February 22, 2016

Regulation A: Small Company Capital Formation

On March 25, 2015, the U.S. Securities and Exchange Commission (SEC) adopted final rules to amend Regulation A under the *Securities Act of 1933*, as amended (Securities Act) to modernize and expand the framework for capital-raising by smaller companies. Regulation A is available to U.S. and Canadian entities that have their principal place of business in the United States or Canada and are not subject to SEC reporting obligations under the *Securities Exchange Act of 1934*, as amended (Exchange Act).[1] The types of securities that may be offered under Regulation A are limited to equity securities, debt securities and debt securities convertible into or exchangeable into equity securities, including any guarantees of such securities.

Regulation A may offer smaller companies a viable capital-raising alternative that is less time-consuming and costly, more efficient than a traditional public offering and more attractive than a private placement. The final rules became effective on June 19, 2015, so it remains to be seen whether Regulation A will be a "game changer" for smaller companies.

The final rules established two tiers of offerings: (i) offerings of up to US$20 million in any 12-month period, including up to US$6 million in secondary sales (Tier 1 offerings); and (ii) offerings of up to US$50 million in any 12-month period, including up to US$15 million in secondary sales (Tier 2 offerings). Under each tier, the amount of securities that selling securityholders can sell at the time of an issuer's first Regulation A offering and within the following 12-month period is limited to 30% of the aggregate offering price of a particular offering. After the expiration of the first 12-month period after an issuer's initial qualification of an offering statement under Regulation A, the amount of securities that affiliated securityholders can sell in a Regulation A offering in any 12-month period is limited to US$6 million in Tier 1 offerings and US$15 million in Tier 2 offerings. Sales by non-affiliated securityholders are not subject to this limit after the initial 12-month period, but are aggregated with sales by the issuer and its affiliates for the purpose of the maximum offering limit for each tier.[2]

Tier 2 offerings are subject to a number of additional requirements for investor protection. Most notably, Tier 2 offerings are subject to investment limits – a non-accredited investor is not permitted to invest more than 10% of the greater of the investor's annual income or the net

[1] Regulation A is not available to issuers that are delinquent in their Regulation A filings or subject to certain "bad actor" disqualification events, such as orders of the SEC or other federal or state regulators.

[2] The final rules eliminated the prohibition on resales by affiliates unless the issuer has had net income from continuing operations in at least one of its last two fiscal years.

worth in any single Tier 2 offering.[3] The investment limits do not apply to Tier 2 offerings of securities that will be listed on a national securities exchange upon qualification. Issuers in Tier 2 offerings must include audited financial statements in the offering statement and will be subject to ongoing reporting requirements. In light of the additional requirements for Tier 2 offerings, securities offered and sold in Tier 2 offerings are exempt from registration and qualification under state securities laws.

An issuer that seeks to conduct a Regulation A offering must prepare, file electronically on EDGAR and qualify an offering statement before any sale of securities can occur. The core of the offering statement is the offering circular, a disclosure document much like the prospectus required of smaller reporting companies in a registered offering.[4] No filing fees are associated with Regulation A filings and the qualification process.

The final rules modernize the Regulation A offering process in a manner consistent with regulatory developments in the registered offering process, including the following:

- The offering statement and all other documents required to be submitted or filed with the SEC under Regulation A, such as ongoing reports, must be submitted or filed electronically on EDGAR.
- An issuer that has not previously sold securities under Regulation A or under an effective registration statement is permitted to make a confidential submission of the offering statement. Confidential submissions (including subsequent amendments and SEC correspondence regarding these submissions) are required to be publicly filed as exhibits to the offering statement not less than 21 days before qualification of the offering statement.
- When a preliminary offering circular is used during the pre-qualification period to offer securities to potential investors, issuers (or broker-dealers participating in the offering) are required to deliver a preliminary offering circular to potential investors at least 48 hours in advance of the sale.[5] If the sale was made in reliance on the delivery of a preliminary offering circular, a final offering circular must be delivered within two business days of the sale but (under the "access equals delivery approach" used in registered offerings) issuers and intermediaries are permitted to satisfy their delivery requirements by filing the final offering circular on EDGAR. Likewise, electronic-only offerings of Regulation A securities (in which investors are permitted to participate only if they agree to accept the electronic delivery of all documents and other information in connection with the offering) are permitted under the final rules, provided that issuers and intermediaries comply with relevant SEC guidance.

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[3] Non-accredited, non-natural persons are also subject to an investment limit and should calculate the limit on the basis of no more than 10% of the greater of the purchaser's revenue or net assets (as at the purchaser's most recent fiscal year-end).

[4] The provisions of section 11 of the Securities Act do not apply to Regulation A offerings. However, other anti-fraud and civil liability provisions of the securities laws do apply to Regulation A offerings, including the liability provisions of sections 12(a)(2) and 17 of the Securities Act and Rule 10b-5 under the Exchange Act.

