Regulation A+: For Smaller Companies (and ICOs) a Better Way to Go Public?

WITH THE PROLIFERATION OF SMALLER COMPANIES SEEKING TO GROW THEIR BUSINESSES, GAIN CREDIBILITY AND ACCESS CAPITAL, REGULATION A+ IS NOW INCREASINGLY BEING USED AS A FUNDRAISING TOOL.

Private companies that want to publicly raise equity capital have historically had to endure the lengthy, difficult and expensive process required to undertake an initial public offering (IPO). The traditional IPO requires extensive meetings with underwriters, accountants and lawyers, the preparation of audited financial statements and the filing of voluminous documents with the Securities and Exchange Commission (SEC). In addition, once a company has raised money in the public equity markets, it is required to comply with extensive SEC periodic disclosure and filing requirements. All of this results in a high-priced, time-consuming process. But, there is an alternative path for public capital raising that is becoming more popular for issuers and investors alike: Regulation A+.
In November 2017, Level Brands, Inc. completed a $12 million IPO and began trading on the New York Stock Exchange using Regulation A+, a less complicated and typically shorter process than the traditional IPO. As an additional benefit, its SEC periodic disclosure and filing requirements are likely to be reduced for some time. Level Brands had originally planned a traditional IPO, but instead decided to utilize Regulation A+, which is often called a mini-IPO. When Regulation A+ was first adopted by the SEC in 2015, many companies continued raising money through private funding rounds or holding out for a traditional IPO. The advantages of Regulation A+ were not yet widely recognized.

With the proliferation of smaller companies seeking to grow their businesses, gain credibility and access capital, Regulation A+ is now increasingly being used as a fundraising tool. Since the beginning of 2018, four companies have filed Form 1-As with the SEC seeking to utilize Regulation A+ to raise funding and go public. In 2017, the following small cap companies used the Regulation A+ process to go public:

<table>
<thead>
<tr>
<th>Name of Company</th>
<th>Exchange Listed On</th>
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<tbody>
<tr>
<td>Myomo, Inc.</td>
<td>NYSE</td>
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<td>Adomani, Inc.</td>
<td>Nasdaq</td>
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<tr>
<td>ShiftPixy, Inc.</td>
<td>Nasdaq</td>
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<td>Chicken Soup for the Soul Entertainment, Inc.</td>
<td>Nasdaq</td>
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<td>Arcimoto, Inc.</td>
<td>Nasdaq</td>
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<td>FAT Brands, Inc.</td>
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<tr>
<td>Level Brands, Inc.</td>
<td>NYSE</td>
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<td>Longfin Corp.</td>
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The use of Regulation A+ as a way to go public began in June 2017, when Myomo, Inc., a medical robotics company, raised $5 million; ADOMANI, Inc. a provider of zero emission vehicle solutions, raised $9 million; and ShiftPixy, Inc., a mobile app designed to sync work opportunities from job providers with open time slots of available shift workers, raised $12 million.

The trend of using Regulation A+ to go public continued throughout the year, as Chicken Soup for the Soul Entertainment, Inc., a video content company, raised $30 million in August; Arcimoto, Inc., the developer of a three-wheeled electric vehicle, raised $19 million.
in September; and FAT Brands, Inc., a global restaurant franchising company, raised $24 million in October, all through Regulation A+ offerings. Longfin Corp. did not disclose the amount raised during its December Regulation A+ offering.

Since the beginning of 2018, several other companies have announced plans to use the flexibility of Regulation A+ to go public, including Novea, Inc., the developer of an app that allows consumers to directly purchase extended warranties; Muscle Maker Inc., the owner of fast-casual restaurant Muscle Maker Grill; iPic Entertainment Inc., an entertainment facilities company; and Aspen REIT Inc., a real estate investment trust formed to own the Colorado mountainside resort, all of which have submitted Form 1-As, the disclosure document required by the SEC, and had those Form 1-As qualified by the SEC. Clearly, the market has begun to understand the advantages of Regulation A+.

**Overview of Regulation A+**

Regulation A+ provides for two tiers of offerings (Tier 1 and Tier 2) that allow smaller companies to go public on a national securities exchange, such as NYSE or NASDAQ, without having to follow the more rigorous IPO process. Companies that would like to file under Regulation A+ must submit a Form 1-A to the SEC, receive SEC qualification and satisfy the requirements of their selected tier. Companies whose securities have not previously been sold under Regulation A+ or an effective registration statement may submit a Form 1-A confidentially, but the document must be publicly filed no less than 21 days before SEC qualification.

**Tier Requirements**

**Tier 1 Requirements:**

- The company must be organized under the laws of the U.S. or Canada
- The company can raise up to $20 million in any 12-month period
  - Companies that want to raise up to $20 million can elect either Tier 1 or Tier 2
- Not more than $6 million can consist of sales by affiliates of the issuer (such as insiders)
• Anyone is permitted to participate and invest

• Public advertising (oral, written or solicitations of interest) is permitted

• The company’s financial statements do not have to be audited

• The company must register or qualify the offering under the applicable “blue sky law” in any state in which the company seeks to offer or sell securities.

