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SEC ADOPTS FINAL RULES ON REGULATION A+

April 2015

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INTRODUCTION

On March 25, 2015, the Securities and Exchange Commission (SEC) adopted final rules to amend Regulation A pursuant to the mandate under Title IV of the Jumpstart Our Business Startups Act (JOBS Act) that directed the SEC to create an exemption from registration under new sections 3(b)(2)-(5) of the Securities Act of 1933, as amended (Securities Act), for offerings of up to $50 million of securities within a 12-month period. The amendments to Regulation A, commonly known as "Regulation A+," are designed to "jumpstart" Regulation A and spur capital formation by addressing certain impediments in the old Regulation A framework. The rules will become effective on or about June 19, 2015.

While the final rules substantially implement the proposed rules, there are important modifications, including new resale restrictions for affiliates and investment limitations for non-accredited investors, as discussed in more detail below. The final rules also provide federal preemption of state securities law requirements for Regulation A+ offerings in excess of $20 million, provided certain conditions are met, which was a point of contention between the SEC and state regulators during the commenting period. For a more detailed discussion of the proposed rules and the background of Regulation A, see our white paper published in January 2014, which you can read by clicking here.

Unlike the private placement of securities under Regulation D, Regulation A+ offerings are unregistered public offerings in which issuers may conduct general solicitation, including solicitation of non-accredited investors, and the securities purchased by investors in a Regulation A+ offering are not "restricted securities" under Rule 144. In addition, the Regulation A+ offering process is simpler and less costly than a registered public offering such as an IPO. As such, Regulation A+ may provide start-ups and larger companies with a viable alternative to raise capital in the public market efficiently and inexpensively, and to improve the liquidity of their securities in secondary markets.

SUMMARY OF FINAL RULES

The final rules retain the two-tier structure as originally proposed with some modifications, including increasing the dollar threshold for Tier 1 offerings and imposing additional restrictions on resales by affiliates. Specifically, a Regulation A+ offering may be made under one of the following two tiers:

- Tier 1 for offerings up to $20 million, including no more than $6 million of securities sold by selling shareholders that are affiliates of the issuer, in any 12-month period.
- Tier 2 for offerings up to $50 million, including no more than $15 million of securities sold by selling shareholders that are affiliates of the issuer, in any 12-month period.

Furthermore, in the company's initial Regulation A+ offering and within 12 months thereafter, selling shareholders (whether or not they are affiliates of the issuers) may sell no more than 30% of the aggregate offering price of a particular offering. Following the expiration of 12 months after the issuer's initial Regulation A+ offering, resales by affiliates and non-affiliates are treated differently—resales by affiliates are limited to no more than $6 million and $15 million over a 12-month period in Tier 1 and Tier 2 offerings, respectively, whereas resales by non-affiliates are not limited except by the maximum offering amount permitted by Tier 1 and Tier 2, which amount is reduced by the amount of concurrent sales by the issuer and affiliates.

As discussed in more detail below, both tiers are subject to certain basic eligibility, disclosure, and procedural requirements, but Tier 2 offerings are subject to additional requirements, including the provision of audited financial statements, ongoing reporting obligations, and certain investment limitations.

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Eligible Issuers

Under the final rules, Regulation A+ exemption is available to United States and Canadian companies that are not subject to the reporting obligations of sections 13 or 15(d) of the Securities and Exchange Act of 1934, as amended (Exchange Act). Ineligible issuers include

- blank-check companies and special purpose acquisition companies;
- companies registered under the Investment Company Act of 1940, amended;
- issuers of fractional interests in oil, gas, or other similar mineral rights;
- companies that have not filed with the SEC the ongoing reports required under Regulation A+ two years immediately preceding the filing of a new offering statement;
- companies that are or have been subject to an SEC order in the past five years revoking or suspending the registration of their securities pursuant to section 12(j) of the Exchange Act; and
- companies subject to "bad actor" disqualification provisions that would be substantially conformed to those in Rule 506(d) of Regulation D. The alignment of the current disqualification provisions with those in Rule 506(d) results in two new disqualification triggers for Regulation A+ offerings: (i) final orders and bars of certain state and federal regulators and (ii) SEC cease and desist orders relating to violations of scienter-based antifraud provisions of the federal securities laws or Section 5 of the Securities Act. Disqualification triggers under current Regulation A will result in disqualification under amended Regulation A. The new disqualification triggers in amended Regulation A, if triggered before the effective date of the final rules, will not cause disqualification, but must be disclosed in offering circulars consistent with Rule 506(e) of Regulation D.

