

Expansion of Regulation A to Reporting Companies: Increased Alternatives Now Available to Public Companies Seeking to Raise Capital or for Mergers and Acquisitions

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On December 19, 2018, the SEC announced that it had adopted final rules that allow reporting companies to rely on the Regulation A exemption from registration for their securities offerings^[1]

Until recently, the only way that companies subject to the reporting requirements of Section 13 or Section 15(d) of the Securities Exchange Act of 1934 (the “Exchange Act”) have been able to access the capital markets has been through a private placement in public equity (PIPE) or a traditional registered public offering. PIPE’s have presented a number of issues regarding confidentiality, illiquidity of securities, limitations on offering size^[2] and greater pricing discounts, whereas registered public offerings can be both time-consuming and costly. These issues are particularly magnified for smaller public companies that may not be eligible to use S-3 shelf registrations.

In announcing the new rules, SEC Chairman, Jay Clayton, stated “[t]he amended [Regulation A] rules will provide reporting companies additional flexibility when raising capital.” This additional flexibility will assist reporting companies in raising capital by reducing costs and streamlining the registration process similar to the streamlined process of registering securities on a Form S-3.

Regulation A provides an exemption from the registration requirements of the Securities Act of 1933, as amended, for offerings of securities that do not exceed \$50 million in a 12 month period, and was only initially available to companies that were not subject to the reporting requirements of the Exchange Act.

Reporting companies may want to consider using Regulation A for reasons including, but not limited to the following:

- Tier 2 issuers that are not listed on national exchanges are eligible for blue sky preemption. This means that OTC listed issuers do not have to make blue sky filings on a state by state basis for a public offering – this is particularly significant for smaller (OTC listed) issuers that traditionally were only able to register their secondary offerings in a very limited number of

states;

- Tier 2 issuers may solicit investors such as qualified institutional buyers, accredited investors and non-accredited investors before the SEC qualifies an offering circular which permits an issuer to gauge investor interest prior to launching the offering;
- Subject to certain regulations, securities issued in a Regulation A offerings are unrestricted and freely tradeable; and
- Regulation A offers cost and time savings compared to traditional offerings. In addition to amending 17 CFR 230.251, the SEC will eliminate the reporting requirements set forth in 17 CFR 230.257 so that Tier 2 issuers will be deemed to meet the periodic and current reporting requirements under Regulation A if they have otherwise complied with the reporting requirements of the Exchange Act.

Prior to the new rules, Regulation A has been used for a number of notable initial public offerings, such as Elio Motors, Inc., Myomo, Inc., Chicken Soup for the Soul Entertainment, Inc. and ShiftPixy, Inc., among others. Each of these issuers was able to utilize Regulation A to sell their securities and list on a national securities exchange, such as Nasdaq and the New York Stock Exchange; however, not all issuers that have used Regulation A as an IPO avenue (mini-IPO) have been successful after listing to national exchanges. This could be due to a number of reasons, including, but not limited to: the fact that these Regulation A offerings were conducted on a best-efforts basis (rather than on a firm commitment basis), and, as such, did not include an over-allotment option which would otherwise help in market stabilization; the valuation of these companies; the performance of these companies; and limited liquidity in the aftermarket. As a result of the performance and post-IPO trading of some companies which have used the mini-IPO route, we believe Nasdaq and the New York Stock Exchange have become reluctant to list companies that do not use the traditional IPO route.

While issuers have generally used Regulation A primarily as a way to conduct an IPO, companies should now consider the variety of ways that they may utilize and take advantage of the benefits of Regulation A such as the following:

- *Follow-on Offerings.* After completing its IPO, an issuer may offer additional securities to the public using one of the following types of follow-on offerings:
 - *Primary Offering.* A primary offering is an offering in which an issuer sells its securities directly to the public.
 - *Secondary Offerings.* A secondary offering is an offering in which selling stockholders of the issuer sell securities rather than the issuer selling its own securities. Although issuers do not receive any proceeds from the sale of secondary offerings, the purpose of such offerings is to provide liquidity to stockholders of the issuer.
- *Rights Offerings.* A rights offering is an offering by the issuer to existing stockholders whereby such existing stockholders purchase additional securities of the issuer in proportion to their existing holdings. By conducting a rights offering, issuers are able to raise capital with little marketing effort and can forego large underwriting fees, and current stockholders are afforded the opportunity to maintain their percentage ownership in the issuer without being diluted by new stockholders.

- *Mergers and Acquisitions.* The Staff of the SEC has indicated in Compliance & Disclosure Interpretation 182.07 that Regulation A can be relied upon by an issuer for business combination transactions such as mergers or acquisitions. This means that issuers can register securities using an offering circular rather than Form S-4 which is a very costly and time-consuming process. For additional information on using Regulation A for mergers and acquisitions, see [Regulation A May Provide Useful Alternative to Form S-4 Registration for Public Companies Doing Smaller M&A Deal](#).
- *Initial Coin Offerings.* In addition to the foregoing, while there has been a lot of talk about issuers considering using Regulation A for conducting initial coin offerings as a way to reach a large audience of potential investors which may include both accredited and non-accredited investors, to date, no such offerings have been approved by the SEC.

Issuers should consult with securities counsel for additional information about the uses of Regulation A as a way for both reporting and non-reporting companies to tap into the public markets.

Please note that the amendments to Regulation A will become effective upon publication in the Federal Register, which has not occurred as of the date this article was posted.

[1] Release No. 33-10591; File No. S7-29-18.

[2] In certain circumstances, issuers listed on Nasdaq may not sell securities through a PIPE without prior stockholder approval if, as a result of such PIPE, the issuer would issue securities in excess of 20% of the issuer's then outstanding common stock or voting power. See Nasdaq Rule 5635(d).

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