (ii) made under compensation plans relying on Rule 701; (iii) made under other employee benefit plans; (iv) made in reliance on Regulation S; (v) made more than six months following the completion of the Regulation A offering; or (vi) made in crowdfunding offerings exempt under Section 4(a)(6) of the Securities Act (Title III crowdfunding–Regulation CF).

The SEC has confirmed that a Regulation A offering can rely on Rule 152 such that a completed exempt offering, such as under Rule 506(b), will not integrate with a subsequent Regulation A offering. Under Rule 152, a securities transaction that at the time involves a private offering will not lose that status even if the company subsequently makes a public offering. The SEC has also issued guidance that Rule 152 applies to prevent integration between a completed 506(b) offering and a subsequent 506(c) offering, indicating that the important factor in the Rule 152 analysis is the ability to publicly solicit. As Rule 506(c) is considered a public offering for this analysis, there would be nothing preventing a company from completing a Rule 506(c) offering either before, concurrently or after a Regulation A offering.

In the absence of a clear exemption from integration, companies would turn to the five-factor test. In particular, the determination of whether the Regulation A offering would integrate with one or more other offerings is a question of fact depending on the particular circumstances at hand. The following factors need to be considered in determining whether multiple offerings are integrated: (i) are the offerings part of a single plan of financing; (ii) do the offerings involve issuance of the same class of securities; (iii) are the offerings made at or about the same time; (iv) is the same type of consideration to be received; and (v) are the offerings made for the same general purpose.

Offering Statement – General

A company intending to conduct a Regulation A offering must file an offering circular with, and have it qualified by, the SEC. The offering circular is filed with the SEC using the EDGAR database filing system. Prospective investors must be provided with the filed, prequalified offering statement 48 hours prior to a sale of securities. Once qualified, investors must be provided with the final qualified offering circular. Like current registration statements, Regulation A rules provide for an “access equals delivery” model, whereby access to the offering statement via the Internet and EDGAR database will satisfy the delivery requirements. As discussed above, this access must be via an active hyperlink.

There are no filing fees for the process. The offering statement is reviewed, commented upon and then declared “qualified” by the SEC with an issuance of a “notice of qualification.” The notice of qualification can be requested or will be issued by the SEC upon clearing comments. The SEC has been true to its word in that the review process has been lighter than that normally associated with an S-1 or other Securities Act registration statement. However, I have noticed over time that offering circulars are being reviewed more in line with an S-1 than when the process first started.

Issuers may file offering circular updates after qualification in lieu of post-qualification amendments similar to the filing of a post-effective prospectus for an S-1. In a CD&I, the SEC clarified the calculation of a 20% change in the price of the offering to determine the necessity of filing a post-qualification amendment which would be subject to SEC comment and review, versus a post-qualification supplement which would be effective immediately upon filing. Rule 253(b) provides that a change in price of no more than 20% of the qualified offering price, may be made by supplement and not require an amendment. An amendment is subject to a whole new review and comment period and must be declared qualified by the SEC. A supplement, on the other hand, is simply added to the already qualified Form 1-A, becoming qualified itself upon filing. The 20% variance can be either an increase or decrease in the offering price, but if it is an increase, it cannot result in an offering above the respective thresholds for Tier 1 ($20 million) or Tier 2 ($50 million).

To qualify additional securities, a post-qualification amendment must be used. In a CD&I the SEC has clarified that where a company seeks to qualify an additional class of securities via post-qualification amendment to a previously qualified Form 1-A, Item 4 of Part I, which requires “Summary Information Regarding the Offering and Other Current or Proposed Offerings,” need only include information related to the new class of securities seeking qualification.

In a reminder that Regulation A is technically an exemption from the registration requirements under Section 5 of the Securities Act, the SEC confirmed that under Item 6 of Part I, requiring disclosure of unregistered securities issued or sold within the prior year, a company must disclose all securities issued or sold pursuant to Regulation A in the prior year.

Offering Statement – Non-public (Confidential) Submission

The rules permit a company to submit an offering statement to the SEC on a confidential basis. The rule provides that only companies that have not previously sold securities under a Regulation A or a Securities Act registration statement may submit the offering confidentially.

