WILMERHALE

SEC Adopts Rules to Implement Regulation A+, Providing New Avenue for Capital Formation

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Overview

On March 25, 2015, the Securities and Exchange Commission (SEC) adopted amendments to Regulation A (Regulation A+) pursuant to Section 401 of the Jumpstart Our Business Startups Act (JOBS Act) for offers and sales of up to $50 million of securities annually. Regulation A+ creates two tiers of offerings that are exempt from registration under the Securities Act of 1933 (Securities Act)—Tier 1 and Tier 2—with different offering caps, disclosure requirements and ongoing reporting obligations, thus allowing issuers increased flexibility depending on their financing needs.

Several aspects of Regulation A, including the absence of preemption of state "blue sky" laws and a $5 million maximum offering size, historically limited the utility of the exemption. From 2009 to 2014, only 158 issuers filed offering statements (only 36 of which were qualified by the SEC) under current Regulation A. In contrast, Regulation A+ increases the maximum offering size to $50 million per 12-month period and preempts state securities law registration requirements for certain offerings.

As an alternative to privately placed venture and other institutional capital, Regulation A+ offers a mechanism to raise capital publicly from both accredited and unaccredited investors while assuming relatively limited public disclosure and reporting obligations. Regulation A+ will become effective on June 19, 2015.

Availability of New Exemption

Eligible Issuers. The new rules are available to issuers organized and with their principal place of business in the United States or Canada that are not subject to the ongoing reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 (Exchange Act) immediately before the offering unless they are so-called "blank check" companies, investment companies or entities issuing fractional undivided interests in oil and gas rights or similar interests in other mineral rights. Issuers that have failed to file the reports required to be filed under Regulation A+ with the SEC during the two years preceding filing of an offering statement (or such shorter period as the issuer has been required to file such reports), issuers that have been subject to an SEC order suspending, denying or revoking registration pursuant to Section 12(j) of the Exchange Act within the

five years preceding the current offering and "bad actors" are also ineligible to use the exemption. The "bad actor" disqualifications in Regulation A+ substantially conform to those of Rule 506(d) of Regulation D under the Securities Act. The new rules permit issuers that are disqualified from relying on the exemption under the "bad actor" provision to request a waiver of disqualification from the SEC.

Eligible Securities. Regulation A+ is available for offerings of equity securities, including warrants, debt securities and debt securities convertible or exchangeable into equity securities, as well as guarantees of such securities. Asset-backed securities cannot be offered and sold pursuant to Regulation A+.

Tiered Offerings

Summary and Offering Amounts. The final rules create two types of offerings—Tier 1 and Tier 2—the availability of which are based on the amount sought to be raised by the issuer. In a Tier 1 offering, an issuer may offer and sell up to $20 million of eligible securities, no more than $6 million of which are permitted to be offered by selling securityholders that are affiliates of the issuer. Tier 1 offerings are subject to SEC review and state blue sky review but have fewer disclosure requirements than Tier 2 offerings and do not impose an ongoing reporting requirement on the issuer.

In a Tier 2 offering, an issuer may offer and sell up to $50 million of eligible securities, no more than $15 million of which are permitted to be offered by affiliated selling securityholders. Tier 2 offerings are subject to SEC review, but not state blue sky review, and require more extensive disclosure than do Tier 1 offerings, most notably audited financial statements. In addition, Tier 2 offerings impose ongoing reporting requirements following the Regulation A+ offering and include limitations on the amount that unaccredited investors may invest. For offerings up to $20 million of eligible securities, an issuer can elect whether to proceed under Tier 1 or Tier 2.

An additional limitation applies to the issuer's initial Regulation A+ offering and each subsequent Regulation A+ offering, whether Tier 1 or Tier 2, that is qualified during the one-year period following the qualification date of the initial offering. For the issuer's first offering or any subsequent Regulation A+ offering qualified during the one-year period following the qualification date of the initial offering, the portion of the aggregate offering price attributable to the securities of selling securityholders shall not exceed 30% of the aggregate offering price.

