The Legal Intelligencer

Regulation A and Regulation Crowdfunding—What's Best for Startups

No matter where a business is in its life cycle, however, there are fairly new and unique ways to raise capital.

By **Maxwell Briskman Stanfield** | March 02, 2020

Maxwell Briskman Stanfield, Meyer, Unkovic & Scott

Equity raises for startups looking to increase capital now come in many different forms, with some types better suited for a business than others, especially when comparing a growing company with an early-stage startup still trying to find its footing. No matter where a business is in its life cycle, however, there are fairly new and unique ways to raise capital.

Two of these more novel methods are Regulation A—or, rather, a new version of Regulation A—and Regulation Crowdfunding. Each has benefits and challenges, with the main differences consisting of how much companies can raise under each, the amount of regulatory oversight, the offering's cost, who is eligible to invest and who can be solicited to invest.

It's up to a business' leaders and, in particular, its legal and financial advisers to wade through these differences and murky regulatory waters in order to determine which is the best fit for the company's current and future needs. With a business' success or failure often riding on the right type of equity raise, especially during its early stages, a well-rounded understanding of Regulation A and Regulation Crowdfunding and their nuances can make a big difference.

Regulation A

It is not necessarily accurate to say Regulation A is new, having been established with the Securities Act in 1933 as a means to exempt from registration requirements certain public offerings of securities—essentially, allowing the public to invest in private companies. However, Regulation A was amended (https://www.sec.gov/info/smallbus/secg/regulation-a-amendments-secg.shtml) in 2015 as part of the Jumpstart Our Business Startups Act (JOBS Act), modernizing its rules and expanding it into two tiers, creating "Regulation A+."

The two tiers of Regulation A+:

- **Tier 1:** A company can raise up to $20 million in a 12-month period from both accredited and nonaccredited investors.
- **Tier 2:** The amount a company can raise goes up to $50 million, but there are limitations placed upon nonaccredited investors.

Many call Regulation A+ a “mini-IPO,” and there are certainly similarities to a traditional initial public offering. Raising funds under the regulation is open to U.S. and Canadian issuers, there are no restrictions on subsequent resale of the securities offered, and general solicitation of the offering is acceptable. One notable exception, of course, is a Regulation A+ offering is not public.

The advantages of a Regulation A+ raise are many for a startup looking to take the next step. By side-stepping a raise from venture capitalists or another large single source of capital, founders may avoid a potential war over the company’s management and board. At the same time, the company’s brand may receive a boost in credibility and publicity as more investors learn of the offering, and the backers themselves likely will feel a sense of responsibility to help the company’s success. The offering may even bring a company closer to a traditional IPO.

Those are all good reasons to suggest a Regulation A+ offering to a company’s management team or board, but attractive as this route may seem, there are some points to consider before doing so:

- Both tiers mandate certain Securities and Exchange Commission (SEC) filings. Tier 2 requirements, because they raise more money, are subject to more stringent reporting requirements.
- Payment may only be accepted by companies for a sale of securities under Regulation A+ after the SEC has reviewed and qualified the offering documents.
- While Regulation A+ raises are much less expensive than a traditional IPO, issuers should still expect to pay significant legal fees and absorb the time it takes to get the qualification of the offering statement.

Because there is still that investment in time and money for a company to make, making a Regulation A+ offering may be a better fit for a business on firmer financial footing and past the unstable early stages of its life cycle.

Regulation Crowdfunding

Regulation Crowdfunding shares some similarities to Regulation A+, notably in that it is not a public raise, but the rules make it a much smaller scale type of offer. It may be beneficial for a company that has a great idea—but little else by way of resources. Adopted under Title III of the JOBS Act, Regulation Crowdfunding is familiar to most observers and investors—professional or casual—by the less formal term “crowdfunding.”

The key features of crowdfunding:

- In a significant difference from a Regulation A+ raise, the SEC allows a company using crowdfunding to raise just a maximum aggregate amount of $1.07 million from accredited and nonaccredited investors over a 12-month period.
- All transactions in the raise must go through an online, financial industry regulatory authority (FINRA)-registered intermediary, such as the platform Kickstarter or a broker-dealer firm.
- General solicitation of the offering is allowed, with some limitations.
- Investors’ shares are tradeable and can be sold, but only after one year.
- Non-U.S. companies cannot use Regulation Crowdfunding, but international investors can invest in U.S. companies, provided they follow the securities laws within their home country.

The maximum amount a company may raise through Regulation Crowdfunding is no small amount for a business that is just getting started, but clearly it is a considerably lower amount than one can raise through Regulation A+. Depending on whether a company needs to make a major investment in equipment or other resources to reach its goals, crowdfunding may not be enough.

Furthermore, before a company is able to launch its offering, it must go through a “bad actor” check for its executives and owners who own 20% or more of the company. This check is to ensure that none of these parties breach any disqualifying provisions, such as certain criminal convictions and SEC disciplinary orders.

Another hurdle is the fact that different funding portals have different requirements. Certain funding portals prohibit companies that promote items such as pornography and weaponry. Moreover, each funding portal has its own varying eligibility requirements.

Just as with a Regulation A+ offering, however, crowdfunding is an excellent marketing tool and helps a company's current leadership maintain control of the business. Another advantage is the fees are more manageable for a small business, with the offering typically costing between $4,000 to $10,000 for the financial review and legal documentation. Funding portals, too, will take a fee, but overall, it is a good option for an entity that is light on capital.

What to Use

The full picture of a company's finances and objectives should be understood by legal and financial advisers before deciding what type of capital raise is proper for a company. Much of this hinges on where the company is in its life cycle. Those with a handful of employees and seemingly less cash on hand may be better off using Regulation Crowdfunding, while those with a larger, more sophisticated organization—but not ready for, or desiring of, an IPO—may find a Regulation A+ raise to be the move that takes the business to the next level.

No matter what method a new or growing company uses to increase capital, there are more options than ever—which makes the job of a counsel guiding important business decisions pivotal to a successful venture.

Maxwell Briskman Stanfield *is an attorney at Meyer, Unkovic & Scott. He focuses his practice on corporate, business, financial and commercial real estate law, and he has a wide variety of experience in the entertainment industry. He can be reached at MBS@MUSLAW.com* (mailto:MBS@MUSLAW.com)*.*