



Securities Law ADVISORY ■

DECEMBER 23, 2013

SEC Proposes Amendments to Regulation A

Introduction

On December 18, 2013, the Securities and Exchange Commission (the “Commission”) proposed new amendments to Section 3(b) (known as Regulation A) of the Securities Act of 1933, as amended (the “Securities Act”), as mandated by the Jumpstart Our Business Startups Act (the “JOBS Act”).¹ Currently, Regulation A exempts certain offerings from the registration requirements under the Securities Act. The proposed rules, known as Regulation A+, would establish two tiers of Regulation A offerings: Tier 1 for offerings not exceeding \$5 million and Tier 2 for offerings not exceeding \$50 million. In addition, the proposed rules would amend Regulation A with respect to issuer eligibility, offering statement contents and “testing the waters” solicitation. Until final rules are adopted, no issuer or prospective issuer may rely on the proposed rules.

¹ This advisory is based on the Commission’s press release and the proposed rules (available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540518165#.UrXPq_RDvuQ).

This advisory is published by Alston & Bird LLP to provide a summary of significant developments to our clients and friends. It is intended to be informational and does not constitute legal advice regarding any specific situation. This material may also be considered attorney advertising under court rules of certain jurisdictions.

Key Takeaways under the Proposed Rules

The proposed rule amendments would exempt certain offerings of up to \$50 million from registration under the Securities Act and update the communications, qualification and offering process requirements under current Regulation A.

Scope of the Proposed Amended Exemption (Regulation A+)

- The proposal would create two tiers of Regulation A offerings –
 - Tier 1: offerings up to \$5 million in a 12-month period, including up to \$1.5 million for the account of selling security holders
 - Tier 2: offerings up to \$50 million in a 12-month period, including up to \$15 million for the account of selling security holders
- An issuer of \$5 million or less of securities could elect to proceed under either Tier 1 or Tier 2

Additional Requirements for Tier 2 Offerings

- Investors would be limited to purchasing no more than 10 percent of the greater of the investor's annual income or net worth
- The financial statements included in the offering statement would be required to be audited
- Issuers would be subject to ongoing reporting requirements

Updates to Communication, Qualification and Offering Process

- All documents would be required to be filed electronically on EDGAR
- Issuers would be permitted to use "testing the waters" materials both before and after the offering statement is filed
- Issuers would be able to make non-public submissions of draft offering statements
- Issuers would be excluded under bad actor disqualifiers and for failure to file required reports

State Securities Law Compliance

- State securities law requirements would be preempted for most Tier 2 offerings

Scope of the Proposed Amended Exemption

When Could Companies Rely on the Proposed Exemption?

Eligible Offerings: The proposed rules would bifurcate Regulation A offerings into two tiers:

- Tier 1: offerings of up to \$5 million in any 12-month period with a \$1.5 million cap on behalf of selling security holders; and
- Tier 2: offerings of up to \$50 million in any 12-month period with a \$15 million cap on behalf of selling security holders.

Integration: When calculating the aggregate value of offerings conducted in a 12-month period, the current Regulation A integration rule provides a safe harbor for:

- prior offers or sales of securities; or
- subsequent offers and sales of securities that are:
 - registered under the Securities Act, except as provided in Rule 254(d);²
 - made in reliance on Rule 701 under the Securities Act;
 - made pursuant to an employee benefit plan;
 - made in reliance on Regulation S; or
 - made more than six months after completion of the Regulation A offering.

The proposed rules would also:

- exempt from the integration requirement subsequent offers or sales of securities made pursuant to the proposed rules for securities-based crowdfunding transactions under Title III of the JOBS Act;³ and
- amend Rule 254(d) to exempt registered offerings conducted after soliciting interest in a contemplated, but abandoned, Regulation A offering unless the issuer solicited nonqualified institutional buyers or non-accredited institutional investors permitted by Section 5(d) of the Securities Act.

What Issuers Would Be Ineligible for the Proposed Exemption?

Eligible Issuers: Regulation A would be available to companies organized in and with their principal place of business in the United States or Canada, as is currently the case under Regulation A.

² Rule 254(d) provides a safe harbor to issuers that have a bona fide change of intention and decide to register an offering under the Securities Act after soliciting interest in a Regulation A offering without filing the required offering statement.

³ For a summary of the SEC's proposed rules on crowdfunding transactions, see: <http://www.alston.com/advisories/crowdfunding-advisory>.

Ineligible Issuers: Under the proposed rules, the exemption would continue to be unavailable to:

- companies subject to ongoing reporting requirements under the Securities Exchange Act of 1934 (the “Exchange Act”);
- companies registered or required to be registered under the Investment Company Act of 1940;
- development stage companies that (i) have no specific business plan or purpose, or (ii) have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies (“blank check companies”); and
- issuers of fractional undivided interests in oil or gas rights, or similar interests in other mineral rights.

