



## What is Regulation A?

The Securities Act of 1933 requires that a company making an offering of securities register that offering with the SEC, unless an exemption is available. Registration is expensive and thus small and emerging companies usually raise funds by relying on an exemption from registration, such as the exemption which Regulation D (which includes Rule 506) provides for private offerings.

Regulation A is one of the SEC's least used exemptions from full registration of offerings. Regulation A is conditioned on the company providing specific disclosures and that disclosure being reviewed by the SEC. In an effort to increase the use of Regulation A and promote access to capital for small companies, Congress required the SEC to adopt rules that increase the size of the exemption from \$5 million to \$50 million as part of [Title IV of the JOBS Act of 2012](#). [The SEC issued its final rules](#) to effect this change on March 25, 2015. The new rules will go into effect around Memorial Day. The changes are being popularly referred to as "[Regulation A+](#)."

The new rules create a two tier system for the use of Regulation A. Tier 1 includes an annual offering limit of \$20 million and does not "preempt" state regulation of the offering (which means that offerings will need to be approved by regulators in each state in which a company is offering its securities). Tier 2 includes an annual offering limit of \$50 million and does preempt state regulation of the offering.

Generally, Regulation A allows operating companies to publicly offer their securities to all investors, whether through online platforms or by traditional means. Those securities are not "[restricted securities](#)" and may be resold by investors.

The civil liability provisions of [Section 12\(a\)\(2\) of the Securities Act](#) will apply to issuers and intermediaries selling securities under Regulation A. This is a higher level of liability than applies to offerings made under Regulation D.

## What changed?

The biggest change to Regulation A is the creation of two tiers of offerings with slightly different requirements.

In Tier 1 offerings, companies can raise up to \$20 million over a 12 month period, including no more than \$6 million on behalf of selling securityholders (such as founders looking for liquidity). A company will file an "Offering Statement," which includes a prospectus-like "Offering Circular," on [Form 1-A](#). These materials will be subject to review by the SEC and any state in which the company is planning to offer its securities. This procedure is the same as what existed previously for Regulation A, but with a larger offering limit.

Tier 2 offerings are a bit different. Instead of a \$20 million limit, companies can raise up to \$50 million over a 12 month period, including no more than \$15 million on behalf of selling securityholders. While the company still has to complete the Form 1-A and Offering Circular, the only review will be by the SEC. States will be preempted from reviewing the offering. The price for this preemption is that companies will be required to provide audited financial statements in a specified format and be subject to ongoing reporting requirements. Additionally, individual investors in Tier 2 offerings who are not “[accredited investors](#)” will be limited to investing up to 10% of the greater of the investor's annual income or net worth.

Recognizing the importance of liquidity to encouraging investors to participate in Regulation A and the potential for informational asymmetries, the SEC has created limitations on secondary sales of securities under Regulation A by affiliates of the issuer within the first year after qualification of the offering. During the first 12-month period after the qualification of a Regulation A offering statement, the aggregate value attributable to selling, affiliate security holders may not exceed 30% of the value of the particular offering.

### **Who can & cannot use Regulation A?**

The final rules do not change the type of companies that are eligible to use Regulation A. Regulation A is limited to companies organized in and with their principal place of business in the United States or Canada. The exemption is unavailable to companies that are already subject to the reporting requirements of the Exchange Act ("reporting companies"), investment companies or funds (including business development companies), blank-check companies, and companies issuing interests in oil and gas developments.

These limitations have important implications for companies that currently use special purpose vehicles (SPVs) when raising funds under Regulation D. Companies that are interested in maintaining clean capitalization tables without lots of small investors frequently use the SPV structure, and some online platforms use a fund structure for their investments in order to avoid registration as a broker-dealer. Under Regulation A, a company will not be able to use a special purpose fund that takes direct investments from investors and invests into the company, because that fund would be an “investment company.” Instead, companies will likely want to carefully craft the terms of any investor agreements to provide maneuverability if future plans involve being acquired or taking on a large, strategic investor. Similarly, real estate projects that in Regulation D offerings used special purpose vehicles as part of the capital stack will be likely have to allow investors to invest directly in the property-owning entity in order to make equity offerings under Regulation A.