Eligible Securities

Eligible securities for Regulation A+ offerings are limited to equity securities, including warrants, debt securities, and securities convertible into or exchangeable into equity interests, including any guarantees of such securities. Asset-backed securities are excluded.

Regulation A+ Offering Process

The final rules substantially adopt all of the proposed modernization of the offering process to follow the prevailing practices for registered offerings. Companies conducting a Regulation A+ offering are required to file the offering statements electronically with the SEC on the EDGAR database. The offering statement is subject to review and comment by the SEC and must be qualified by the order of the SEC prior to any sales in a "notice of qualification," which is similar to the declaration of effectiveness of registration statements. In addition, if a preliminary offering circular is used to market the offering and the issuer is not already subject to the Tier 2 on-going reporting requirements, the issuer or participating broker-dealer must deliver the preliminary circular to prospective purchasers at least 48 hours prior to a sale. In such a case, a final offering circular must be delivered within two business days after the sale. Adopting the "access equal delivery" model, the final rules provide that the delivery requirement for final offering circulars can be satisfied by filing on EDGAR.

Nonpublic Submission of Offering Statements

The final rules provide issuers with the option of submitting draft offering statements to the SEC for non-public review, where the issuer has not previously sold securities pursuant to a qualified offering statement under Regulation A+. However, all non-public submissions of the offering statement and correspondence with the SEC regarding such submissions must be publicly filed on EDGAR as exhibits to a subsequent offering statement not less than 21 calendar days before qualification of the offering

statement. Draft offering statements must be substantially complete upon submission in order for the SEC to initiate review.

The non-public review process is different from the more favorable confidential treatment afforded to emerging growth companies under Title I of the JOBS Act for registered offerings. Whereas Title I provides a mandated protection of confidentiality by statute for draft registration statements, there is no statutory basis for withholding non-public submission of draft offering statements absent an exemption from the Freedom of Information Act (FOIA). Accordingly, the SEC may, under certain circumstances, be compelled to disclose draft offering statements to requesting parties under FOIA prior to the date on which issuers would be required to file them publicly on EDGAR.

"Test the Water" Communications

The final rules permit issuers to "test the water" (solicit interest) about a potential offering from the general public before and after the filing of the offering statement. Unlike the "test the water" provisions for "emerging growth companies" that are restricted to QIBs and institutional accredited investors, the Regulation A+ "test the water" provision is not limited by investor type. Any solicitation materials used in "test the water" meetings after public filing of the offering statement must be accompanied by a preliminary offering circular or contain a notice informing investors about how to access a preliminary circular (e.g., by including a URL address). "Test the water" materials must be filed as exhibits to any offering statement that is either submitted for non-public review or filed publicly, but companies are not required to submit "test the water" materials at or before the time of first use.

Content of Offering Statements: Form 1-A

The existing Form 1-A consists of three parts: Part I (Notification), Part II (Offering Circular), and Part III (Exhibits). The final rules retain the basic three-part structure of Form 1-A, but revise various disclosure requirements—most notably the changes in Part II regarding the offering circular. Specifically, the final rules eliminate the "question and answer" format in Part II and replace it with a narrative disclosure format that is closely aligned with the smaller reporting company disclosure requirements for registered offerings. Part II would require issuers to provide certain basic information about the company similar to Part I of Form S-1 except on a scaled–down level. Such information includes the following:

- description of business;
- description of property;
- financial statements and related MD&A disclosures;
- material risks;
- use of proceeds, officers and directors, and compensation;
- related party transactions; and
- description of the offered securities.

Form 1-A requires financial statements for the two most recently completed fiscal year ends (or from time of existence if less than two years), including the following:

- Balance sheet—the most recent being as of a date not more than nine months before the date of qualification;
- Income statement, cash flow statement, statement of stockholders' equity for the two fiscal years and stub period between last fiscal year and date of most recent balance sheet;
- Financial statement of significant acquired businesses and pro forma information regarding significant business combinations; and

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- Financial statements for domestic issuers must be prepared in accordance with US GAAP and for Canadian issuers may be prepared either in accordance with US GAAP or IASB IFRS.

