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ZAG-S&W CORPORATE ADVISORY

SEC Adopts "Regulation A+" Creating a New Category of Exempt Private Placements

The SEC has adopted new rules that provide for an additional category of offerings exempt from registration under the Securities Act. This new "Regulation A+" restatement of the Regulation A exemption was mandated by the JOBS Act and is intended to make the previously underutilized Regulation A more useful to smaller companies engaged in capital-raising offerings.

The groundbreaking developments under Regulation A+ make possible the sale of substantial amounts of securities to unaccredited investors. In addition, the securities sold under Regulation A+ are unrestricted and freely salable. Before the adoption of Regulation A+ and under the exemptions from registration that were most commonly used, sales needed to be made solely to accredited investors, or in the alternative to accredited investors and a limited number of unaccredited investors. "General solicitation" was only permitted in sales to solely accredited investors, whereas sales to accredited investors and a limited number of unaccredited investors required a prior relationship between the issuer and the offerees.

The new exemption comes at a cost. Under the first prong, companies must qualify under state "blue sky" laws and a compliant disclosure document must be prepared and filed with the SEC. Adhering to these requirements can be very difficult. One notable example from the past: Massachusetts securities authorities did not permit the sale of Apple's IPO shares to non-exempted Massachusetts residents because it was too risky in their opinion; Massachusetts residents were therefore unable to benefit from the explosive trading price rise of Apple's stock immediately following its IPO.

This advisory will provide additional details on Regulation A+. Attached to this advisory is a chart comparing Regulation A+ to Regulation D/Rule 506, the regulation under which private placements are usually conducted.

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Scope

Regulation A+ provides for two tiers of offerings applicable to smaller companies:

- Tier 1 offerings, which allow companies to raise up to \$20 million in any rolling 12-month period; and
- Tier 2 offerings, which allow companies to raise up to \$50 million in any rolling 12-month period. Tier 2 offerings are subject to additional disclosure and reporting requirements.

The SEC will review the ceiling limits for both the Tier 1 and Tier 2 exemptions every two years. Both tiers preserve, with some modification, Regulation A's existing provisions concerning issuer eligibility, the contents of offering circulars, "testing the waters" solicitation and "bad actor" disqualifications. In addition, the new rule expands Regulation A by also:

- Permitting companies who have not previously sold securities under a Regulation A+ offering to submit draft offering documents to the SEC for non-public review before filing;
- Allowing for the distribution of "testing the waters" solicitation materials before and after filing the offering statement as long as the materials state where the most current offering circular is located;
- Expanding "bad actor" disqualifications to include market participants who have proven track records of non-compliance or abuse; and
- Modernizing the qualification, communication and offering process in Regulation A to conform more closely to analogous provisions of the Securities Act registration process, including with regards to the allowance of electronic filing on EDGAR and the acceptance of the access-equals-delivery model of providing information to investors.

Companies engaged in either tier of offering are subject to financial reporting requirements. Offerings under both tiers require companies to file balance sheets and financial statements covering the two years preceding an offering. Tier 1 offerings require companies to file summary offering information on an exit report within 30 days of completing the offering, whereas companies engaged in Tier 2 offerings have the option to include this information on an exit report or in the alternative as

part of an annual report. Tier 2 offerings include substantially more ongoing reporting, including requiring companies to submit audited financial statements with their offering circulars and to file annual, semiannual and Form 1-U current reports with the SEC. Additional Tier 2 ongoing reporting will terminate under Regulation A+, with some exceptions, if a company files a completed offering exit report or becomes subject to ongoing reporting requirements under Section 13 of the Securities Exchange Act, as further described below.

Non-accredited investors in Tier 2 offerings are limited to an investment cap equal to the greater of 10% of their annual income or net worth, in the case of individuals, or 10% of their revenues or net assets, in the case of entities. The new rules do not place any similar investment limitation on Tier 1 offerings. Securities issued in offerings under either tier of Regulation A+ are not restricted securities and are freely salable; however, the new rules limit the amount of securities that a selling security holder may sell in the twelve months following a company's first offering under Regulation A+ to 30% of the aggregate purchase price. Following the expiration of this twelve-month limited resale period, the amount of issuer securities that affiliates of the issuer may sell in any 12-month period remains limited to \$6 million, in the case of Tier 1 offerings, and \$15 million, in the case of Tier 2 offerings.

Eligibility

Like the current Regulation A, the SEC's new rules limit the availability of the Regulation A+ exemption to companies organized and with their principal place of business in the United States or Canada. In addition, the exemptions are unavailable to companies that:

- are already SEC reporting companies;
- are registered or required to be registered under the Investment Company Act of 1940;
- are development-stage companies with no specific business plan, or whose plan is to engage in a merger or acquisition with an unidentified company (i.e., "blank check companies");
- are seeking to offer and sell asset-backed securities or fractional undivided interests in oil, gas or other mineral rights;

- have not filed with the SEC the annual, semi-annual and current reports required by the rules during the two years preceding the filing of a new offering statement (or for any shorter period during which the company was required to file such reports); or
- have been disqualified under the “bad actor” disqualification rules.