The new rules also adopt the more stringent [Bad Actor disqualification](#) provisions that the SEC previously adopted for Rule 506 of Regulation D. The disqualification provision prevents any issuer from using the exemption if the issuer or any of its “covered persons” have committed any one of the enumerated bad acts. Covered persons include the issuer and any predecessor of the issuer or affiliated issuer; any director, executive officer, other officers participating in the offering, general partner, or managing member of the issuer; any beneficial owner of 20% or more of the issuer's outstanding voting equity securities; any promoter connected with the issuer; any underwriter or person paid for

solicitation of purchasers (as well as any general partner, managing member, officer, or director of the underwriter or solicitor). The new Bad Actor prohibition expands the scope of the Bad Acts that were previously included in [Rule 262](#) to include regulatory orders of the SEC, federal financial regulators, and state financial regulators.

Additionally, the SEC has created disqualifications for any company that is or has been subject to an SEC order under Section 12(j) of the Exchange Act within the past five years, as well as companies that are required to, but have not filed ongoing reports under the new Regulation A rules. Unlike the Bad Actor rules, which attaches to the principals of a company and follows them to new issuers, the disqualification that results from being subject to an order under Section 12(j) of the Exchange Act or failure to file ongoing reports under Regulation A is only attached to the issuer.

### **What kind of offerings can be made?**

Regulation A restricts the types of securities that may be sold to investors. However, the allowable securities satisfy the capital raising needs of most operating companies (whether they are C corporations or LLCs). The types of securities that are eligible for Regulation A are equity securities, debt securities, and debt securities convertible or exchangeable into equity interests, including guarantees of such securities. Warrants are permitted. In effect, this limitation only restricts companies from selling exotic asset-backed securities and derivatives.

### **What steps are involved in a Regulation A offering?**

In very general terms, this is how a Regulation A offering occurs:

- The issuer publishes “test the waters” materials to see if there is enough investor interest to warrant the expense of filing an Offering Statement.
- Assuming there is, the issuer engages legal and accounting professionals to prepare disclosure and financial information that goes into the Offering Statement.
- The Offering Statement is converted into the format of the SEC’s filing system, [EDGAR](#) (this is called “EDGARization”) and filed with the SEC.
- In a Tier 1 offering, the Offering Statement is filed with the state authorities. In a Tier 2 offering, “notice filings” may be required in the relevant states.
- The issuer may choose to post the Offering Circular in preliminary form on an online investment platform, or to make offers using that document offline, either by itself or through a broker-dealer.
- The SEC reviews the Offering Statement and gives comments. In a Tier 1 offering the state authorities also give comments. This issuer revises its disclosure.
- The SEC “qualifies” the Offering Statement, at which point sales of securities may be made.
- The final version of the Offering Circular must be provided to purchasers.

### **What has to be disclosed?**

The Form 1-A requires significant disclosure from any company pursuing an offering under Regulation A. The subjects of the disclosure include:

- Basic identifying information about the company,
- Risk factors of the offering,
- The business and assets of the company,
- Any offering price considerations,
- Projected use of proceeds,
- Capitalization of the company,
- A description of the securities,
- The plan of distribution,
- Dividends, distributions, and redemptions,
- Identification and experience of officers and key personnel,
- Identification and experience of the Directors,
- Identification of principal owners,
- Compensation to management and related party transactions,
- Legal actions in which the company is involved,
- Tax aspects of the investment,
- Financial statements of the company, and
- Management discussion and analysis.

### **What financial statements are required?**

The issuer has to produce financial statements for the two most-recently completed fiscal years, including balance sheets, income statements, cash flow and changes in stockholders' equity. If the issuer is less than two years old, it produces financial statements for the period since inception. If more than nine months has elapsed since the last fiscal year, interim financial statements covering a date no sooner than six months after the fiscal year-end are required. These timings apply to both the date of filing with the SEC, and the time the Offering Statement is qualified by the SEC, so an update of financial statements may be required midway through the process. Special rules apply to oil and gas producers. The financial statements must be prepared in accordance with US Generally Accepted Accounting Principles (GAAP) unless the issuer is Canadian, in which case it may use international standards.

Tier 1 financial statements need not be audited, unless an audit has been prepared for other purposes. Tier 1 financial statements do not have to comply with Regulation S-X, which specifies the content and format of financial statements. Tier 2 financial statements must be audited and must be prepared in accordance with Regulation S-X.

### **Can I gauge investor interest before filing an offering statement?**

Yes. The SEC expressly created an opportunity for companies to "test the waters" (TTW) before going through the process of qualifying an offering under Regulation A. This was required by the statutory changes in the JOBS Act.

