

# ALERT

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## SECURITIES OFFERINGS AND REGULATION

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## **GAO Publishes Report on Factors That May Affect Trends in Regulation A Offerings**

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One of the primary objectives behind the Jumpstart Our Business Startups Act (the JOBS Act) was to increase small business capital formation. The JOBS Act required that the Securities and Exchange Commission (the SEC) amend the exemptions related to Regulation A offerings by raising the cap for use of the registration exemption over a 12-month period from \$5 million to \$50 million. This month the Government Accountability Office (the GAO) published a report summarizing its findings of a study examining trends in Regulation A offerings, factors that affect these trends, and the effect the JOBS Act will have on the use of Regulation A offerings. This study concluded that the number of Regulation A offerings has been decreasing and explained that because a variety of factors are affecting offering trends the GOA was unable to say for certain how the JOBS Act will affect the future use of Regulation A offerings.

### **Factors Responsible for the Decline in Regulation A Offerings**

The GAO's study found that the number of Regulation A offerings filed and qualified has decreased in recent years. In 1997 and 1998, peak years for Regulation A offerings, 116 initial Regulation A offerings and 57 qualified offerings were made. By 2011, however, Regulation A offerings filed were down to 19 and only one qualified offering was made. The GAO found that one of the factors responsible for the decline in Regulation A offering is that small businesses prefer to use Regulation A offerings as a way of appealing to nonaccredited investors and members of the local business community. An additional factor decreasing small

businesses' willingness to use Regulation A offerings is that when a small business makes a Regulation A offering, it must file it with the SEC and address any comments from the SEC. In some cases, the business must go through several rounds of comments. The SEC comment process is time-consuming, costly and almost as burdensome as the filing process required for a registered public offering. Further, Regulation A offerings do not bypass state securities registration requirements, and dealing with the varying requirements of individual states is time-consuming for small businesses and can drive up legal fees and other costs. Finally, offerings under Rule 506 of Regulation D tend to be more cost efficient, consume less time, have no maximum offering amount and preempt state blue sky laws, making Regulation D offerings preferable to Regulation A offerings.

### **Will the JOBS Act Increase Regulation A Offerings?**

Many believe that the number of Regulation A offerings will increase as a result of raising the cap on these offerings. The GAO found three reasons for this view. First, increasing the offering amount could attract businesses that thought the \$5 million ceiling was too low. Second, increasing the ceiling could generate interest among more underwriters, making Regulation A offerings more appealing to small businesses. Finally, the higher ceiling could lead small businesses to accept the higher transaction costs involved with Regulation A offerings because these costs will represent a smaller proportion of the overall costs of the offerings.

The GAO also recognized that some hold the opposite view and do not think the JOBS Act will increase the number of Regulation A offerings. One reason for this is that the JOBS Act still generally requires Regulation A offerings to comply with state blue sky laws. The negative influence such laws have on the use of Regulation A offerings would likely continue even after the JOBS Act takes effect. Also, offerings under Rule 506 of Regulation D might still be preferable to Regulation A offerings for several reasons. Regulation D does not (i) require small businesses to have their offerings qualified by the SEC and (ii) does not require small businesses to register in individual states and has no ceiling on the amount of capital a business may raise. Additionally, the JOBS Act contains provisions that will allow issuers to make general solicitations and advertise offerings made under Rule 506 exclusively to accredited investors, which could make Regulation D offerings even more appealing to small businesses.

The authors believe that for all the reasons stated above Regulation A will continue to be held in disfavor by the securities bar and small companies seeking to raise capital.

For the full text of the GAO Report, please click [here](#).

For the full text of the GAO Highlights page for the report, please click [here](#).

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*To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact:*

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