Confidential submissions will allow a Regulation A issuer to get the process under way while soliciting interest of investors using the “test-the-waters” provisions without negative publicity risk if it alters or withdraws the offering before qualification by the SEC. The confidential filing, SEC comments, and all amendments must be publicly filed at least 15 calendar days before qualification.

Confidential submissions to the SEC are completed by choosing a “confidential” setting in the EDGAR system. To satisfy the requirement to publicly file the previous confidential information, the company can file all prior confidential information as an exhibit to its non-confidential filing, or change the setting in the EDGAR system on its prior filings, from “confidential” to “public.” In the event the company chooses to change its EDGAR setting to “public,” it would not have to re-file all prior confidential material as an exhibit to a new filing.

If a company wants to keep certain information confidential, even after the required time to make such information public, it will need to submit two confidential requests, one as part of the offering review process and one when prior confidential filings are made public. During the confidential Form 1-A review process, the company should submit a request under Rule 83 in the same manner it would during a typical review of a registered offering. Once the company is required to make the prior filings “public” (15 days prior to qualification), the company would make a new request for confidential treatment under Rule 406 in the same manner other confidential treatment requests are submitted. For a confidential treatment request under Rules 83 and 406, a company must submit a redacted version of the document via EDGAR with the appropriate legend indicating that confidential treatment has been requested. Concurrently, the company must submit a full, unredacted paper version of the document to the SEC using the ordinary confidential treatment procedure (such filings are submitted via a designated fax line to a designated person to maintain confidentiality).

Offering Statement – Form and Content

An offering statement is submitted on Form 1-A. Form 1-A consists of three parts: Part I – Notification, Part II – Offering Circular, and Part III – Exhibits. Part I calls for certain basic information about the company and the offering, and is primarily designed to confirm and determine eligibility for the use of the Form and a Regulation A offering in general. Part

I includes issuer information; issuer eligibility; application of the bad-actor disqualifications and disclosures; jurisdictions in which securities are to be offered; and unregistered securities issued or sold within one year. As Regulation A is technically an unregistered offering, all Regulation A securities sold within the prior year must be included in this section.

Part II is the offering circular and is similar to the prospectus in a registration statement. Part II requires disclosure of basic information about the company and the offering; material risks; dilution; plan of distribution; use of proceeds; description of the business operations; description of physical properties; discussion of financial condition and results of operations (MD&A); identification of and disclosure about directors, executives and key employees; executive compensation; beneficial security ownership information; related party transactions; description of offered securities; and two years of financial information.

The required information in Part 2 of Form 1-A is scaled down from the requirements in Regulation S-K applicable to Form S-1. Issuers can complete Part 2 by either following the Form 1-A disclosure format or by including the information required by Part I of Form S-1 or Form S-11 as applicable. Note that only issuers that elect to use the S-1 or S-11 format will be able to subsequently file an 8-A to register and become subject to the Exchange Act reporting requirements or to trade on a national exchange.

Companies that had previously completed a Regulation A offering and had thereafter been subject to and filed reports with the SEC under Tier 2 can incorporate by reference from these reports in future Regulation A offering circulars.

Form 1-A requires two years of financial information. All financial statements for Regulation A offerings must be prepared in accordance with GAAP. Financial statements of a Tier 1 issuer are not required to be audited unless the issuer has obtained an audit for other purposes. Audited financial statements are required for Tier 2 issuers. Audit firms for Tier 2 issuers must be independent and PCAOB-registered. An offering statement cannot be qualified if the date of the balance sheet is more than nine months prior to the date of qualification. Financial statements do not go stale for nine months, as opposed to 135 days for other filings under Regulation S-X. Interim financial statements should be for a minimum period of six months following the date of the fiscal year-end.

A recently created entity may choose to provide a balance sheet as of its inception date as long as that inception date is within nine months before the date of filing or qualification and the date of filing or qualification is not more than three months after the entity reached its first annual balance sheet date. The date of the most recent balance sheet determines which fiscal years, or period since existence for recently created entities, the statements of comprehensive income, cash flows and changes in stockholders' equity must cover. When the balance sheet is dated as of inception, the statements of comprehensive income, cash flows and changes in stockholders' equity will not be applicable.