Additional Requirements for Tier 2 Offerings

To address the concerns of investor protection as a result of the more flexible and expansive offering process, the final rules impose the following additional requirements for Tier 2 offerings:

Audited Financial Statements

The final rules require companies to include in the offering statement two years of audited financial statements that generally follow the requirements for smaller reporting companies under Article 8 of Regulation S-X. The financial statements must be audited in accordance with either US Generally Accepted Auditing Standards (GASS) or standards established by the Public Accounting Oversight Board (PCAOB), but the auditors need not be registered with the PCAOB. The auditor must be independent under Rule 2-01 of Regulation S-X.

Investment Limitation

The final rules impose an investment limitation on non-accredited investors in Tier 2 offerings. Such persons may not purchase more than 10% of the greater of the investor's annual income and net worth, as determined under Rule 501 of Regulation D. The 10% investment limitation for non-accredited investors will be calculated based on annual revenue and net assets. The investment limitation will not apply to accredited investors (as defined under Rule 506 of Regulation D), nor will it apply to offerings where the securities are listed on a national securities exchange such as NYSE or NASDAQ. The final rules make it clear that the issuer has no obligation to verify the investor's financial information to confirm whether the investment limitation is met and instead may rely on a representation of compliance by the investor, provided the issuer does not know the representation is untrue. Issuers must notify investors of the 10% limitation in the offering through disclosure in the offering statement.

Ongoing Reporting Requirements

The final rules require companies conducting Tier 2 offerings to provide ongoing disclosures following the completion of the offering. These disclosures are similar to, but less extensive than, the periodic reporting requirements under the Exchange Act and must be filed publicly on EDGAR. These filing requirements include the following:

- Annual Report on Form 1-K, due within 120 calendar days of the issuer's fiscal year end, will consist of two parts. Part I (Notification) will be an online XML-based fillable form that includes certain basic information about the issuer previously disclosed in the offering statement. It will also require, in the first annual report, information about sales in a terminated or completed qualified Regulation A offering. Part II will contain certain business and financial disclosures, including the following:
    - business operations for the prior three fiscal years;
    - two years of audited financial statements and related MD&A disclosures;
    - related party transactions;
    - identities of executive officers and directors;
    - executive compensation information; and
    - beneficial ownership of securities by officers, directors and 10% owners.

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- Semiannual Report on Form 1-SA, due within 90 calendar days after the issuer's second fiscal quarter, is similar to the quarterly report on Form 10-Q and would primarily consist of financial statements and related MD&A disclosures. Unlike a Form 10-Q, Form 1-SA will not require disclosures about quantitative and qualitative market risk, controls and procedures, updates to risk factors or defaults on senior securities.
- Current Report on Form 1-U is modeled after the current report on Form 8-K and must be filed within four business days of the occurrence of specified events. Form 1-U is required to be filed upon the occurrence of the following triggering events:
  - Fundamental changes;
  - Bankruptcy or receivership;
  - Material modification to the rights of securityholders;
  - Changes in the issuer's certifying accountant;
  - Non-reliance on previous financial statements or a related audit report or completed interim review;
  - Changes in control of the issuer;
  - Departure of the principal executive officer, principal financial officer, or principal accounting officer; and
  - Unregistered sales of 10% or more of outstanding equity securities.

Issuers may terminate or suspend the ongoing reporting obligations by filing Form 1-Z (which replaces the current Form 2-A) if certain conditions are met. These conditions are similar to the provisions for termination and suspension of periodic reporting requirements under the Exchange Act.

Continuous and Delayed Offering

The current Regulation A permits continuous and delayed offering, but requires companies to file a post-qualification amendment for any revision or update to a qualified offering statement, which is time consuming and costly. The final rules will modernize this requirement by adopting a new procedure modeled after Rules 415 and 424(b) of the Securities Act for continuous and delayed offerings, which is similar to the "shelf" registration statement process. Under the final rules, companies will no longer be required to file a post-qualification amendment for any change of information in the offering statement. Instead, the information may be updated annually in the financial statements filed with the SEC, and a post-qualification amendment will only be required to reflect certain "fundamental changes" after qualification. In addition, the offering circulars would be permitted to omit certain information with respect to offerings analogous to the provisions for registered offerings under Rule 430A. Companies will also be permitted to use offering circular supplements for final pricing information where the offering statement is qualified on the basis of a bona fide price range estimate.