Under Rule 255(a), at any time before the qualification of an offering under Regulation A, companies may solicit prospective investors by any means to determine interest in a potential offering. Companies should be aware that these communications are offers of securities that are subject to the antifraud

provisions of state and federal securities laws. Any solicitation made during the testing the waters period must include specific notices to prospective investors that (1) no money or consideration is being solicited and will not be accepted until after the offering is qualified, (2) no offer to buy can be accepted nor can any part of the purchase price be accepted prior to qualification, and (3) that a person's indication of interest involves no obligation or commitment of any kind. If a preliminary Offering Circular has been filed, but is not yet qualified, any testing the waters communication must include information on how to obtain the Offering Circular, including by electronic access.

### **Can social media be used? What kind of communications?**

The new rules for Regulation A modernize the scope of allowable communications for offerings, and do so in a way to reflect analogous provisions of the Securities Act registration process. Under a Tier 2 offering, the SEC has preempted state securities laws registration and qualification requirements in order to allow companies relying on Regulation A to communicate with potential investors about their offerings using the internet, social media, and other means of widespread communication, without concern that such communications might trigger registration requirements under state law.

Additionally, the SEC has adopted the standard of "access equals delivery." By adopting the "access equals delivery" model, companies will be able to effectively use social media, email, and targeted advertising where character limits apply. In those communications, companies must include an active hyperlink to the filed Offering Circular located on the SEC's EDGAR filing system. However, issuers should be very careful that the communication (email, Tweet or posting) that contains the link to the Offering Circular or materials does not include any misleading statements or any information inconsistent with the materials it links to.

### **Can I do a Regulation D offering and a Regulation A offering at the same time?**

In theory, but it gets really complicated, and it's not clear why you would want to. Securities offerings made at the same time, or close in time, may be "integrated" — treated as if they were part of the same offering, and thus both subject to all the conditions that apply to each type of offering. It is clear that the SEC believes that such concurrent offerings are possible if the issuer can show that each offering complied with the conditions applicable to that offering (for example, showing that investors in a Rule 506(b) offering where general solicitation is not allowed were not solicited by the TTW materials used in a Regulation A offering). However, the "safe harbor" in the SEC's rules that provides protection from integration for specific types of offering does not cover concurrent Regulation A and Regulation D offerings. Only try this with guidance from experienced securities lawyers.

### **Can companies use intermediaries to help them place their securities? Do they have to?**

A company making an offering under Regulation A can sell its securities by itself (in which case it will want to make sure that it has checked the broker-dealer laws in all the states in which it is selling to make sure it has complied with any required filings and also make sure it's not compensating any of its own employees for the sales of securities). It can also employ an intermediary, which may be a traditional broker-dealer or an online investment platform. When using an online platform, the issuer

should be sure that the platform is in compliance with broker-dealer registration requirements. The circumstances in which a non-broker online platform can promote an offering of securities under Regulation A are extremely limited, and if an issuer uses a platform that should have been registered but wasn't, investors may force the issuer to take the securities back and reimburse them (plus interest).

### **What anti-fraud liability applies to Regulation A?**

Securities fraud is a broader concept than fraud in other commercial contexts. Not only does it include the act of making a misstatement of a material fact, it also includes the omission of a material fact necessary to make a previous statement not misleading. However, depending on the particular anti-fraud provisions that are applicable, the company and any seller of the securities may not have had to intend to deceive, or an investor may not have to demonstrate reliance. The applicable anti-fraud provisions of the federal securities laws include [Section 12\(a\)\(2\) of the Securities Act](#), [Section 17 of the Securities Act](#), and [Rule 10b-5](#) under the Securities Exchange Act of 1934. State anti-fraud rules are also applicable.

By statute and convention, offers under Regulation A are subject to the strict anti-fraud provisions of Section 12(a)(2) of the Securities Act. Section 12(a)(2) allows for a private right of action. This liability provision extends to all persons who "offers or sells" the security, which includes the issuer itself, any broker-dealer involved in the transaction, and any compensated solicitor selling on behalf of the issuer. In an action proceeding under Section 12(a)(2), any claim for damages is limited to the recovery of any consideration paid plus interest. As there is no requirement that a plaintiff demonstrate scienter (intent) on the part of a defendant under Section 12(a)(2), the only defense available is for the defendant to show that it did not know, and in the exercise of reasonable care could not have known of the misstatement or omission. This is known as the "due diligence defense" to a securities fraud claim.

