

Small Securities Offerings Getting Bigger - Regulation A+

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The Jumpstart Our Business Startups Act ("JOBS Act") amends Section 3(b) of the Securities Act of 1933 ("Securities Act") to require that the Securities and Exchange Commission ("SEC") issue rules that will exempt "small offerings" from registration under certain conditions.

Prior to the JOBS Act, Section 3(b) of the Securities Act allowed the SEC to provide exemptions from registration if certain conditions were met, subject to an aggregate \$5 million limit. The SEC issued "Regulation A" under this Section, but this exemption is basically useless because of several burdens and limitations, including the rather small \$5 million limitation and the lack of an exemption from state securities laws.

The JOBS Act requires the SEC to issue rules, which some are calling "Regulation A+," that will allow a company to issue exempt securities under the following terms and conditions:

- An aggregate limit on the securities issued of \$50 million per year (to be adjusted every two years);
- The securities issued are to be "covered securities" so that state law registration requirements will be preempted;
- The exempt securities must be limited to equity, debt, and convertible debt securities, and may be further limited by the SEC;
- A public offering and sale would be allowed;
- The exempted securities would not be subject to the resale restrictions imposed by current securities laws, but the anti-fraud provisions of current laws would apply;
- "Testing the waters" would be allowed, subject to conditions to be imposed by the SEC;
- Audited financial statements would be required to be filed with the SEC; and,
- Other terms and conditions to be imposed by the SEC must be satisfied, with specific authorization for the SEC to:
 - Require offering statements to contain such content as it deems appropriate;
 - Impose disqualification provisions it deems appropriate; and,
 - Require periodic disclosures it deems appropriate.

While there was no deadline for the SEC to issue these rules, it finally issued proposed rules on December 18, 2013. These rules have not yet become effective.

The proposed Regulation A+ creates two tiers of Section 3(b) securities, one for offerings of up to \$5 million and one for offerings of up to \$50 million. The first tier ("Tier 1") offering rules essentially preserve the old, useless Regulation A, including state securities review. A proposed Tier 2 offering would be available, with the following additional limitations:

- It would not be available for asset-backed securities;
- Sales would be limited to 10% of the greater of an investor's annual income and net worth, based on

the investor's representations;

- Sales by selling shareholders would be limited to \$15 million; and,
- Financial statements must be audited in accordance with standards of the Public Company Accounting Oversight Board.

It is important to understand that Regulation A+ offerings will be much more time-consuming and costly than private offerings under Rule 506. The reporting requirements would be similar to those the SEC imposes on "smaller reporting companies."

So, why would an issuer consider using Regulation A+ instead of a Rule 506 offering? It might wish to be able to solicit retail investors and to be able to test the waters prior to preparing and filing offering materials, both of which will be allowed under Regulation A+, subject to certain filing and disclaimer requirements. Although using Regulation A+ will be costly and burdensome, it will be less so than a registered offering. The securities sold in a Regulation A+ offering will not be restricted securities, which may appeal to investors (though the securities probably will not be listed on a securities exchange following a sale).

One big potential problem with Regulation A+ is registration under the Securities Exchange Act of 1934 ("Exchange Act"). The JOBS Act provides that crowdfunding shareholders will not count against the cap for Exchange Act registration, but makes no similar provision for Regulation A+ offerings. If an issuer raises \$50 million in capital -- especially with the SEC's new 10% limitation on the greater of income and assets -- it is extremely likely that an issuer will exceed even the new, higher limits for Exchange Act registration. These requirements would be somewhat more burdensome than the reporting requirements imposed under Regulation A+. The SEC seems disinclined to modify the Exchange Act triggers for Regulation A+ offerings.

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