Preemption of State Securities Laws

When the SEC proposed to exempt Tier 2 offerings from state securities law requirements, it was met with strong criticism from state regulators who asserted that a coordinated review program established by the North American Securities Administrators Association (NASAA) would substantially reduce the costs and burden of multi-state qualification requirements and thus eliminate the need for federal preemption. Under the NASAA program, an administrator would select a lead disclosure examiner and a lead merit examiner who are responsible for reviewing the offering statement, drafting and circulating comment letters to the participating jurisdictions, and seeking resolution of those comments with the issuer and its counsel. The SEC was skeptical of the NASAA program's ability to provide an efficient process, and does not currently believe that the program can fully address the concern of disparity among states in the standard of qualification requirements.

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The final rules adopt the state preemption provisions substantially as proposed. The rules provide for preemption of state securities law for all tier 2 offerings. Tier 1 offerings continue to be subject to state securities law requirements. The SEC reasoned that preemption of Tier 2 offerings is justified because the additional Tier 2 requirements (i.e., audited financials, investment limitation and periodic reporting) are sufficient to address the interest of the states to protect public investors. Accordingly, a Tier 2 offering for an amount less than $20 million may qualify for state preemption as long as the issuer complies with Tier 2 additional requirements.

Preemption for Secondary Offerings

While the SEC is clear about stating that Tier 2 offerings are exempt from state securities or "blue sky" laws, the SEC clarifies, only in a footnote, that state securities laws will continue to have application to secondary trading of Regulation A+ securities issued in a Tier 2 offering. In general, the states provide certain exemptions for non-issuer (i.e., secondary) trading of private company securities, including a "manual exemption." To claim the manual exemption for secondary trading, the issuer and the security must be listed in a securities manual recognized by the relevant state. The listing entry in the manual must also typically disclose (i) the names of the issuer and its officers and directors, (ii) the issuer's balance sheet and (iii) a profit and loss statement for either the fiscal year preceding the balance sheet or for the most recent fiscal year of operations.

Therefore, to facilitate secondary market trading, issuers in Tier 2 offerings must look to the state exemptions available for secondary trading. Regarding the application of state blue sky laws to secondary trading of shares sold in Tier 2 offerings, the SEC notes "[w]hile further preemption of state securities law regulation of the secondary trading of Regulation A securities issued in a Tier 2 offering could, as some commenters suggest, further advance the development of a national securities market by easing the compliance obligations of investors that trade in the secondary markets, we believe that the approach to preemption of state securities laws adopted today is more appropriate at the outset and will afford the Commission time to subsequently review the development of, and consider potential changes to, the final rules for primary and secondary Regulation A markets."

We expect that the SEC will be asked to provide further guidance about secondary market trading of Tier 2 securities.

Integration

The final rules generally preserve the existing Regulation A safe harbor from integration and provide additional guidance on potential integration conducted concurrently with a Regulation A offering. As adopted, Regulation A offerings will not be integrated with prior offer or sales of securities, including any Reg D offerings. Subsequent offers and sales of securities will not be integrated if they are (i) registered under the Securities Act, except for certain abandoned offerings; (ii) made pursuant to an employee benefit plan or under Rule 701 of the Securities Act of 1933, as amended (Securities Act); (iii) made pursuant to Regulation S; (iv) made more than six months after the completion of the Regulation A+ offering; and (v) crowdfunding transactions pursuant to Section 4(a)(6) of the Securities Act. In addition, if a company decides to abandon a Regulation A offering and switch to a registered offering, any offers made under Regulation A would not be integrated with the registered offering unless the company engaged in solicitation of persons other than qualified institutional buyers (QIBs) and institutional accredited investors in TTW communications.

Liability Under Section 12(a)(2)

Consistent with the current Regulation A, the final rules will impose civil liability under section 12(a)(2) of the Securities Act for any offer or sale by means of an offering circular or an oral communication that contains a material misleading statement or a material misstatement of fact. In addition, the antifraud liability provisions under section 10(b) of the Exchange Act are applicable to Regulation A offerings.