In addition to Section 12(a)(2), offerings made under Regulation A are also subject to the anti-fraud liability provisions of Section 17 of the Securities Act. Similarly to Section 12(a)(2), Section 17 does not require a demonstration of intent. However, there is no private right of action under Section 17 and actions may only be brought by the SEC.

Issuers in offerings relying on Regulation A are also subject to Rule 10b-5. An action under Rule 10b-5 may be brought by the SEC, or by private plaintiffs. In a private action under Rule 10b-5, the plaintiff must demonstrate that the defendant has the intent to deceive and that the plaintiff relied on the deception when making the decision to buy or sell securities. The damages in a private action under Rule 10b-5 are limited to the actual damages incurred by the plaintiff.

### **Does "the crowd" have a role in these offerings?**

Unlike the provisions of Title III of the JOBS Act of 2012 and the SEC's proposed rules for Regulation Crowdfunding, there is no express role for "the crowd" in securities offerings relying on Regulation A. There is no requirement to have any sort of comment or chat board on an online offering page. If a company chooses to engage the crowd it will only be able to do so in a limited fashion. The principal time during which a company could engage the crowd, and where the crowd could publicly critique the company's prospects, would be in the testing the waters phase, prior to qualification of the Offering

Statement. In that time period there is no restriction on the type of communication. A company could choose to host an online chat in which the proper notices under Rule 255 are provided along with a hyperlink to any publically filed offering statement.

Note that the record of any chat must be filed with the SEC as Exhibits to the Offering Statement as solicitation materials. Should any information provided to prospective investors during that testing the waters period need to be updated, the company would be required to update the statements it made during that chat and provide those updates to every person who participated or viewed the chat. This could be a challenge if the chat board did not require use of real names.

### **Do offerings have to comply with state as well as federal law?**

The biggest difference between Tier 1 and Tier 2 (apart from offering size) is the fact that Tier 1 offerings must be qualified (or whatever the local equivalent is) by the securities regulator in each state where the issuer is offering its securities. The issuer may be able to take advantage of the North American Securities Administrators Association (NASAA)'s [Coordinated Review Program](#), but this program is very new and not all states have signed up for it. States may impose filing fees on Tier 1 offerings.

Tier 2 offerings are not required to be reviewed by state authorities. However, "notice filings" and filing fees are permitted. This preemption of state law only applies to the registration or review of offerings. State antifraud provisions still apply, as do any regulations relating to whether an issuer or intermediary needs to be registered under the state's broker-dealer registration requirements.

### **What is included in the ongoing disclosure requirement?**

For Tier 1 offerings, the only required disclosure following a qualification of an Offering Statement under Regulation A is the filing of the Form 1-Z exit report within 30 calendar days after the termination or completion of the offering. The Form 1-Z includes information such as the date the offering was qualified and commenced, the amount of securities qualified, the amount of securities sold in the offering, the price of the securities, the portions of the offering that were sold on behalf of the issuer and any selling securityholders, any fees associated with the offering, and the net proceeds to the issuer. That is the end of the reporting obligation following a Regulation A offering under Tier 1.

Tier 2 offerings, in anticipation of a more active trading market in the securities, include an ongoing reporting regime that is robust, but less burdensome than for SEC-reporting companies. The various reports must be filed following specific events, on an annual basis, and on a semi-annual basis.

The annual reports for Tier 2 offerings are required to be filed on the Form 1-K and filed within 120 calendar days after the end of the issuer's fiscal year. Form 1-K includes two parts. Part I includes identification that is based on the previously disclosed identifying information about the issuer previously filed Part I of Form 1-A when the offering was qualified. Part I also includes the reporting information required by the Form 1-Z exit report for Tier 1 offerings. Part II includes a greater amount of detail on the company's operations, including audited financial statements.

The semi-annual reports for Tier 2 offerings are required to be filed on the Form 1-SA and are most similar to the 10-Q quarterly reports for registered companies. The semi-annual reports primarily

consist of unaudited financial statements and management discussion and analysis. The Form 1-SA must be filed within 90 calendar days after the end of the first six months of the issuer's fiscal year.

The current event reports for Tier 2 offerings are required to be filed on the Form 1-U. Current reports must be filed with the issuer experiences events such as the following: fundamental changes, bankruptcy or receivership, material modification to the rights of securityholders, changes in the issuer's certifying accountant, non-reliance on previous financial statements or a relate audit report or interim review, changes in control of the issuer, departure of the principal officers of the issuer, unregistered sales of 10% or more of outstanding equity securities, and other events issuers would want to disclose to the market. The Form 1-U must be filed within four business days after the occurrence of any triggering events.

