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Will Regulation A Take Off? Expansion Makes Exchange Act Reporting Companies Eligible

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In May 2015, we discussed the Securities and Exchange Commission's (SEC) amendments to Regulation A promulgated under the Securities Act of 1933, as amended (the Securities Act), informally referred to as Regulation A+ (see "Amendments to Regulation A: Expanding Access to Capital," *The Legal Intelligencer*, May 5, 2015). The amendments established two tiers of exempt offerings and expanded the exemption from registration under Regulation A to cover larger offerings of up to $50 million during a 12-month period. The Regulation A+ amendments were part of the Jumpstart Our Business Startups Act in 2012 (Jobs Act), a bill that eased capital raising for public and private companies.

At the time of adoption, Regulation A was not available to companies subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act). However, as mandated by the Economic Growth, Regulatory Relief, and Consumer Protection Act, which was signed into law on May 24, 2018, new amendments, adopted by the SEC on Dec. 19, 2018, and effective immediately upon publication in the Federal Register, permit reporting companies to rely on the Regulation A exemption for offers and sales of securities. Importantly, the amendments also provide that compliance with the Exchange Act reporting requirements will be deemed to have met the reporting requirements of Regulation A.

AMENDMENTS TO REGULATION A ELIGIBILITY

Exemptions under Regulation A+ currently are not available to reporting companies, investment companies registered or required to be registered under the Investment Company Act of 1940 and non-Canadian foreign issuers, among others. This will change with reporting companies becoming eligible once the new amendments become effective. To expand the eligibility of Regulation A to reporting companies, the SEC removed Rule 251(b)(2) thereby permitting reporting companies to offer and sell securities in reliance on the Regulation A exemption. The SEC also made conforming changes to Form 1-A to address this change in eligibility.

The amendments make clear that reporting companies must include in their Form 1-A filing for a Regulation A exempt offering financial statements for the two previous fiscal years (or such shorter time that they have been in existence). The financial statements must, at a minimum, be prepared in accordance with the form and content requirements of Part F/S. Rule 252 of Regulation A requires issuers to include in their offering statement "any other material information necessary

to make the required statements, in light of the circumstances under which they are made, not misleading." It is important to note that reporting companies may therefore need to include any more recently issued audited or reviewed financial statements preparing in accordance with the standard required for the issuer's Exchange Act reports.

REGULATION A ONGOING REPORTING REQUIREMENTS

Regulation A establishes compliance requirements for exempt offerings under a two-tier system based on the aggregate size of the offering. Tier 1 issuers under Regulation A are not subject to ongoing reporting obligations. On the other hand, Tier 2 issuers under Regulation A are subject to certain ongoing reporting obligations, including the filing of annual reports, semi-annual reports and current reports. The reports must be filed with the SEC via EDGAR on Form 1-K, Form 1-SA and Form 1-U.

Although the Regulation A amendments did not change the ongoing reporting requirements for Tier 2 issuers, the amendments provide that reporting companies that "meet" their Exchange Act reporting obligations will be deemed to satisfy the Tier 2 ongoing reporting obligations (i.e., the annual and semi-annual report forms for Regulation A offerings). The SEC implemented this change by amending Rule 257(b) to add new subsection (6), which specifies that the reporting requirements under Rule 257 will be deemed satisfied if an issuer is subject to Section 13 and 15(d) of the Exchange Act and, as of the due date for the periodic report, has filed all reports required to be filed during the 12-month period (or such shorter period during which the company was required to file reports) preceding such date. The SEC made a related technical change by removing Rule 257(d)(1), which currently provides for an automatic suspension of the duty to file reports under Rule 257 if and so long as the issuer is subject to the duty to file reports required by Section 13 or 15(d) of the Exchange Act. The SEC also made certain conforming changes to Rule 257(e) to clarify the reporting requirements in the event a reporting company terminates or suspends its reporting obligations under the Exchange Act.

POTENTIAL IMPACT OF THE AMENDMENTS

According to the SEC, the amendments will likely have the most impact on reporting companies that are not listed on a national securities exchange. Below are some of the benefits for reporting companies that are newly eligible for Regulation A:

- Test-the-Waters Communications

  Reporting companies, who are not also emerging growth companies, will gain additional flexibility with respect to solicitation of investor interest. In particular, Regulation A issuers may conduct test-the-waters communications with all types of investors, including retail investors (as opposed to just qualified institutional buyers and institutional accredited investors for emerging growth companies), regarding their securities offerings under Regulation A. An issuer may, subject to certain conditions, assess interest in a proposed offering prior to filing the Form 1-A by "testing the waters" using oral and written communications with potential investors.

- Blue Sky Pre-emption

  Blue sky pre-emption generally is not available in registered offerings for nonexchange listed issuers. Such issuers are likely to benefit from the new Regulation A changes since blue sky pre-emption is available for Tier 2 offerings under Regulation A. As such, a Tier 2 offering may be an attractive option for such issuers, as it will allow them to avoid the added cost, complexity and timing issues involved with complying with blue sky laws. The changes would not impact blue sky compliance for issuers in Tier 1 offerings, for which blue sky pre-emption is not available in the absence of another exemption.

- Costs Efficiencies

  Since reporting companies are already subject to the reporting requirements of the Exchange Act, the relative total cost of engaging in a Regulation A offering will likely be lower for a reporting company than those issuers not subject to the Exchange Act. Reporting companies not eligible to use Form S-3 or subject to the "baby shelf" rules of Form S-3 may therefore find a Tier 2 offering an attractive alternative. Regulation A issuers that become reporting companies may now also be able to realize these benefits through follow-on Regulation A offerings.

THE USE AND FUTURE OF REGULATION A

The SEC noted in the adopting release that, between June 19, 2015, (the effective date of the 2015 amendments) and Sept. 30, 2018, "there were approximately 260 qualified offerings seeking up to approximately $5.8 billion in the aggregate." The adopting release also noted that Tier 2 offerings accounted for the majority of the Regulation A capital raising activity. Notwithstanding the number of attempted Regulation A offerings and the amount of capital raised, questions remain about how effective a Regulation A offering is as a capital raising tool since only a more limited number of issuers actually raised capital and even fewer ultimately became listed on an exchange.

The SEC noted in the adopting release that it anticipates the additional flexibility afforded by the amendments will attract additional and a wider range of issuers to utilize Regulation A. Another step the SEC could have taken to attract greater utilization of Regulation A would be to increase the Tier 2 offering limit (which the SEC is required to review every two years under the Jobs Act). In the meantime, given some of the advantages summarized above, including that such offerings can potentially be less expensive and completed faster, it makes sense for reporting companies to consider a Regulation A offering as an option.

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