In a CD&I the SEC confirmed that companies using Form 1-A benefit from Section 71003 of the FAST Act. The SEC interprets Section 71003 of the FAST Act to allow an emerging growth company (EGC) to omit financial information for historical periods if it reasonably believes that those financial statements will not be required at the time of the qualification of the Form 1-A, provided that the company file a prequalification amendment such that the Form 1-A qualified by the SEC contains all required up-to-date financial information. Section 71003 only refers to Forms S-1 and F-1, but the SEC has determined to allow an EGC the same benefit when filing a Form 1-A. Since financial statements for a new period would result in a material amendment to the Form 1-A, potential investors would need to be provided with a copy of such updated amendment prior to accepting funds and completing the sale of securities.

Part III requires an exhibits index and a description of exhibits required to be filed as part of the offering statement. A tax opinion is not required to be filed as an exhibit to Form 1-A, but a company may do so voluntarily.

Offering Price

All Regulation A offerings must be at a fixed price. That is, no offerings may be made "at the market" or for other than a fixed price. This applies to all aspects of the Regulation A offering. For example, a company could not complete an offering whereby a purchaser exercises an option or warrant at a variable price with the resale of such securities being registered at a fixed price. As a result of this, and the inability to obtain any prequalification commitment from a purchaser whatsoever, a Regulation A offering is not conducive for use in equity line transactions.

Ongoing Reporting

Both Tier I and Tier 2 issuers must file summary information after the termination or completion of a Regulation A offering. A Tier I company must file certain information about the Regulation A offering, including information on sales and the termination of sales, on a Form 1-Z exit report no later than 30 calendar days after termination or completion of the offering. Tier I issuers do not have any ongoing reporting requirements.

Tier 2 companies are also required to file certain offering termination information and have the choice of using Form 1-Z or including the information in their first annual report on Form 1-K. In addition to the offering summary information, Tier 2 issuers are required to submit ongoing reports including: an annual report on Form 1-K, semiannual reports on Form 1-SA, current event reports on Form 1-U and notice of suspension of ongoing reporting obligations on Form 1-Z.

A Tier 2 issuer may file an exit form 1-Z and relieve itself of any ongoing requirements if no securities have been sold under the Regulation A offering and the Form 1-Z is filed prior to the company's first annual report on Form 1-K.

The ongoing reporting for Tier 2 companies is less demanding than the reporting requirements under the Securities Exchange Act. In particular, there are fewer 1-K items and only the semiannual 1-SA (rather than the quarterly 10-Q) and fewer events triggering Form 1-U (compared to Form 8-K). Companies may also incorporate text by reference from previous filings. In a CD&I, the SEC confirmed that it will not object if an auditor's consent is not included as an exhibit to an annual report on Form 1-K, even if the report contains audited financial statements. The report would still need to contain the auditor's report, but a separate consent is not required.

The annual Form 1-K must be filed within 120 calendar days of fiscal year-end. The semiannual Form 1-SA must be filed within 90 calendar days after the end of the semiannual period. The current report on Form 1-U must be filed within 4 business days of the triggering event. Successor issuers, such as following a merger, must continue to file the ongoing reports.

The rules also provide for a suspension of reporting obligations for a Regulation A issuer that desires to suspend or terminate its reporting requirements. Termination is accomplished by filing a Form 1-Z and requires that a company be current over stated periods in its reporting, have fewer than 300 shareholders of record, and have no ongoing offers or sales in reliance on a Regulation A offering statement. Of course, a company may file a Form 10 to become subject to the full Exchange Act reporting requirements.

The ongoing reports will qualify as the type of information a market maker would need to support the filing of a 15c2-11 application. Accordingly, an issuer that completes a Tier 2 offering could proceed to engage a market maker to file a 15c2-11 application and trade on the OTC Markets. The OTC Markets allows Regulation A reporting companies to apply for any of its tiers of listing, including the OTCPink, OTCQB or OTCQX, depending on which tier the company qualifies for.