[5] A final offering circular would continue to be required to accompany or precede any written communications that constitute an offer in the post-qualification period.

- Issuers are permitted to "test the waters" by publicly soliciting indications of interest from *any* potential investor both before and after the filing of the offering statement. Solicitation materials must include certain disclaimers and satisfy certain other requirements and are subject to the anti-fraud and other civil liability provisions of federal securities laws. Issuers must submit or file all solicitation materials as an exhibit when the offering statement is either submitted for non-public review or filed with the SEC (and update for substantive changes in such solicitation material after the initial non-public submission or filing). Solicitation materials used by Regulation A issuers that file an offering statement with the SEC will be publicly available as a matter of course. Any solicitation materials used after the public filing of an offering statement would need to be preceded or accompanied by a preliminary offering circular or contain a notice informing potential investors where and how to obtain the most current preliminary offering circular. This requirement could be satisfied by providing the URL link to the preliminary offering circular or offering statement on EDGAR.

Issuers of Tier 1 offerings are not subject to ongoing reporting obligations, but must provide on Form 1-Z no later than 30 days after the termination or completion of the offering certain summary information concerning the offering, including the date on which the offering was qualified and commenced, the number of securities qualified and sold in the offering, the price of the securities sold, the fees associated with the offering and net proceeds to the issuer.[6] Issuers of Tier 2 offerings, however, are required to file annual reports on Form 1-K, semiannual reports on Form 1-SA and current reports on Form 1-U, and to provide notice to the SEC of the suspension of their ongoing reporting obligations on Part II of Form 1-Z.[7]

An issuer of Regulation A securities does not take on Exchange Act reporting obligations unless it separately registered a class of securities under section 12 of the Exchange Act or conducted a registered public offering. Section 12(g) of the Exchange Act, however, requires issuers with total assets exceeding US$10 million to register under the Exchange Act any class of equity securities held of record by either 2,000 persons or 500 persons who are not accredited investors. Securities of a class issued in a Tier 2 offering are exempt from the provisions of section 12(g) so long as the issuer (i) engages the services of a transfer agent registered with the SEC under the Exchange Act with respect to such class; (ii) remains subject to, and is current in, its Regulation A periodic reporting obligations; and (iii) has a public float of less than US$75 million as of the last business day of its most recently completed semiannual period, or,

[6] Issuers conducting Tier 2 offerings are also required to provide this information on Form 1-Z at the time of filing an exit report, if not previously provided on Form 1-K as part of their annual report.

[7] A Tier 2 issuer may suspend its reporting obligations by filing a Form 1-Z at any time after completing its reporting for the fiscal year in which the offering statement was qualified, provided that (i) the issuer has filed all required ongoing reports for the shorter of the period since the issuer became subject to such reporting obligations or its most recent three fiscal years and the portion of the current year preceding the date of filing the Form 1-Z; (ii) the securities of each class to which the offering statement relates 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. Regulation A reporting requirements are automatically suspended if the issuer registers a class of securities under Section 12 of the Exchange Act or if a registration statement filed by the issuer under the Securities Act becomes effective.

in the absence of a public float, has annual revenues of less than US$50 million as of its most recently completed fiscal year.[8]

Regulation A offerings are not integrated with (i) prior offers or sales of securities; or (ii) certain subsequent offers and sales of securities, including offers and sales that are made under the new crowdfunding rules, provided that each offering complies with the requirements of the exemption that is being relied upon for the particular offering. For example, an issuer conducting a concurrent exempt offering for which general solicitation is not permitted will need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on Regulation A. Alternatively, an issuer conducting a concurrent exempt offering for which general solicitation is permitted must not include in any such general solicitation an advertisement of the terms of a Regulation A offering unless that advertisement also included the necessary legends for, and otherwise complied with, Regulation A.

Unlike in Rule 506 and 144A offerings, securities that are issued under Regulation A offerings are not "restricted" or subject to transfer restrictions. In addition, Regulation A does not limit the number of offerees or investors that can participate in an offering; nor does it impose any requirement that investors be accredited or financially sophisticated. Finally, Regulation A securities can be offered to the public by way of general solicitation.

On the other hand, Rule 506 offerings do not limit the amount of securities that may be sold in the offering or the amount of securities that a non-accredited investor may purchase. Rule 506 also pre-empts state securities law requirements, whereas Tier 1 offerings are still subject to state securities requirements. Finally, Rule 506 offerings do not involve any review of the offering documents by the SEC, whereas Regulation A offering documents are subject to review by the SEC staff (and state securities regulators in the case of Tier 1 offerings).

If you have any questions regarding the foregoing, please contact Jeffrey Nadler (212.588.5505) or Nir Servatka (212.588.5579) in our New York office.

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[8] An issuer that exceeds either of the thresholds, in addition to exceeding the threshold in section 12(g) of the Exchange Act, is granted a two-year transition period before it would be required to register its class of securities under section 12(g), provided that it timely files all ongoing reports due during such period.