For both Tier 1 and Tier 2 offerings, the offering caps are calculated by adding the aggregate offering price to be received in the current offering to the amount of gross sales proceeds for all securities sold pursuant to other offering statements during the 12 months before the start of and during the current offering. The regulations provide guidance for calculating offering caps where the securities are offered or sold for consideration denominated in a foreign currency and non-cash consideration, as well as when the securities are convertible or exchangeable within one year of the offering statement's qualification. Over time, these caps may change, as Section 3(b)(5) of the Securities Act requires the SEC to review the Tier 2 offering limitation every two years. The SEC indicated in the adopting release that it plans to undertake a review of the Tier 1 limits concurrently with the SEC's review of the Tier 2 cap, and the SEC may increase or decrease the Tier 1 limit based on the

information in the staff's report.

Investment Limitations in Tier 2 Offerings. Purchasers in Tier 2 offerings are subject to certain limitations on their investment if they are not an "accredited investor" (as defined in Rule 501(a) of Regulation D). For natural persons, the limit is 10% of the greater of such person's annual income or net worth, calculated as provided in Rule 501 of Regulation D, and for non-natural persons, 10% of the greater of such entity's annual revenue or net assets at fiscal year end. No limit will apply if the purchased securities will be listed on a national securities exchange upon qualification. Issuers must notify investors of this limit, but they may rely on a representation from the prospective purchaser when determining compliance as long as the issuer does not know at the time of sale that the representation is untrue. Tier 1 offerings are not subject to these investment limitations.

Offering Requirements

Offering Statement. Issuers planning a Regulation A+ offering must file an offering statement with the SEC. Prior to making a sale, an issuer's offering statement must be qualified by the SEC, and any offers made following such qualification must be preceded or accompanied by the most recent filed offering circular. For issuers that are not already subject to Tier 2 periodic reporting obligations, a preliminary offering circular must be delivered at least 48 hours prior to sale.

The offering statement will include an offering circular, which is a disclosure document that will provide investors with information about the issuer and the offering to assist in their investment decision. Offering statements must be filed on Form 1-A, which has been amended in the Regulation A+ rulemaking, and the contents of the offering statement will vary depending on whether the issuer is conducting a Tier 1 offering or a Tier 2 offering. Upon completion of its review of the Form 1-A, the SEC will issue a notice of qualification.

Offering circulars for both Tier 1 and Tier 2 offerings must include basic information about the issuer; material risks and risk factors; information about dilution; a description of the intended use of proceeds to be received by the issuer; information about the issuer's business and properties; management's discussion and analysis; information about executive officers and directors, including compensation; security ownership of management and 10% stockholders; information about "bad actor" events that did not disqualify the issuer because they occurred prior to June 19, 2015; a description of related party transactions; identification of selling securityholders; a description of the securities being offered; and the plan of distribution.

Issuers must also include in the offering circular balance sheets as of the two most recently completed fiscal year ends and other financial statements prepared in accordance with U.S. generally accepted accounting principles, unless the issuer is Canadian, in which case financial statements prepared in accordance with IFRS are permitted. The financial statements must be dated not more than nine months before the date of non-public submission, filing or qualification, with the most recent annual or interim balance sheet not older than nine months. If interim financial statements are required, they must cover a period of at least six months. The financial statements in Tier 2 offerings must be audited by an independent audit firm in accordance with either the auditing standards of the American Institute of Certified Public Accountants (AICPA) (referred to as U.S.

Generally Accepted Auditing Standards or GAAS) or the standards of the Public Company Accounting Oversight Board (PCAOB). The audit firm need not be registered with the PCAOB unless the issuer is planning to list the securities on a national securities exchange. Financial statements in Tier 1 offerings are not required to be audited. However, if the issuer has obtained an audit of the financial statements for other reasons, it must file the audited financial statements.

In addition, issuers are required to include any other material information necessary to make the required statements, in light of the circumstances under which they are made, not misleading. Offering statements must include a number of exhibits, including material contracts, an opinion as to the legality of the securities being offered, all "testing the waters" communications materials, any non-public draft offering statement submissions or amendments to those submissions, all correspondence with the SEC staff regarding non-public draft offering statements and, if audited financial statements are included, a consent from the accountant.