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A company that reports under the scaled-down Regulation A requirements is not considered to be subject to the Exchange Act reporting requirements, and therefore shareholders that have purchased restricted securities in exempt offerings (including 506(b) or 506(c) offerings in advance of the Regulation A) will need to satisfy the longer one-year holding period under Rule 144. Shares purchased in the Regulation A offering itself are freely tradable.

Freely Tradable Securities

Securities issued to non-affiliates in a Regulation A offering are freely tradable. Securities issued to affiliates in a Regulation A offering are subject to the affiliate resale restrictions in Rule 144, except for a holding period. The same resale restrictions for affiliates and non-affiliates that apply to Regulation A offerings also apply to securities registered in a Form S-1.

Since neither Tier 1 nor Tier 2 Regulation A issuers are subject to the Exchange Act reporting requirements (unless a Form 8-A is filed), the Rule 144 holding period for shareholders that have purchased restricted securities in exempt offerings (including 506(b) or 506(c) offerings in advance of the Regulation A) will need to satisfy the longer one-year holding period under Rule 144. Shareholders would not be able to rely on Rule 144 at all if the company has been a shell company at any time in its history. For more information on Rule 144 as it relates to shell companies, see HERE.

Treatment under Section 12(g)

Exchange Act Section 12(g) requires that an issuer with total assets exceeding $10,000,000 and a class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited, register with the SEC, generally on Form 10, and thereafter be subject to the reporting requirements of the Exchange Act.

Regulation A exempts securities in a Tier 2 offering from the Section 12(g) registration requirements if the issuer meets all of the following conditions:

- The issuer utilizes an SEC-registered transfer agent. Such transfer agent must be engaged at the time the company is relying on the exemption from Exchange Act registration;
- The issuer remains subject to the Tier 2 reporting obligations;
- The issuer is current in its Tier 2 reporting obligations, including the filing of an annual and semiannual report; and
- The issuer has a public float of less than $75 million as of the last business day of its most recently completed semiannual period or, if no public float, had annual revenues of less than $50 million as of its most recently completed fiscal year-end.

Moreover, even if a Tier 2 issuer is not eligible for the Section 12(g) registration exemption as set forth above, that issuer will have a two-year transition period prior to being required to register under the Exchange Act, as long as during that two-year period, the issuer continues to file all of its ongoing Regulation A reports in a timely manner with the SEC.

State Law Preemption

Tier I offerings do not preempt state law and remain subject to state blue sky qualification. The SEC encourages Tier 1 issuers to utilize the NASAA-coordinated review program for Tier I blue sky compliance. For a brief discussion on the

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NASAA-coordinated review program, see my blog HERE. However, in practice, I do not think this program is being utilized; rather, when Tier 1 is being used, it is limited to just one or a very small number of states and companies are completing the blue sky process independently.

Tier 2 offerings are not subject to state law review or qualification – i.e., state law is preempted. State law can still require a notice filing. Securities sold in Tier 2 offerings were specifically added to the NSMIA as federally covered securities. Federally covered securities are exempt from state registration and overview. Regulation A provides that "(b) Treatment as covered securities for purposes of NSMIA… Section 18(b)(4) of the Securities Act of 1933… is further amended by inserting… (D) a rule or regulation adopted pursuant to section 3(b)(2) and such security is (i) offered or sold on a national securities exchange; or (ii) offered or sold to a qualified purchaser, as defined by the Commission pursuant to paragraph (3) with respect to that purchase or sale." For a discussion on the NSMIA, see my blogs HERE and HERE.

State securities registration and exemption requirements are only preempted as to the Tier 2 offering and securities purchased pursuant to the qualified Tier 2 Form 1-A offering circular. Subsequent resales of such securities are not preempted. However, securities traded on a national exchange are covered securities. Moreover, the OTCQB and OTCQX levels of OTC Markets are becoming widely recognized as satisfying the manual's exemption for resale trading in most states.

