BURNS & LEVINSON LLP

SECURITIES LAW UPDATE

April 2015

SEC RULES EXPAND ACCESS TO CAPITAL VIA LARGER PRIVATE OFFERINGS (REGULATION A+)

On March 25, 2015, the Securities and Exchange Commission ("SEC") issued new rules that will enable private companies to raise as much as $50 million in a 12-month period through private offerings of securities exempt from the registration and reporting requirements associated with "going public."

The new rules amend the existing Regulation A and are generally referred to as Regulation A+. The rules are in response to mandates created by the Jumpstart Our Business Startups "JOBS" Act which we previously summarized in our April 2012 Securities Law Update entitled, "JOBS Act Makes It Easier to Raise Capital."

"Our goal in this rulemaking is to make Regulation A-plus an effective, workable path to raising capital that also provides strong investor protections," said SEC Chair Mary Jo White.

Noting that companies have long neglected the use of former Regulation A, in part because of disparate and costly state regulatory hurdles, White added that the new rules "preempt state registration and qualification laws for certain offerings of up to $50 million that we call Tier 2 offerings." By contrast, the former Regulation A permitted only $5 million offerings without any federal preemption protections from state regulations.

Under the new two-tier system, companies will be able to offer up to $20 million worth of securities to investors in Tier 1 offerings without having to provide audited financial statements or ongoing reports to the SEC. Companies that wish to raise more money can do so by means of a Tier 2 offering, which requires audited financial statements for investors and ongoing annual and semiannual reports to the SEC that will be less detailed than public company reports.

Purchasers of shares in a Regulation A+ offering receive unrestricted shares that for non-affiliates are not subject to transferability restrictions under Rule 144 of the Securities Act of 1933, as amended ("Securities Act").

Noting that just one company successfully qualified a Regulation A offering in 2011, and fewer than 10 companies per year in 2012 to 2014, the SEC announced that the new rules would also streamline the Regulation A+ approval process for both Tier 1 and Tier 2 issuers to make it more user-friendly.

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SECURITIES LAW GROUP:

Burns & Levinson's Securities Law Group represents public and private companies, underwriters and investment banks, venture capital and investment funds, real estate investment funds, investment advisors, broker-dealers, stockholder groups and individuals in public and private securities offerings and transactions, SEC, FINRA and stock exchange compliance, corporate governance, fund formation and offerings, SEC enforcement and securities litigation.

The Group's practical and proactive approach to understanding the rapidly changing securities disclosure and corporate governance laws enables them to provide clients with updates and guidance regarding specific situations in which clients may be impacted, and to implement the changes that are either required or advisable to comply with the new regulatory schemes and investor sentiment.

Our attorneys also represent underwriters in initial and follow-on public offerings and investment banks in private placements and mergers and acquisitions.

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The rules will permit the SEC's Division of Corporation Finance to qualify Regulation A+ offerings after receipt of mandated electronic filings. Furthermore, with the adoption of a modern "access equals delivery" model of disclosure, issuers will be able to deliver investor solicitation materials via the Internet.

"Electronic filing [and access] is expected to reduce processing delays and costs associated with the current paper system, improve the overall efficiency of the filing process for issuers, benefit investors by providing them with faster access to the offering statement, and allow offering materials to be more easily accessed and analyzed by regulators and analysts," the SEC stated in its adopting release.

The final rules also permit issuers to "test the waters" by using solicitation materials before an offering statement is filed (and before making actual sales). The SEC said this should enable issuers to determine potential market interest in their securities before incurring the costs of preparing and filing an offering statement under Regulation A+.

The SEC asserted that many companies should be able to utilize the new Regulation A+ roads for access to capital, noting that 75 initial public offerings and 246 seasoned equity offerings of up to $50 million in securities in 2014 could have been eligible for Regulation A+.

The full text of the 453-page SEC Release no. 33-9741; 34-74578 (the "SEC Release") regarding Regulation A+ can be viewed at: http://www.sec.gov/rules/final/2015/33-9741.pdf.

Effective Date: The new rules become effective June 19, 2015.

ELIGIBILITY REQUIREMENTS FOR USE OF REGULATION A+

1. Eligible Issuers

Under the final rules, Regulation A+ is available for use only by companies organized in and with their principal place of business in the United States or Canada. It is not available to:

- Certain publicly registered companies subject to the ongoing reporting requirements in Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act").
- Companies required to register with the SEC under the Investment Company Act of 1940 and business development companies (which invest in other businesses).
- Blank check companies (companies with no specific business plans).
- Issuers of fractional undivided interests in oil, gas or mineral rights or similar interests.
- Issuers that are required to, but that have not filed ongoing reports with the SEC required by rule under Regulation A during the two years preceding the filing of a current Regulation A offering statement (or for shorter periods as required by rule).
- Issuers that are or have been subject to an order by the SEC denying, suspending or revoking the registration of a class of securities pursuant to Section 12(j) of the Exchange Act entered within five years prior to filing of an offering statement.
- Issuers subject to "bad actor" disqualification.

The SEC specifically declined to exclude all shell companies or issuers of penny stock. There will also be no restrictions on the size of a company that can utilize Regulation A+.

2. Eligible Securities

The final rules do not permit use of the new Regulation A+ for any sale of asset-backed securities, but they do permit the use of Regulation A+ for the sale of all other securities that Securities Act Section 3(b)(3) permits to be exempted from registration, including: equity securities, debt securities, and debt securities convertible or exchangeable to equity interests, including any guarantees of such securities.

