THE BLACK SWAN CONNECTION

August 2016

The Reg A Report

Regulation A is a provision of the JOBS Act was signed into law on April 5, 2012

The JOBS Act substantially changed a number of laws and regulations making it hypothetically (more on that later) easier for companies to both go public and to raise capital privately and stay private longer. Changes include exemptions for crowdfunding, a more useful version of Regulation A, generally solicited Regulation D Rule 506 offerings, and an easier path to registration of an initial public offering (IPO) for emerging growth companies.

The legislation, among many other things, extends from two years to five years the amount of time that certain new public companies have to begin compliance with certain requirements, including certain requirements that originated with the Sarbanes–Oxley Act.

In an open meeting 25 March 2015, the Securities and Exchange Commission (SEC) elected to approve and release the long-awaited final rules for Title IV of the JOBS Act (commonly referred to as Regulation A+). Per the final rules, under Regulation A companies will be permitted to offer and sell up to $50 million of securities to the general public subject to certain eligibility, disclosure and reporting requirements. The final Regulation A rules were published in the Federal Register on April 20, 2015 and became effective on June 19, 2015.

Not bad that only took 3 years…….Don't get me started.

The regulation is found under Title 17 of the Code of Federal Regulations, chapter 2, part 230. The legal citation is 17 C.F.R. §230.251 *et seq.*

Regulation A was divided into two tiers.

- Tier 1, for securities offerings of up to $20 million in a 12-month period
- Tier 2, for securities offerings of up to $50 million in a 12-month period

An issuer of $20 million or less of securities can elect to proceed under either Tier 1 or Tier 2. The final rules for offerings under Tier 1 and Tier 2 build on current Regulation A and preserve, with some modifications, existing provisions regarding issuer eligibility, Offering Circular contents, testing the waters, and "bad actor" disqualification. The new rules modernize the Regulation A filing process for all offerings, align practice in certain areas with prevailing practice for registered offerings, create additional flexibility for issuers in the offering process, and establish an ongoing reporting regime for certain Regulation A issuers. Under the final rules, Tier 2 issuers are required to include audited financial statements in their offering documents and to file annual, semiannual, and current reports with the SEC on an ongoing basis.

Non-accredited Investors

Regulation A allows the general public to invest in private companies. With the exception of securities that will be listed on a national securities exchange upon qualification, purchasers in Tier 2 offerings must either be accredited investors, as that term is defined in Regulation D (SEC), or be subject to certain limitations on the size of their investment.

Tier 1

In addition to qualifying a Regulation A offering with the SEC, companies using a Tier 1 offering must register or qualify their offering in any state in which they seek to offer or sell securities pursuant to Regulation A. Some states provide the option to have Tier 1 offerings that will be conducted in multiple states reviewed through a coordinated state review program by the North American Securities Administrators Association.

Tier 2

Issuers in Tier 2 offerings are required to qualify offerings with the Commission before sales can be made pursuant to Regulation A, but they are not required to register or qualify their offerings with **state securities regulators**. This partially exempts Tier 2 companies from blue sky laws securities rules in each state. Tier 2 offerings by such issuers, do remain subject to some state law enforcement and antifraud rules. Issuers in Tier 2 offerings may still be subject to filing fees in the states in which they intend to offer securities.

Clearly times have changed since the 1933 and 1934 Acts that created the SEC in the wake of the great stock market crash of 1929 and economic meltdown that became known as the great depression. At that time there was no internet, no TV, a few newspapers and telegraph had just started to really get rolling. Maybe you got your mail by Pony Express or the train. Virtually all of these communications modes were delayed considerably and most you had to pay for. The shysters of the day could and did take great advantage of that situation by controlling the information flow and the content leaving individual investors absolutely at their mercy.

A classic example:

My ancestors were homesteaders in Kansas and from the outset, there were criminals selling dust bowl properties in the great plains to unsuspecting foreigners and US residents alike publishing beautiful pictures in papers and brochures of tree lined boulevards etc. No idea if my Kin were suckered or not but many were. Read "The Worst Hard Time" that documents what the settlers went through if you're feeling down about your current lot in life.

Not to get too far afield but there was a definitive need for regulation in the securities industry primarily aimed and making sure that financial information was disclosed on a consistent and accurate basis and that companies and offerings of securities met some basic tests prior to selling and trading them.

Now you know everything about everything immediately at virtually no cost. GAAP (that's not a shoe store) accounting rules clearly establish the criteria for reporting finances and by the way shouldn't people be allowed to assume responsibility for their own investment decisions in this ages of enlightenment?

Clearly Congress realized that and the fact that our regulations as reigned over by the SEC with its $1.7 billion budget had made life far too complicated and expensive for small companies to raise the capital that creates most of the new jobs in the US. Congratulations well done!

Whoa, not so fast.

Remember that the SEC has been building an empire for 83 years that has been focused on protecting investors from these malicious start-up companies that would otherwise steal your money. Their job has been one of making sure that unless you toe the line as a fully reporting entity you are not generally soliciting anyone in the US to buy shares in your company. Who at the SEC sat around a conference table and said, wow this Jobs Act is amazing, there really should be general solicitation in this day of blinding information flow? They won't need a bunch of us pushing paper and trying to regulate the startup businesses to death. No one I suspect…

In essence, for the past three years the SEC has done everything possible (aside from finally thumbing their nose at Congress) to hold this up and all in the name of their sacred cow "investor protection".

Ok finally the rules are published and away we go. Not so fast….

The Offering Process

There are a number of behind the scenes issues that they did not address as part of the rule set, intentionally or not, there are still some roadblocks to raising the money and finally getting your company listed as a result.

The process of getting through the SEC registration process is not very different in principal from doing an S-1 and from early discussions the securities attorney's fee structure is about the same. You submit the document and go through a comment period ending in your offering being qualified at which point you can now proceed with your offering and accept investor subscriptions.

During that period you should have engaged an SEC registered transfer agent, gotten certificates designed, prepared a subscription agreement, obtained a CUSIP # etc.

It is worth noting that you can solicit indications of interest during the comment period but not accept subscriptions.

Broker-Dealer participation and selling group

If you are engaging a broker dealer to assist in the offering you will need to work with them to develop a banking agreement that spells out the commission to be paid and they will/should conduct a due diligence review on your company.

Due to the intense scrutiny broker dealers are getting and the fact that they are held to a very high standard in terms of suitability of an investment for a particular client, be prepared to pay $20,000.00 or more for the broker dealer to conduct that due diligence review which will normally be prepared by counsel to the broker dealer.

Once a "Lead" broker has signed on there may be other "Selling Group" member brokers that want to participate. The company can solicit them and refer them to the "Lead Broker" to join the selling group and or the "Lead Broker" may have other brokers that want to participate.

Listing The Reg A stock

The securities may be eligible for listing on the "Over The Counter Market" and under certain conditions a recognized exchange. One thing that is not commonly known is that the FINRA examiners will not issue a symbol for a company that has an open offering. That is, you cannot expect to get a new stock symbol *and then* be able to do your Reg A offering.

More on using a portal and the listing process next month.

Below are links to the Actual Reg A SEC form and the latest Reg A registrations that have been filed.

Link to actual 1-A Form: https://www.sec.gov/about/forms/form1-a.pdf

Latest Reg A Filings: https://www.sec.gov/cgi-bin/srch-edgar?text=1-A%2C+not+POS&first=2016&last=2016