State law preemption only applies to the securities offering itself and not to the person or persons who sell the securities. Unfortunately, not all states offer an issuer exemption for issuers that sell their own securities in public offerings such as a Regulation A offering. In particular, Arizona, Florida, Texas, New York and North Dakota require issuers to register with the state as issuer broker-dealers to qualify to sell securities directly. Each of these states has a short-form registration process in that regard. In addition, Alabama and Nevada require that the selling officers and directors of issuers register with the state.

Federally covered securities, including Tier 2 offered securities, are still subject to state antifraud provisions, and states may require certain notice filings. In addition, as with any covered securities, states maintain the authority to investigate and prosecute fraudulent securities transactions.

Broker-dealer Placement

Broker-dealers acting as placement or marketing agents are required to comply with FINRA Rule 5110 regarding filing of underwriting compensation, for a Regulation A offering.

Regulation A – Private or Public Offering?

The legal nuance that Regulation A is an "exempt" offering under Section 5 has caused confusion and the need for careful thought by practitioners and the SEC staff alike. Regulation A is treated as a public offering in almost all respects except as related to the applicability of Securities Act Section 11 liability. Section 11 of the Securities Act provides a private cause of action in favor of purchasers of securities, against those involved in filing a false or misleading public offering registration statement. Any purchaser of securities, regardless of whether they bought directly from the company or secondarily in the aftermarket, can sue a company, its underwriters, and experts for damages where a false or misleading registration statement had been filed related to those securities. Regulation A is not considered a public offering for purposes of Section 11 liability.

Securities Act Section 12, which provides a private cause of action by a purchaser of securities directly against the seller of those securities, specifically imposes liability on any person offering or selling securities under Regulation A. The

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general antifraud provisions under Section 17 of the Securities Act, which apply to private and public offerings, of course apply to Regulation A.

As mentioned above, the SEC has now confirmed that a Regulation A offering can rely on Rule 152 such that a completed exempt offering, such as under Rule 506(b), will not integrate with a subsequent Regulation A filing. Under Rule 152, a securities transaction that at the time involves a private offering will not lose that status even if the issuer subsequently makes a public offering. Along the same lines, as Rule 506(c) is considered a public offering for this analysis, there would be nothing preventing a company from completing a Rule 506(c) offering either before, concurrently or after a Regulation A offering.

Regulation A is definitely used as a going public transaction and, as such, is very much a public offering. Securities sold in a Regulation A offering are not restricted and therefore are available to be used to create a secondary market and trade, such as on the OTC Markets or a national exchange.

Tier 2 issuers that have used the S-1 format for their Form 1-A filing are permitted to file a Form 8-A to register under the Exchange Act and become subject to its reporting requirements and to register with a national exchange. The Form 8-A must be filed within 5 days of the qualification of the Form 1-A or any post-qualification amendments. A Form 8-A is a simple registration form used instead of a Form 10 for issuers that have already filed the substantive Form 10 information with the SEC. Upon filing a Form 8-A, the issuer will become subject to the full Exchange Act reporting obligations, and the scaled-down Regulation A+ reporting will automatically be suspended. A form 8-A can also be used as a short-form registration to list on a national exchange under Section 12(b) of the Exchange Act. Registration under 12(g) occurs automatically; however, Registration under 12(b) requires that the applicable national securities exchange certify the registration within five calendar days. As with any SEC filings based on calendar days, where the fifth day falls on a Saturday, Sunday or federal holiday, the certification may be received on the next business day.

A Regulation A process is clearly the best choice for a company that desires to go public and raise less than $50 million. An initial or direct public offering on Form S-1 does not preempt state law. By choosing a Tier 2 Regulation A offering followed by a Form 8-A, the issuer can achieve the same result – i.e., become a fully reporting trading public company without the added time and expense of complying with state blue sky laws. In addition to the state law preemption benefit, Regulation A provides relief from the strictly regulated public communications that exist in an S-1 offering.

