April 8, 2015

SEC Adopts Rules to Update Regulation A

On March 25, 2015, the Securities and Exchange Commission ("SEC") voted unanimously to adopt amendments to its public offering rules to exempt an additional category of small capital raising efforts as mandated by Title IV of the Jumpstart Our Business Startups Act (the "JOBS Act"). The final rules establish an exemption for offerings of securities of up to $50 million within a 12-month period and are substantially consistent with the proposed rules. Notably, however, the Tier 1 offering threshold (described below) has been raised from $5 million to $20 million, and certain changes have been made in the final rules intended to make Tier 1 offerings more useful for small capital formation. The SEC has retained the controversial preemption of state securities law registration and qualification requirements for securities offered in a Tier 2 offering.

The Final Rules

Tier 1 and Tier 2 Offer Limitations. The final rules update and expand the Regulation A exemption by creating two tiers of Regulation A offerings:

- Tier 1, which includes securities offerings of up to $20 million in a 12-month period, including up to $6 million for the account of selling securityholders that are affiliated with the issuer (rather than $5 million and $1.5 million, respectively, as set forth in the proposed rules); and

- Tier 2, which includes offerings of up to $50 million in a 12-month period, including up to $15 million for the account of selling securityholders that are affiliated with the issuer.

For offerings of up to $20 million, an issuer can elect to use either Tier 1 or Tier 2.

Secondary offerings by non-affiliates that are made pursuant to a qualified offering statement following the expiration of the first year after an issuer's initial qualification will not be limited, except by the maximum offering amount permitted by either Tier 1 or Tier 2.

Eligibility. Regulation A is available to companies organized in, and with their principal place of business in, the United States or Canada. The Regulation A exemption is not available to SEC reporting companies, certain investment companies, certain development stage companies, or companies that are seeking to offer asset-backed securities or fractional undivided interests in oil, gas, or other mineral rights. Regulation A is also unavailable to issuers delinquent in their Regulation A filings or subject to certain SEC orders. In addition, the requirement that a securities offering be disqualified from relying on

Regulation A if the issuer or other covered persons are felons or other "bad actors" has been conformed to the bad actor disqualifications in Rule 506(d) of the Securities Act of 1933 (the "Securities Act").

The final rules add two new issuer eligibility requirements to those described above, namely:

- Potential issuers must have filed all required ongoing reports under Regulation A during the two years immediately preceding the filing of a new offer document, and

- Issuers subject to orders by the SEC entered pursuant to Section 12(j) of the Securities Exchange Act of 1934 (the "Exchange Act") within a five-year period immediately preceding the filing of the offering statement are not eligible to conduct an offering pursuant to Regulation A.

Modernization of Communications and Offering Process. Consistent with the proposed rules, the final rules update Regulation A to modernize the communications and offering process and to reflect analogous provisions of the Securities Act registration process. Among other things:

- An issuer using Regulation A can obtain indications of interest from potential investors both before and after filing the offering statement, a practice known as "testing the waters." Any solicitation materials need to be filed with the SEC.

- The offering statement is "qualified" by SEC order so that the SEC has the opportunity to review and comment.

- Confidential submission of draft offering statements and amendments are permitted, provided the documents were publicly filed no later than 21 calendar days before qualification. In a change from the proposed rules, the final rules clarify that draft offering statements will automatically receive confidential review.

- A preliminary offering circular has to be delivered to potential investors at least 48 hours in advance of a sale unless the issuer is subject to, and current in, its Tier 2 ongoing reporting obligations. Where the issuer is subject to, and current in, a Tier 2 ongoing reporting obligation, issuers and intermediaries will only be required to comply with the general delivery requirements for offers.

- A final offering circular has to be delivered within two business days after the sale in cases where the sale was made in reliance on the delivery of a preliminary offering circular. Issuers and intermediaries are able to satisfy the delivery requirements under an "access equals delivery" approach when the final offering circular is filed and available on EDGAR.

- All filings are required to be submitted to the SEC in electronic format via EDGAR.

Offering Statement. Under the final rule, issuers continue to be required to prepare an offering statement, including the narrative and financial information required by Form 1-A. However, Form 1-A, as amended, no longer permits disclosure in reliance on the Model A "question and answer" disclosure format. Form 1-A also updates Model B, which requires various disclosures, including basic information about the issuer, material risks, use of proceeds (including, as added in the final rules, disclosure about whether any other funds to be used in conjunction with the proceeds raised in the Regulation A offering are firm or contingent), an overview of the issuer's business, an MD&A type discussion, disclosures about executive officers and directors and compensation, beneficial ownership information, related party transactions, a description of the offered securities, and two years of financial statements (or for such shorter time that the issuer has been in existence). 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.