Additionally, when there is an extended gap between the financial statements included in the offering circular under a Tier 2 offering and the first periodic report, a special financial report will be required of issuers.

### **Is there a limit on the number of people a company can sell to?**

There is no limit on the number of people a company can sell to. Many people had been worried that there would be an implicit limit on the number of potential equity investors because, under the SEC's normal rules, if a company acquires 2,000 shareholders of record, or 500 shareholders who aren't "accredited" (i.e., rich), it has to become a "reporting company," complying with all the SEC's rules, which is very burdensome. The SEC has granted a conditional exemption from this full registration. So long as a company engages a registered transfer agent to keep its shareholder records, complies with the continuing disclosure requirements outlined above and does not have a "public float" (total value of traded shares) more than \$75 million, or revenues more than \$50 million, it does not have to become an SEC-reporting company. Keeping accurate records of the shares that were issued, and the type of offering they were issued in, will be essential.

### **Are there limits on who can invest and how much?**

There are limits on the amount of investment from any particular investor for Regulation A offerings under Tier 2, but there are no limits for offering under Tier 1.

For Tier 2 offerings, an investor who is not an accredited investor, as defined by Rule 501(a) of Regulation D, can invest in any offering relying on Regulation A no more than: (1) 10% of the greater of annual income or net worth (for natural persons), or (2) 10% of the greater of annual income or net assets at fiscal year-end (for non-natural, legal persons). However, if the issuer is listing the securities on a national securities exchange and becoming a reporting company under Section 12(g) of the Exchange Act, there are no individual investment limits upon qualification with that exchange. The issuer can rely on investors' representations that they are accredited or that they are not exceeding the investor limits. However, the SEC's commentary makes it clear that the SEC believes that the reasons for permitting self-certification here would not apply to the determination of accredited status in Regulation D offerings.



Investors do not have to be US persons, and in theory sales could be made to persons outside the United States in reliance on Regulation A. However, any sales made into another country would have to comply with that country's rules regarding the offering of securities.

### **When can investors resell their securities?**

Securities purchased in an offering relying on Regulation A are not restricted securities — they will not contain the restrictive legend that must be removed before a resale takes place, and the securities will not be subject to the [Rule 144](#) conditions for reselling securities. While non-affiliates of the company may freely trade their acquired securities after purchasing from the company, there are restrictions on the resales by affiliates of the issuer.

Affiliates will be subject to an annual limit based on the volume of securities qualified in the Regulation A offering by the company. Other avenues for affiliates to resell their securities include registration in an IPO, a public sale in compliance with the rules applicable to affiliates under Rule 144, or through a non-public sale. However, any non-public sale of the securities would cause those securities to become restricted.

Additionally, since the exemption from the registration provisions of Section 12(g) of the Exchange Act follows the securities and not the investors, it will be critically important for the stock transfer agent to keep track of the securities that were originally issued in a Regulation A offering.

### **Is this registration?**

No. Companies making Regulation A offering must not say that they are, or that the offering is, “registered with the SEC.” Regulation A is an exemption from registration. Registration has a very specific meaning under the securities laws and a very specific set of responsibilities and liabilities. The technical term is “qualification.” Companies must also be careful not to say or imply that the SEC has approved the offering in any way.

## Exhibit A: Summary of permitted communications

Bear in mind that under securities law, virtually all communications intended to create interest in the offering of securities is an “offer.” This rule applies even if the communication says “this is not an offer.” Also remember that “written” includes any communications that are transmitted electronically. Thus, webinars and the like, even if transmitted live only and not stored, are “written offers.”

Timing	Can an oral offer be made?	Can a written offer be made?	Can sales be made?
<b>Before the Offering Statement is filed</b>	No; only TTW communications are permitted and TTW must be written	Only TTW communications	No
<b>After the Offering Statement is filed</b>	Yes	Yes, either: <ul style="list-style-type: none"> <li>• By means of a Preliminary Offering Circular that complies with Rule 254; this may be possible to format as a profile page on an online investment platform but the content of social media communications may be constrained</li> <li>• TTW communications permitted but the content of social media communications may be constrained</li> </ul>	No
<b>After the Offering Statement is qualified</b>	Yes	Yes; but Rule 254 Preliminary Offering Circular only, no TTW communications after Offering Statement is qualified	Yes (Final Offering Circular must be delivered within 48 hours of sale)