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Treatment Under Section 12(g) of Exchange Act

Section 12(g) of the Exchange Act requires a private company to register its securities under the Exchange Act, thus becoming an Exchange Act reporting company, if its total assets exceed $10 million and if it (i) has 2,000 holders of record of its equity securities or (ii) 500 persons who are not accredited investors. The proposed rules left the question open as to whether Regulation A+ securities will be subject to the Section 12(g) registration requirements. The final rules provide a conditional exemption for securities issued in a Tier 2 offering, which will be exempt from the "holders of record" threshold under Section 12(g) as long as the issuer (i) remains subject to and is current in its Regulation A ongoing reporting requirements, (ii) engages the services of a registered transfer agent, and (iii) either has a public float of less than $75 million as of its most recently completed semiannual period or annual revenues of less than $50 million as of its most recently completed fiscal year. An issuer that meets the public float or revenue requirement would be granted a two-year transition before it would be required to register its securities under Section 12(g), provided that it timely files all ongoing Regulation A periodic reports.

Reporting Requirements Under Rule 15c2-11 and Rule 144 of Exchange Act

In connection with the final rules, the SEC is amending Rule 15c2-11 to provide that Tier 2 ongoing reporting requirements satisfy broker-dealers' obligations to review and maintain certain information about the issuer in order to initiate or continue quotation of the issuer's securities on OTC markets. However, Tier 2 ongoing reports will not satisfy the "adequate current public information" requirement under Rule 144, because no quarterly filing is required. Issuers seeking to satisfy the Rule 144 information requirement may voluntarily file quarterly reports on Form 1-U.

Form 8-A Exchange Act Registration

In the proposed rules, the SEC did not address the issue of whether a company seeking to list its securities on a national securities exchange in connection with a Regulation A offering would be required to file a Form 10 to register the securities under the Exchange Act. Such requirement would, of course, have rendered the Regulation A amendments meaningless because of the additional burden and costs associated with preparing that full-scale registration statement. Accordingly, the final rules provide that companies conducting Tier 2 offerings must file a Form 8-A to register any securities on an exchange. We note, however, that registration of securities on an exchange will result in the issuer becoming subject to Exchange Act reporting requirements, which generally are substantially more rigorous than the ongoing reporting requirements applicable to Tier 2 issuers.

IMPACT OF REGULATION A+

Regulation A+ provides a meaningful option for nonpublic companies to raise capital other than through a Regulation D private offering or undertaking a generally more costly IPO. At the moment, however, it does not seem that Regulation A+ can compete effectively with Regulation D, particularly for financing of early and mid-stage companies. The cost and delay in preparing and qualifying offering circulars with the SEC, plus the ongoing reporting obligations for Tier 2 offerings, may prove to be too onerous when compared to the less expensive and more familiar process of Regulation D financing. However, the SEC is currently considering amendments to the definition of "accredited investor" under Regulation D that may change the calculus between Regulation A+ and Regulation D. If the SEC adopts a more restrictive definition, hence narrowing the scope of potential investors eligible to participate in Regulation D offerings, it may create more incentives for companies to consider Regulation A+ as an alternative.

Regulation A+ may be more attractive to late-stage companies with more resources that are seeking to eventually complete an IPO. Such companies may not be able to conduct a traditional IPO for a variety of reasons (such as lack of support from investment banks, lower valuation, and the high cost of financial audits) and Regulation A+ may provide a solution. In particular, if such companies can meet the initial

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listing criteria of national securities exchanges (e.g., NASDAQ or NYSE), Regulation A+ could provide a cheaper alternative to go public and become an Exchange Act reporting company. Even without an exchange listing, Regulation A+ may still be valuable in serving as a springboard for companies to become fully "public companies" by raising the profiles of these companies in the public market and improving the liquidity and trading of their securities. Recently, the SEC staff has indicated that it wants to encourage the use of Regulation A+ offerings by treating them as IPO-lite transactions and working to avoid making the qualification process unduly burdensome.

Furthermore, Regulation A+ itself may be revised again in two years; the JOBS Act requires the SEC to review the offering limitations under the new rules every two years and, in so doing, the SEC will consider how Regulation A+ has been used. By April 2016, the SEC will have initiated that first review with, as the adopting release states, "a view to considering whether to increase the $50 million offering limitation." This review requirement may help ensure that amended Regulation A will become a useful capital raising tool for nonpublic issuers.

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