Information with respect to the public offering price, underwriting syndicate, underwriting discounts or commissions, discounts or commissions to dealers, amount of proceeds, conversion rates, call prices and other items dependent upon the offering price, delivery dates and terms of the securities dependent upon the offering date may be omitted from the offering circular at the time of qualification if the offering is for cash, the cover of the offering circular includes an estimate of the range of the maximum offering price and maximum number of securities to be offered and certain other conditions are satisfied. Information that is omitted must be filed with the SEC within 15 business days after the qualification date. Otherwise, a post-qualification amendment to the offering statement will be required.

The Form 1-A and any amendments to the offering statement must be signed by the issuer, its principal executive officer, principal accounting officer and a majority of the members of its board of directors or other governing body.

Filing of Offering Statement and Delivery of Offering Circular. All offering statements must be filed electronically on EDGAR. No fees are required in connection with the filing.

For sales of securities by issuers, underwriters and dealers within the 90-day period following qualification, a copy of the final offering circular must be delivered to each purchaser within two business days of the completion of the sale (the date of settlement). For securities listed on a national securities exchange, the offering circular delivery period for dealers is shortened to 25 days and dealers are not required to deliver a final offering circular if the issuer is subject to the periodic reporting requirements under Regulation A+.

Regulation A+ permits the final offering circular delivery requirement to be satisfied under an "access equals delivery" model by providing purchasers with a notice that the sale was made pursuant to a qualified offering statement that includes the URL where the final offering circular may be obtained on EDGAR along with contact information for where a purchaser may request a final offering circular. In an electronic-only offering, the URL must be an active hyperlink.

Post-qualification Amendments. Regulation A+ permits, and in certain cases requires, issuers to file offering post-qualification amendments. Issuers are permitted to file post-qualification

amendments to add additional securities to a qualified offering. Post-qualification amendments are required at least every 12 months for ongoing offerings to include the financial statements that would be required by Form 1-A as of such date or to reflect facts or events arising after qualification that represent a "fundamental change" in the information in the offering statement.

Confidential Review of Offering Statements. For issuers that have not previously sold securities pursuant to a qualified offering statement under Regulation A+ or an effective registration statement under the Securities Act, Regulation A+ provides for the non-public submission of a draft offering statement to the SEC and for a non-public review by the staff of the SEC before public filing, similar to the process that currently allows for confidential submission of draft Securities Act registration statements to the staff by emerging growth companies. The confidentially submitted offering statement initially filed, as well as all confidential amendments to the original submission and non-public correspondence with the SEC staff, which would include the issuer's responses to SEC comments, must be filed publicly at least 21 calendar days before qualification of the offering statement (not 21 calendar days before the start of the road show, as is required for registration statements confidentially submitted by emerging growth companies).

Communications. Regulation A+ gives both Tier 1 and Tier 2 issuers substantial flexibility to communicate with potential investors both before and after an offering statement has been filed. Any solicitation materials used in connection with these "test the waters" communications are required to be filed as exhibits to the offering statement. Issuers may solicit indications of interest from investors, but issuers cannot accept offers to buy the securities or money from investors prior to qualification of the offering statement. Regardless of when made, the communications are subject to securities law antifraud provisions. After filing the offering statement publicly, issuers must provide a copy of, or notice of where to obtain, the most current preliminary offering circular with or in advance of providing any other soliciting material.

Continuous or Delayed Offerings. Regulation A+ offers issuers limited ability to conduct continuous or delayed offerings. Specifically, issuers may engage in continuous or delayed offerings for (1) offers and sales by selling securityholders; (2) securities under a dividend or interest reinvestment plan or employee benefit plan; (3) securities issued upon exercise of outstanding options, warrants, or rights; (4) securities to be issued upon conversion of other outstanding securities; (5) securities pledged as collateral; or (6) securities the offering of which will commence within two calendar days after qualification and that will be conducted on a continuous basis for a period greater than 30 days and in an amount that is reasonably expected to be offered and sold within two years from initial qualification. Under these parameters, Regulation A+ issuers would not be able to qualify a shelf offering statement and do takedowns at a later date. In addition, Regulation A+ will not allow at-the-market offerings. If a continuous offering has not been completed within three years from the date of qualification, a new offering statement must be filed and qualified. To be eligible to conduct a delayed or continuous offering the issuer must be current in its annual and semi-annual Tier 2 reporting obligations at the time of sale.