Additionally, the proposed rules would expand the list of ineligible issuers to include:

- companies that have not filed with the Commission the ongoing reports required by the proposed rules during the two years immediately preceding the filing of a new offering statement; and
- companies that are or have been subject to an order by the Commission denying, suspending or revoking the registration of a class of securities pursuant to Section 12(j) of the Exchange Act⁴ that was entered within five years before the filing of the offering statement.

Section 12(g) of the Exchange Act: The proposed rules would not exempt issuers from Section 12(g) of the Exchange Act, which requires issuers with total assets exceeding \$10 million to register any class of equity securities held of record by either 2,000 persons or 500 unaccredited investors.

“Bad Actors”: Regulation A currently provides for the disqualification of “bad actors” in Rule 262. The proposed rules would amend Regulation A by (i) expanding the list of covered persons and disqualification triggers under Rule 262, and (ii) applying the bad actor provisions recently adopted under Rule 506(d) of the Securities Act⁵ to Regulation A. As a result, the proposed rules would disqualify issuers and other relevant persons that have been convicted of or are subject to court or administrative sanctions for securities fraud and other violations of specified laws. Under the proposed amendment, the bad actor disqualification provisions would apply to certain “covered persons,” including directors, officers, significant shareholders, promoters and underwriters.

The disqualification trigger events under the proposed rules are substantially similar to those of Rule 262 and Rule 506(d). The proposed rules would, however, expand these trigger events to include (i) final orders and bars of certain state and other federal regulators and (ii) Commission cease-and-desist orders relating to violations of scienter-based anti-fraud provisions of the federal securities laws.

⁴ Section 12(j) of the Exchange Act authorizes the Commission to deny, suspend or revoke registration of an issuer, after notice and opportunity of a hearing, if the Commission finds that the company failed to comply with any of the provisions, rules or regulations of the Exchange Act.

⁵ For a summary of the SEC’s final rules under 506(d), see <http://www.alston.com/advisories/JOBS-Act>.

Under the proposed rules, an issuer would not lose the benefit of the Regulation A exemption if it could show that it did not know and, in the exercise of reasonable care, could not have known, of the existence of a disqualification.

What Securities Would an Issuer Be Able to Offer in Reliance on the Exemption?

The proposed rules would limit the Regulation A exemption to those securities enumerated in Section 3(b)(3) of the Securities Act, which include equity securities, debt securities and debt securities convertible or exchangeable into equity interests, including any guarantees of such securities. Under the proposed rules, however, issuers offering asset-backed securities would not be able to rely on the Regulation A exemption.

How Much Would an Investor Be Able to Purchase in an Exempt Offering?

With respect to Tier 2 offerings, the proposed rules would limit the amount of securities investors could purchase to 10 percent of the greater of their annual income or their net worth. Issuers would be required to disclose this investment limitation to investors. The proposed rules would permit issuers to rely on an investor's representation of compliance with the investment limitation provided that the issuer did not know, at the time of the sale, that the investor's representation was false. The proposed rules would not limit an investor's investment in a Tier 1 offering.

Would Securities Be Subject to Resale Limitations?

Under both current Regulation A and the proposed amendments, securities sold in Regulation A offerings would not be restricted securities. Thus, they would not be subject to transfer restrictions.

Communication, Qualification and Offering Process

Filing and Delivery of Regulation A Documents

The proposed rules would require issuers to electronically file offering statements and other documents required to be filed in conjunction with Regulation A offerings on EDGAR. This would be an update of current Regulation A, which requires filing offering statements with the Commission in paper form.

In the prequalification period, the proposed rules would require issuers to deliver a preliminary offering circular to prospective purchasers at least 48 hours in advance of sale. The proposed rules would allow issuers to satisfy their delivery requirements as to the final offering circular under an "access equals delivery" model when the final offering circular is electronically filed on EDGAR.

Would "Testing the Waters" Be Permitted?

The proposed rules would continue to allow issuers to "test the waters," or publicly solicit interest in a potential offering. Current Regulation A requires issuers to cease using the solicitation materials after the initial filing of the offering statement. Issuers must submit and file all solicitation materials with the Commission. The current rule does not limit the type of investors that may be solicited.

The proposed rules would permit issuers to use solicitation materials both before and after the offering statement is filed. They would not impose any limit on the investors that may be solicited. Materials used after publicly filing an offering statement would have to include a current preliminary offering circular or inform investors where the preliminary offering circular can be obtained. This requirement could be satisfied by providing the URL where the preliminary offering circular or offering statement may be found on EDGAR.

How Would the Proposal Revise the Offering Statement?