In addition, the final rules provide for certain additional scaled disclosure items applicable to Tier 1 offerings, including a higher related party transaction disclosure threshold, and permit the disclosure of group-level, rather than individual, compensation data for the three highest paid executives or directors of the issuer.

Other Items. The final rules eliminate the prohibition on affiliate resales that applies unless the issuer has had net income from operations in at least one of the last two fiscal years. The final rules also add subsequent offers or sales made in crowdfunded offerings to the list of integration safe harbor provisions and outline the scope of permissible continuous or delayed offerings under Regulation A.

Additional Requirements for Tier 2 Issuers

In addition to the provisions described above, issuers conducting Tier 2 offerings are subject to the following additional requirements:

Audited Financial Statements. Unlike Tier 1 offerings, the financial statements included in the offering statement for a Tier 2 offering are required to be audited. In a departure from the proposed rules, the final rules permit issuers conducting Tier 2 offerings to provide financial statements that are audited in accordance with either U.S. GAAS or the standards issued by the PCAOB.

Ongoing Reporting Requirements. Consistent with the proposed rules, issuers in Tier 2 offerings are subject to an ongoing reporting regime and are required to file various reports, including annual reports on Form 1-K, semi-annual reports on Form 1-SA, and current reports on Form 1-U. The regime also includes special financial reports and exit reports on Form 1-Z.

Form 1-K requires disclosures relating to the issuer's business and operations for the preceding three years (or since inception, if in existence for less than three years); related party transactions; beneficial ownership; executive officers and directors; executive compensation; MD&A; and two years of audited financial statements. Form 1-SA and Form 1-U are analogous to Form 10-Q and Form 8-K, respectively, but with scaled disclosure requirements. Special financial reports are intended to close lengthy gaps in financial reporting between the financial statements included in Form 1-A and the issuer's first periodic report due after qualification of the offering statement.

In addition, in a change from the proposed rules, the final rules:

- Conditionally exempt securities issued in a Tier 2 offering from the mandatory registration requirements of Section 12(g) of the Exchange Act, for so long as the issuer engages the services of a transfer agent that is registered with the SEC, remains subject to Tier 2 reporting obligations, is current in its annual and semi-annual reporting at fiscal year-end, and had a public float of less than $75 million as of the last business day of its most recently completed semiannual period, or, in the absence of a public float, had annual revenues of less than $50 million as of its most recently completed fiscal year; and

- Permit a Tier 2 issuer to use a Form 8-A short form registration statement concurrently with the qualification of a Regulation A offering statement in order to register a class of securities under Section 12(g) or 12(b) of the Exchange Act (at which point its obligation to file ongoing reports under Regulation A would be suspended so long as it remains subject to Exchange Act reporting requirements).

Investor Limitations. Investors in a Tier 2 offering that are not accredited investors are limited to purchasing no more than (a) 10% of the greater of the investor's annual income or net worth, whichever is greater (for natural persons), or (b) 10% of the greater of the investor's annual revenue or net assets at fiscal year-end (for non-natural persons). Pursuant to the final rules, this limit will not apply to purchases of securities by accredited investors or to securities that are listed on a national securities exchange upon qualification. Tier 2 issuers are permitted to rely on an investor's representation of compliance with these limitations unless they know at the time of sale that this representation was untrue.

Interaction with State Securities Laws

Previously, Regulation A offerings were subject to registration and qualification requirements in the states where the offering is conducted unless a state-level exemption was available. This requirement was identified by the Government Accountability Office and market participants as one of the main reasons for the limited use of Regulation A. The SEC provided in the proposed rules that state securities law requirements be preempted for Tier 2 offerings, noting that the additional requirements applicable to Tier 2 offerings should provide significant additional investor protection.

The North American Securities Administrators Association ("NASAA") expressed its vigorous objection to the proposed preemption of state regulation of Regulation A offerings. In response to criticisms of multiple state registration and qualification requirements, NASAA recently established a coordinated review program intended to streamline the state filing and review process for Regulation A offerings, whereby a single state "lead" examiner consolidates comments from other states and serves as a single point of contact with the issuer.

In the commentary to the final rules, the SEC noted that the coordinated review process, while promising, is relatively new and remains largely untested. It also reiterated its belief that the substantial investor protections embedded in the final rules for Tier 2 offerings support the limited preemption of state securities laws registration and qualification requirements. As a result, the final rules provide that Tier 2 offerings will not be subject to state review (although they will remain subject to state filing obligations and anti-fraud provisions). Tier 1 offerings will, however, remain subject to state securities law requirements and Tier 1 issuers may avail themselves of the coordinated review program described above.

The final rules will become effective sixty days after publication in the Federal Register. For a copy of the final rules and the SEC's accompanying release, see:

http://www.sec.gov/rules/final/2015/33-9741.pdf

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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