Integration with Other Offerings

Regulation A+ establishes a limited safe harbor against integration of Regulation A+ offerings with

registered offerings, offerings exempt from registration under Rule 701, offerings pursuant to an employee benefits plan, Regulation S offerings, offerings more than six months after completion of the Regulation A offering and crowdfunding offerings exempt under Section 4(a)(6) of the Securities Act. In addition, if the issuer abandons a Regulation A+ offering and subsequently decides to register an offering under the Securities Act, the abandoned Regulation A offering will not be integrated with the registered offering if the issuer's test the waters communications were only with qualified institutional buyers and institutional accredited investors and 30 days have elapsed between the last solicitation of interest in the Regulation A+ offering and filing of the registration statement.

Beyond these specific integration safe harbors, whether a Regulation A+ offering will be integrated with another offering will require analysis of the particular facts and circumstances of the offerings.

In addition, an issuer may conduct an exempt offering (e.g., under Regulation D) concurrently with a Regulation A+ offering without the offerings being integrated, so long as the issuer complies with the requirements of each exemption being relied upon for the particular offering. In this regard, an issuer conducting concurrent offerings should structure each offering carefully, paying particular attention to general solicitation issues and ensuring its solicitations contain the proper legends.

Ongoing Reporting Requirements

Tier 1

Tier 1 issuers must provide information about sales in such offerings and update certain issuer information by electronically filing a Form 1-Z exit report with the SEC no later than 30 calendar days after termination or completion of an offering.

Tier 2

Tier 2 issuers must file annual reports, semi-annual reports and current event reports on EDGAR. The annual report on Form 1-K is required to contain much of the same information about the issuer as is disclosed on Form 1-A, including financial statements and exhibits required to be included in the offering statement. A Tier 2 issuer's first annual report on Form 1-K after qualification of the offering statement must also include information regarding sales in the offering. The information required in the semi-annual report on Form 1-SA is limited to six-month financial statements, management's discussion and analysis, and any information required to have been included in a current report on Form 1-U during the period that was not so reported. Current reports on Form 1-U are required to be filed within four business days of the occurrence of certain events. Many of these events are similar to those that trigger Current Reports on Form 8-K for Exchange Act reporting companies, including bankruptcy, changes in accountants, and non-reliance on financial statements. A current report on Form 1-U is also required when the issuer enters into or terminates a material definitive agreement that has resulted in or would be reasonably expected to result in a fundamental change to the nature of the issuer's business or plan of operations.

In addition, the issuer must file special financial reports containing audited financial statements for the issuer's most recently completed fiscal year within 120 days of the qualification and unaudited

financial statements covering the first six months of the issuer's current fiscal year within 90 days of qualification, in each case if not previously included in the offering statement or the issuer's first required periodic report.

Reporting obligations under Tier 2 are automatically suspended when a Tier 2 issuer becomes subject to reporting obligations arising under Section 13 of the Exchange Act. Tier 2 issuers may voluntarily suspend reporting by filing an exit report on Form 1-Z after completing reporting for the fiscal year in which an offering statement was qualified, so long as the securities of each class to which the offering statement relates are held of record by fewer than 300 persons, or fewer than 1,200 persons for banks or bank holding companies, and offers or sales made in reliance on a qualified Tier 2 Regulation A offering statement are not ongoing.

