

# SEC Releases Proposed Rules for Regulation A+ under the JOBS Act: A Promising and Innovative Route to Capital Formation for Young Companies

## Related People:

David F. Broderick  
Theodore M. Grannatt  
Michele F. Vaillant  
Michael M. Horn

## M&E Corporate, Securities and Financial Institutions Alert

01.15.2014

The SEC has released long-awaited proposed rules to implement Title IV of the JOBS Act, now known as Regulation A+.<sup>1</sup> This regulation could bridge a difficult gap for small companies looking to raise capital. If your company has a financing goal larger than privately sourced equity generally permits, but is not ready for the expense and risk of an IPO, Regulation A+ is worth your attention.

Regulatory compliance costs of IPOs average \$2.5 million initially, followed by an ongoing \$1.5 million per year, according to comments in the SEC publication. But you may be able to use Regulation A+ to achieve a similar result—a public offering exempt from registration resulting in freely tradable shares—for a fraction of that cost.

By permitting companies to raise up to \$50 million annually, Regulation A+ addresses a major problem of current Regulation A offerings, which were capped at \$5 million annually.<sup>2</sup> The SEC proposes two levels for Regulation A+: Tier 1 (up to \$5 million in any 12-month period, including up to \$1.5 million for the account of selling securityholders) and Tier 2 (\$50 million and \$15 million, respectively). The proposals preserve attractive parts of current Regulation A and would overcome some major stumbling blocks. Notable highlights include:

- *U.S. and Canadian companies are eligible to use Regulation A+.* Generally speaking, they must be operating companies. Certain types of companies (e.g., “blank check” companies and investment companies) and those that are already required to file SEC reports are not eligible.
- *Securities that young companies typically sell are eligible.* These include equity (common and preferred stock) and debt as well as options and warrants and their underlying shares.
- *Tier 2 Investors may not invest more than the greater of 10% of their net worth or annual income.* Issuers are required only to notify investors of these limits and need not independently verify investor eligibility.
- *A company could “test the waters” for investor interest even before filing documents.* The proposed rules offer considerable

flexibility for companies to gauge investor interest before incurring large expense. With certain precautions, a company could communicate orally or in writing with any potential investor to determine their level of interest before filing its offering statement. After the public filing but before SEC qualification, a company may use its preliminary offering circular to make written offers.

- *The Form 1-A offering statement contains itemized information similar to Form S-1 for registered IPOs, but is scaled back.* It has three parts: notification, offering circular, and exhibits. The SEC staff would review and comment on it, and companies may not use an offering circular for sales until the SEC approves. Generally, two years of financial statements are required, but only Tier 2 offerings require audited statements.
- *The offering statement could be submitted confidentially to the SEC.* This would allow a company to “test the waters” without publicizing the offering. When qualified, amendments and SEC comments to the offering statement will become public.
- *Tier 2 offerings would be exempt from state “blue sky” regulation.* For Tier 2 offerings, this means that the review and qualification of the offering statement is limited to the SEC at the federal level. The proposed rules would also allow a company doing a Tier 1 offering to “test the waters,” but the company could sell the securities only after qualification of the offering statement by the relevant state securities regulators as well as the SEC.
- *Ongoing SEC reporting for Tier 2 issuers is less demanding than for other SEC reporting companies.* Tier 2 companies would be required to file ongoing reports electronically with the SEC: an annual report on Form 1-K, semiannual reports on Form 1-SA, and current reports on Form 1-U. Although based on the continuous disclosure regime for registered companies, the reporting for Tier 2 companies is less demanding. Form 1-K has fewer disclosure items than Form 10-K; Form 1-SA is a semiannual report rather than a quarterly 10-Q report; and fewer events trigger an immediate Form 1-U compared with Form 8-K. Tier 1 companies file a one-time report, but would not be subject to ongoing reporting.
- *Tier 2 companies could develop a trading market for their shares.* The ongoing-reporting regime for Tier 2 companies allows them to create a public market for the securities sold under Regulation A+. This is essential for initial investors desiring to resell shares bought in a company’s offering and for later investors wanting to buy and sell on the open market. Of course, development of an active market remains uncertain as the securities would presumably be sold over-the-counter.
- *Tier 2 companies could finance using shelf and continuous offerings.* The proposed rules modernize current Regulation A by enabling companies to use finance techniques often used by young companies, but are now generally limited to companies that are fully SEC reporting with stock listed on a securities exchange. This would mean that Regulation A+ companies could undertake so-called “shelf” offerings and also qualify the public resale of shares issued on exercise of warrants and options.

#### **What Companies Should Consider Regulation A+?**

Although its benefits are obvious, Regulation A+ is not appropriate for every company. In particular, a company thinking about a Tier 2 offering should consider whether it is ready for the ongoing reporting and development of a trading market for its shares. You could view Regulation A+ as yet another answer to the problem addressed by the JOBS Act – how to ease capital formation by small companies that find fundraising from family and friends too restrictive, the bar too high if limited to venture capital firms, and expense and completion risk too great in a traditional IPO. The JOBS Act addresses these with (1) crowdfunding (for very early stage companies), (2) generally advertised private placements (enabling access to a larger pool of investors, but purchasers must be accredited), and (3) the IPO for emerging-growth companies (reduced registration requirements, on-ramp to becoming fully SEC

reporting). Regulation A+ fills a gap between (2) and (3) by permitting a public offering of substantial amounts without registration, yet enabling a resale trading market for investor exits and after-market purchasers. And the companies relying on Regulation A+ wouldn't have to close the door on an eventual transition to becoming a full Exchange Act reporting company and possible national securities exchange listing.

---

<sup>1</sup> The SEC's discussion of the proposed rules cites a number of suggestions in our July 2012 comment letter to increase the attractiveness of the Regulation A+ finance option.

<sup>2</sup> The relatively high transaction costs (given the low annual cap) arising from compliance with both federal and state securities regulators, and resulting delays, have been cited for the decline in use of current Regulation A.

Disclaimer by McCarter & English, LLP: This publication is for informational purposes only and is not offered as legal advice regarding any particular matter. No reader should act on the basis of this publication without seeking appropriate professional advice. Before making your choice of attorney, you should give this matter careful thought. The selection of an attorney is an important decision. If this publication is inaccurate or misleading, the recipient may make a report to the Committee on Attorney Advertising, Hughes Justice Complex, P.O. Box 037, Trenton, NJ 08625.

Copyright 2014. McCarter & English, LLP. All Rights Reserved.

[January 2014 Corporate AlertDownload](#)