Practice Tip on Registration Rights Contracts

In light of the fact that Regulation A is technically an exemption from the Section 5 registration requirements, it might not be included in contractual provisions related to registration rights. In particular, the typical language in a piggyback or demand registration right provision creates the possibility that the company could do an offering under Regulation A and take the position that the shareholder is not entitled to participate under the registration rights provision because it did not do a "registration." As an advocate of avoiding ambiguity, practitioners should carefully review these contractual provisions and add language to include a Form 1-A under Regulation A if the intent is to be sure that the shareholder is covered. Likewise, if the intent is to exclude Regulation A offerings from the registration rights, that exclusion should be added to the language to avoid any dispute.

Further Thoughts

Although I am a big advocate of Regulation A, companies continue to learn that it is just a legal process with added benefits, such as active advertising and solicitation including through social media. There is no pool of funds to tap into; it is not a line of credit; it is just another process that companies can use to reach out to the investing public and try to convince them to buy stock in, or lend money to, their company.

As such, companies seeking to complete a Regulation A offering must consider the economics and real-world aspects of the offering. Key to a successful offering are a reasonable valuation and rational use of proceeds. A company should demonstrate value through its financial statements and disclosures and establish that the intended use of proceeds will result in moving the business plan ahead and hopefully create increased value for the shareholders. Investors want to know that their money is being put to the highest and best use to result in return on investment. Repayment of debt or cashing out of series A investors is generally not a saleable use of proceeds. Looking for $50 million for 30% of a pre-revenue start-up just isn't going to do it! The company has to be prepared to show you, the investor, that it has a plan, management, vision and ability to carry out the business proposition it is selling.

From the investors' perspective, these are risky investments by nature. Offering materials should be scrutinized. The SEC does not pass on the merits of an offering – only its disclosures. The fact that the registration statement has been qualified by the SEC has no bearing on the risk associated with or quality of the investment. That is for each investor to decide, either alone or with advisors, and requires really reviewing the offering materials and considering the viability of the business proposal. At the end of the day, the success of the business, and therefore the potential return on investment, requires the company to perform – to sell their widgets, keep ahead of the competition, and manage their business and growth successfully.

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Securities attorney Laura Anthony and her experienced legal team provides ongoing corporate counsel to small and mid-size private companies, OTC and exchange traded issuers as well as private companies going public on the NASDAQ, NYSE MKT or over-the-counter market, such as the OTCQB and OTCQX. For nearly two decades Legal & Compliance, LLC has served clients providing fast, personalized, cutting-edge legal service. The firm's reputation and relationships provide invaluable resources to clients including introductions to investment bankers, broker dealers, institutional investors and other strategic alliances. The firm's focus includes, but is not limited to, compliance with the Securities Act of 1933 offer sale and registration requirements, including private placement transactions under Regulation D and Regulation S and PIPE Transactions as well as registration statements on Forms S-1, S-8 and S-4; compliance with the reporting requirements of the Securities Exchange Act of 1934, including registration on Form 10, reporting on Forms 10-Q, 10-K and 8-K, and 14C Information and 14A Proxy Statements; Regulation A/A+ offerings; all forms of going public transactions; mergers and acquisitions including both reverse mergers and forward mergers, ; applications to and compliance with the corporate governance requirements of securities exchanges including NASDAQ and NYSE MKT; crowdfunding; corporate; and general contract and business transactions. Moreover, Ms. Anthony and her firm represents both target and acquiring companies in reverse mergers and forward mergers, including the preparation of transaction documents such as merger agreements, share exchange agreements, stock purchase agreements, asset purchase agreements and reorganization agreements. Ms. Anthony's legal team prepares the necessary documentation and assists in completing the requirements of federal and state securities laws and SROs such as FINRA and

DTC for 15c2-11 applications, corporate name changes, reverse and forward splits and changes of domicile. Ms. Anthony is also the author of SecuritiesLawBlog.com, the OTC Market's top source for industry news, and the producer and host of LawCast.com, the securities law network. In addition to many other major metropolitan areas, the firm currently represents clients in New York, Las Vegas, Los Angeles, Miami, Boca Raton, West Palm Beach, Atlanta, Phoenix, Scottsdale, Charlotte, Cincinnati, Cleveland, Washington, D.C., Denver, Tampa, Detroit and Dallas.

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