Exchange Act Reporting Thresholds and Registration Requirements

Exchange Act Section 12(g) requires an issuer with total assets over $10 million and a class of equity securities held of record by either 2,000 persons or 500 unaccredited investors, to register such securities. Regulation A+ exempts securities issued in Tier 2 offerings from being counted toward the "holder of record" threshold under Section 12(g) if the issuer (1) uses the services of a transfer agent registered with the SEC under Section 17A of the Exchange Act, (2) remains subject to a Tier 2 reporting obligation, (3) remains current in their annual and semi-annual reporting at fiscal year end, and (4) has a public float below $75 million as determined on the last business day of the issuer's most recently completed semi-annual period (or revenues below $50 million as the issuer's most recently completed fiscal year if public float is not readily determinable). Once an issuer exceeds the Section 12(g) threshold, it will have a two-year transition period before it must register its securities under Section 12(g).

For issuers seeking to list their securities on a national securities exchange, the SEC amended Form 8-A to make it available to issuers that are concurrently qualifying a Tier 2 offering. Once an issuer has registered its securities under Section 12(b) or 12(g) of the Exchange Act, it will become subject to full Exchange Act reporting under Section 13 or 15(d) once the issuer's Form 8-A becomes effective.

Securities Act Liability

Unlike Regulation D offerings, issuers of Regulation A+ securities will be subject to Section 12(a)(2) liability for offers or sales made through offering circulars or oral communications that include a materially misleading statement or omission. Regulation A+ exempt offerings are excluded from Section 11 of the Securities Act, but such offerings remain subject to the antifraud provisions under federal securities laws.

Application of State Securities Laws

Notably, Regulation A+ preempts state securities law registration and qualification requirements for securities offered or sold to any person in a Tier 2 offering. This means that an issuer may conduct a national Tier 2 offering without the burden of complying with each state's securities registration laws. The preemption does not extend to notice filings the states may require, and states retain the

ability to prosecute fraudulent securities transactions. Tier 1 offerings remain subject to applicable state requirements for registration and qualification. The North American Securities Administrators Association has introduced a multi-state coordinated review program in an attempt to streamline the registration and review process.

FINRA Review

FINRA Rule 5110 will require that any FINRA member participating in a Regulation A+ offering make a filing with FINRA that is subject to FINRA review and clearance. In addition, Rule 5110 requires disclosure of underwriting compensation.

Potential Impact of Regulation A+

It remains to be seen whether Regulation A+ will become a popular path to raising capital. The JOBS Act was intended to offer many choices to issuers in need of capital at different stages of their development, with such choices including exemptions for crowdfunding, a more useful version of Regulation A, generally solicited Regulation D Rule 506 offerings, and the easier and smoother path to registration of an IPO for emerging growth companies. By adopting different standards for Tier 1 and Tier 2 Regulation A+ offerings, the SEC has added even more flexibility to this menu of choices.

As noted, old Regulation A was only rarely used. The small business community has called for revisions to Regulation A for years. These advocates for Regulation A modernization were attracted to the ability to generally solicit and sell to retail investors, as well as the absence of ongoing reporting requirements that came with Regulation A, but they wanted the exemption to have a higher offering amount cap and provide for blue sky preemption. The SEC's final rules for Tier 2 offerings under Regulation A+ are, in many respects, surprisingly responsive to those requests. However, unlike old Regulation A, companies relying on new Regulation A+ will be required to include audited financial statements in both their Regulation A+ offering circular and annual reports and will become subject to further ongoing reporting obligations and other requirements that arguably come close to the requirements applicable to companies registering offerings under the Securities Act through the traditional Form S-1 route. In addition, Regulation A+ imposes Section 12(a)(2) liability on issuers relying on the exemption and, unlike offerings registered on Form S-1, imposes limits on the amount of securities that may be sold to non-accredited investors. As a result, issuers may find that using Rule 506(c) of Regulation D for generally solicited offerings limited to accredited investors-which likewise offers blue sky preemption, but without Section 12(a)(2) liability and without any particular disclosure or ongoing reporting requirements-has more appeal than new Regulation A+. On the other hand, the not insignificant number of smaller companies that in the past have registered offerings on Form S-1 and not had the benefit of blue sky preemption because they would not be listed on a qualifying exchange, may find that Regulation A+ offers an attractive alternative in light of the blue sky preemption and the relatively less burdensome ongoing reporting requirements.

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