Disclosure Options: Under the proposal, Regulation A offering statements would continue to be filed on Form 1-A. The proposed rules would not alter the structure of Form 1-A, but would update the content of disclosure. The proposal would eliminate the current Model A question-and-answer disclosure option and update the current Model B narrative option, renaming it "Offering Circular." Alternatively, issuers would still be able to satisfy the requirements of Form 1-A by providing the narrative disclosure required by Part I of Form S-1.

Financial Statements: As proposed, issuers would be required to disclose two years of financial statements in the offering statement. Under the proposed rules, the financial statements of Tier 2 issuers would be required to be audited. Tier 1 issuers would need to provide audited financial statements to the extent they were prepared for other purposes.

Draft Offering Statements: The proposal would add a new provision allowing for the non-public submission of draft offering statements for issuers that have not previously sold securities pursuant to Regulation A or under an effective Securities Act registration statement. All non-public materials would be required to be filed as exhibits to the offering statement at least 21 days before qualification of the offering statement.

How Would the Offering Statement Be Qualified?

The proposed rules would require offering statements to be qualified by Commission action. Under the current rule, an offering statement that does not include a delaying notation will be qualified without Commission action on the 20th day after filing. Issuers can include delaying notations on the cover of the form, stating that the offering statement shall only be qualified by order of the Commission. The proposed rules would eliminate the delaying notation process.

In certain circumstances, the proposal would permit continuous or delayed offerings, such as in the case of offerings sold on behalf of selling security holders, securities offered under employee benefit plans, and securities issued on the exercise of options or warrants.

Would Issuers Be Subject to Ongoing Reporting Requirements?

All Issuers: Under the proposed rules, all issuers would be required to file reports at the termination or completion of the offering. Current Regulation A requires issuers to file Form 2-A every six months to report sales or within 30 days after termination of sales under the rule. The proposed rules would eliminate Form 2-A. Instead, all issuers would be required to provide information about the offering and sales after termination or completion of the offering on new Form 1-Z or 1-K.

Tier 2 Issuers: In addition, Tier 2 issuers would be required to comply with an ongoing reporting regime. They would be required to electronically file on EDGAR:

- annual reports on proposed new Form 1-K to provide information about the issuer, the offering, the issuer's business, related persons transactions, beneficial ownership, executive compensation, two years of audited financial statements and MD&A;
- semiannual reports on proposed new Form 1-SA to provide disclosure similar to Form 10-Q, without information about market risk, risk factors, and controls and procedures; and
- current reports on proposed new Form 1-U to report events, including fundamental changes in the business, bankruptcy, changes in the issuer's certifying accountant, changes in control and departure of officers.

The reporting obligations of issuers conducting Tier 2 offerings would cease when the securities become registered under the Exchange Act or upon the filing of an exit report on Form 1-Z if (i) the issuer has filed all its ongoing reports for a certain amount of time, (ii) the securities are held of record by fewer than 300 persons and (iii) offers or sales made in reliance on a qualified offering statement are not ongoing.

Preemption of State Securities Laws

Under current Regulation A, offerings are subject to state registration requirements. The proposed rules would preempt state securities law requirements for Tier 2 offerings if the securities are sold to "qualified purchasers," defined as all offerees in Regulation A offerings and all purchasers in Tier 2 offerings. Tier 1 offerings would continue to be subject to state registration requirements, unless there is a state-level exemption available. The release explains that the enhanced reporting requirements and investment limit for Tier 2 offerings provide sufficient investor protection without the additional disclosure required by state laws.

Public Comment Period

The comment period for the proposed rule is 60 days following its publication in the Federal Register. Comments on the proposed rules may be submitted to the Commission via online form, email or mail.⁶

⁶ Instructions on how to submit a comment are available at <http://www.sec.gov/rules/submitcomments.htm>.

ALSTON & BIRD LLP

WWW.ALSTON.COM

© ALSTON & BIRD LLP 2013

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213-576-1100
NEW YORK: 90 Park Avenue ■ 12th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260
SILICON VALLEY: 275 Middlefield Road ■ Suite 150 ■ Menlo Park, California, USA, 94025-4004 ■ 650-838-2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.756.3300 ■ Fax: 202.756.3333
VENTURA COUNTY: 2801 Townsgate Road ■ Suite 215 ■ Westlake Village, California, USA, 91361 ■ 805.497.9474 ■ Fax: 805.497.8804

***For more information, contact your Alston & Bird attorney
or one of the attorneys in the firm's Securities Group.***

For other related securities advisories, [click here](#). If you or a colleague would like to receive future *Securities Law Advisories* and *Special Alerts* electronically, please forward your contact information, including your e-mail address, to securities.advisory@alston.com. Be sure to put "subscribe" in the subject line.