**Tier 2 Requirements:**

• The company must be organized under the laws of the U.S. or Canada

• The company can raise up to $50 million in any 12-month period

• Not more than $15 million can consist of sales by affiliates of the issuer (such as insiders)

• Anyone is permitted to participate and invest, however, non-accredited investors cannot purchase more than 10 percent of the greater of the non-accredited investor’s annual income or net worth

• Public advertising (oral, written or solicitations of interest) is permitted

• The company must provide audited financial statements

• State “blue sky laws” are preempted, greatly simplifying the process

• The company must file annual, semi-annual and current event reports after the offering

• The company is not required to register or qualify the offering with state securities regulators
**Ongoing Reporting Obligations**

Once a company has filed its Form 1-A and completed its equity offering, its ongoing SEC reporting obligations differ based on which Regulation A+ tier it used for the offering. Tier 1 companies have no ongoing reporting obligations, aside from the filing of a Form 1-Z exit report within 30 calendar days after the termination or completion of an offering. The Form 1-Z requires companies to report, among other things, the amount of securities sold, the names of the underwriters, any fees received by the underwriters and the net proceeds for the issuer.

After 12 months following the offering, Tier 2 companies will have three ongoing reporting obligations:

- Annual reports must be filed within 120 days after the company’s fiscal year end. The filing consists of disclosure on the company’s business operations, transactions with related persons, beneficial ownership of voting securities, management discussion and analysis of the financial statements, and information about directors, officers and significant employees and executive compensation. The filing must also include two years of audited financials.

- Semiannual reports must be filed within 90 days after the end of the first six months of the company’s fiscal year, and consists of financial statements and MD&A. The financial statements in semiannual reports do not need to be audited.

- Current event reports are required to be filed within four days of certain events, including fundamental changes in the nature of the business and material modification of the rights of security holders.

If a company chooses to list on a national exchange, the company would also be subject to the relevant rules of that exchange. In addition to listing on a national securities exchange, companies also have the option of being publicly listed on the over-the-counter markets, which have less burdensome requirements than the national securities exchanges.
**Change in Reporting Status**

A company that completes an offering using Regulation A+ will become subject to the same periodic reporting requirements (i.e., the filing of 10-Ks, 10-Qs, 8-Ks, etc.) that apply to companies that have completed traditional registered public offerings if the company: 1) has more than $10 million of total assets, and 2) has a class of equity securities that are “held of record” by either 2,000 persons or 500 persons who are not accredited investors. For companies issuing under Tier 1, it is likely to be some time before they become subject to periodic reporting requirements. For Tier 2 companies, Regulation A+ provides an exemption to the periodic reporting requirements as long as the company complies with certain requirements, including being current in its Tier 2 reporting obligations and having a public float held by non-affiliates of less than $75 million or annual revenues of less than $50 million. If the company does not comply with these requirements, it will have a two-year transition period before it will become subject to periodic reporting requirements discussed above.

In addition, even if a company does become subject to the more extensive periodic reporting requirements, it will be considered an “emerging growth company” if the company has annual gross revenues of less than $1,070,000,000 during its most recent fiscal year. Emerging growth status provides the company with additional benefits, such as reduced requirements for financial statement and MD&A disclosure, and delays or exemptions from certain accounting standards and audit requirements.

**Advantages of Regulation A+**

Regulation A+ provides compelling advantages for companies with a strong user base and clear value proposition that are seeking to raise capital, including:

- companies can obtain a public listing, which crowdfunding does not provide

- purchasers of Regulation A+ securities may immediately resell them, as they are not restricted

- audited financials are not required in a Tier 1 offering and there are no reporting requirements after a Tier 1 offering except for an exit report
• companies can offer shares to a broad range of purchasers, including both accredited and non-accredited investors, which enables a company to involve its own customers and use its own ecosystem for the offering

• companies can engage in public advertising campaigns, including to its own customers, to market and promote the offering, which is not allowed in a traditional IPO or private placement

• the SEC wants to encourage Regulation A+ filings and is said to be highly efficient and responsive to Regulation A+ filers

• Regulation A+ offerings may be quicker than traditional equity capital raisings, and

• legal, accounting and other professional service costs may be lower for a Regulation A+ offering.

**Token Sales/ICOs and Regulation A+**

Companies considering token sales or ICOs may be particularly interested in the benefits of a Regulation A+ offering. Since the Regulation A+ offering is an SEC-approved mechanism for raising equity capital, and is best used by companies with a strong user base, it provides a viable mechanism by which companies can do a token sale. If a company sold security tokens, the company could execute a Regulation A+ offering of securities, and each security would be issued in the form of a token. This would enable a company to sell tokens and investors to receive tokens while the company remains safely within the bounds of the U.S. securities laws. In addition, the tokens issued in a Regulation A+ security token offering may be able to be freely traded on an alternative trading system (ATS). ATS platforms that can trade security tokens are currently under development and it is expected that such platforms will become available later this year.

**Conclusion**

Regulation A+ has a limited history, but the recent experiences of companies that have gone public using Regulation A+ show that it is quickly becoming a valuable and viable tool for capital raising. It is less burdensome and requires a shorter timetable than a traditional IPO, but provides the same benefits of significant public equity capital raising and potentially a public trading market. In addition, Regulation A+ companies are, for some time after they go public, exempt from many SEC disclosure and periodic filing require-
ments. These benefits of Regulation A+ may also be particularly valuable to companies considering an ICO or a token sale, as it may provide those companies with an efficient way to sell tradeable security tokens. We believe that Regulation A+ provides smaller growth companies with an efficient and effective tool to raise capital and receive the benefits of going public.

**Pepper Points**

- Regulation A+, introduced in 2017 as a way to go public, is fast becoming a valuable capital raising tool for emerging companies.

- It offers a shorter timetable than a traditional IPO and is less burdensome from a regulatory standpoint.

- Regulation A+ is also well-positioned to provide companies with an efficient way to sell tradeable security tokens in the future.