Preemption

Tier 1 offerings are still subject to “blue sky” laws. However, such laws are preempted in Tier 2 offerings. Individual states retain the right to investigate and bring enforcement actions with respect to fraud and unlawful conduct, require all securities filings to be filed with the state as well as with the SEC and suspend the intrastate offer and sale of securities for the failure to adhere to the state’s filing and fee payment requirements.

Exchange Act Registration

Securities issued in Tier 2 offerings are conditionally exempt from the registration requirements of Section 12(g) of the Securities Exchange Act as long as the issuer engages a registered transfer agent, remains subject to and is current with Tier 2 reporting obligations, and maintains a market capitalization held by non-affiliates (a so called “public float”) of less than \$75 million (or, in the absence of a public float, had revenues of less than \$50 million in the most recently completed fiscal year). Without an exemption, Section 12(g) of the Securities Exchange Act requires companies with greater than \$10 million in assets and more than 2,000 holders of record or more than 500 holders of record who are non-accredited investors to comply with additional public company reporting obligations. An issuer who exceeds the public float threshold and also has enough holders of record to be subject to Section 12(g) regulation is allowed a two-year transition period before it becomes subject to Section 12(g) reporting obligations.

Issuers conducting a Tier 2 offering under Regulation A+ are also permitted to list the securities on a national securities exchange by using a Form 8-A registration statement filed concurrently with the qualification of the Regulation A+ offering statement. This means, in essence, that the issuer becomes a “public company” with concomitant reporting and

other legal obligations. Issuers taking advantage of this short form registration are required to provide disclosures in the Regulation A+ offering statement that follow either Part 1 of Form S-1 or the Form S-11 disclosure model.

For More Information

To obtain further information about Regulation A+ or other registration exemptions and to discuss the exemption that might be best for your company, please consult the lawyer at ZAG-S&W with whom you regularly consult, or any of the lawyers listed above.



PRINCIPAL PRIVATE PLACEMENT EXEMPTIONS, INCLUDING REGULATION A+

Type of Offering	Dollar Limit	Manner of Offering	Type and Number of Investors	Filing Requirement	Restriction on Resale	Blue Sky Exemption
Rule 506 (b) Regulation D	None	No general solicitation or advertising; prior relationship with offerees required	Unlimited accredited investors and 35 non-accredited investors	File Form D with SEC not later than 15 days after first sale. Filing not a condition of the exemption	Restricted securities (i.e., subject to holding period)	Yes
<p><u>Advantages:</u> No dollar limit. Can include a limited number of unaccredited investors.</p> <p><u>Disadvantage:</u> If non-accredited investors are in the deal, they must be given an SEC-compliant disclosure document, which is supposed to be much like a prospectus and is expensive and time-consuming to prepare. Disclosure documents create their own risks.</p>						
Rule 506 (c) Regulation D	None	General solicitation and general advertising is permitted, provided all purchasers are accredited investors	All purchasers must be accredited investors, substantiated by an enhanced due diligence process	File Form D with SEC not later than 15 days after first sale. Filing not a condition of the exemption	Restricted securities	Yes
<p><u>Advantages:</u> General solicitation permitted. No disclosure document is mandated but some disclosure is required for marketing purposes. No dollar limit.</p> <p><u>Disadvantage:</u> Limited to accredited investors with enhanced verification requirements.</p>						
Tier 1 Regulation A	\$20 million within prior 12 months, but no more than \$6 million by selling security holders	“Testing the waters” permitted before and after filing Form 1-A Sales permitted after Form 1-A qualified	Eligible issuer No investor requirement	File test-the-waters documents, Form 1-A, any sales material and report of sales and use of proceeds with the SEC	Not restricted securities (i.e., freely tradeable)	Subject to state blue sky laws regarding pre-offering review, filing, and anti-fraud
<p><u>Advantages:</u> General solicitation permitted.</p>						

Type of Offering	Dollar Limit	Manner of Offering	Type and Number of Investors	Filing Requirement	Restriction on Resale	Blue Sky Exemption
<p>Shares are freely tradeable.</p> <p><u>Disadvantages:</u> Need to receive blue sky clearance – a significant disadvantage (expense and delay). Disclosure document required subject to SEC review. Shares may be tradeable, but that has negative aspects (e.g., need to handle mechanics of transfer; bad actors may buy the shares; at best a thin trading market may develop). \$20 million limit per 12 months.</p>						
Tier 2 Regulation A	\$50 million within the prior 12 months, but no more than \$15 million by selling security holders	“Testing the waters” permitted before and after filing Form 1-A. Sales permitted after 1-A qualified	Eligible issuer No investor requirement; however, investors who are natural persons and are not accredited investors are subject to an investment limit	File test-the-waters documents, Form 1-A, any sales material and report of sales and use of proceeds with the SEC Issuer subject to ongoing reporting requirements	Not restricted securities	Not subject to state blue sky laws regarding pre-offering review; however, subject to state blue sky filing and anti-fraud requirements
<p><u>Advantages:</u> General solicitation permitted. High dollar amount. Freely tradeable securities.</p> <p><u>Disadvantages:</u> Disclosure documentation required subject to SEC review. Ongoing disclosure filings required. \$50 million limit per 12 months.</p>						