3. Offering Limitations

3a. Tier 1 and Tier 2 Offering Limits

Tier 1 issuers may sell up to $20 million worth of eligible securities in a Regulation A+ offering in a 12-month period, including no more than $6 million sold by affiliated selling stockholders.

Tier 2 issuers may sell up to $50 million worth of eligible securities in a Regulation A+ offering in a 12-month period, including no more than $15 million sold by affiliated selling stockholders.

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In addition, in both Tier 1 and Tier 2 offerings, sales by selling stockholders in an issuer's first Regulation A+ offering (and any subsequent Regulation A offerings in the next 12 months) are limited to thirty percent of the aggregate offering price.

The restrictions on sales by selling stockholders were enacted by the SEC in part "in order to strike an appropriate balance between allowing selling securityholders continued access to avenues for liquidity in Regulation A and the concern that secondary offerings do not directly provide new capital to companies…"

3b. Options and Other Underlying Rights

Issuers will be required by the new rules to aggregate the price of all securities being offered, including any underlying rights that are convertible, exercisable or exchangeable within the first year after qualification of an offering. The rules will also require issuers to use the maximum estimated price for which securities may be converted or exchanged when calculating the price of securities being offered.

4. Limitations on Investment in Regulation A Offerings

The SEC adopted limitations on the amount of securities that can be sold to any individual investor in Tier 2 offerings, but stated that those limits will not apply to securities sold to accredited investors who meet certain income and net worth tests as currently defined in Rule 501 of Regulation D.

By rule, non-accredited investors who are natural persons will be able to purchase only up to 10 percent of the greater of the purchaser's annual income or net worth as provided in Rule 501, and the purchases of non-natural persons (such as corporations) will be limited to 10 percent of their annual revenue or net assets, calculated as of the purchaser's most recent fiscal year end.

Issuers must also notify investors of these limitations, and they may rely on an investor's representation of compliance with the limitations, unless the issuer knows at the time of sale that such a representation is untrue. The SEC specifically declined to require issuers to take reasonable steps to verify investor suitability or to have a "reasonable belief" in that suitability.

5. Integration of Offerings

Noting that issuers have legitimate concerns about whether an exempt offering could be integrated with another offering that would nullify an exemption from registration, the SEC adopted an integration safe harbor.

This safe harbor rule provides that offerings pursuant to Regulation A+ will not be integrated with prior or subsequent offers or sales of securities, provided that any subsequent offers or sales are:

- Registered under the Securities Act (except as provided in Rule 255(c) pertinent to asset-backed securities).
- Made pursuant to Rule 701 of the Securities Act (relating to securities offered as part of compensation packages).
- Made pursuant to any employee benefit plan.
- Made pursuant to Regulation S (for offerings made outside the U.S.).
- Made pursuant to Section 4(a)(6) of the Securities Act (for transactions with significant size restrictions).
- Made more than six months after final completion of a Regulation A+ offering.

However, the SEC Release cautions that "an issuer conducting a concurrent exempt offering for which general solicitation is not permitted will need to be satisfied that purchasers in that offering were not solicited by means of the offering made in reliance on Regulation A."

6. Exchange Act Section 12(g) Limits on Numbers of Investors

Because of the permitted size of a Tier 2 offering and the limits on total sales per investor, the SEC concluded that many Regulation A+ issuers could run afoul of the provisions of Exchange Act Section 12(g), which requires public registration of any issuer with total assets of more than $10 million and a class of securities held by at least 2,000 persons, or 500 persons who are not accredited investors.

Thus, the new rules exempt securities issued in a Tier 2 Regulation A+ offering from Section 12(g), provided that an issuer engages the services of a registered transfer agent and also remains current in its periodic reporting obligations.

This conditional exemption is only available to issuers that have a public float of less than $75 million, determined as of the last business day of the most recently completed semi-annual period, or in the absence of a public float, annual revenues of less than $50 million as of the most recently completed fiscal year. A two-year transition period will be

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provided to issuers that need to register publicly as a result of exceeding these thresholds.

OFFERING STATEMENT CONTENT AND FILING REQUIREMENTS

1. Filing and Delivery Requirements

Under the new rules, issuers must file their Regulation A+ offering statements and related materials electronically on the SEC's EDGAR system.

Form 1-A for Regulation A disclosures will consist of three parts:

- Part I being an eXtensible Markup Language ("XML") based form with drop-down menus, indicator boxes or buttons, and text boxes.
- Part II being a text file attachment containing the body of the disclosure document and financial statements.
- Part III being text file attachments containing the signatures, exhibits and exhibit index to the offering statement.

Because of the requirement to make materials available in searchable formats on EDGAR, the SEC declined to require issuers to maintain a corporate website for access to all filings.

The SEC also adopted the modern "access equals delivery" model for Regulation A+ offering circulars when the final offering circular is filed and available on EDGAR and sales are made on the basis of offers conducted during the prequalification period (the period prior to notice of qualification from the SEC). This delivery requirement also necessitates the inclusion of applicable hyperlinks to offering materials on EDGAR that must be provided to investors.

Where sales occur after qualification on the basis of a preliminary offering circular, issuers and intermediaries may satisfy delivery requirements to investors simply by reference to the existing filings on EDGAR.

In all instances of "electronic only" offerings, however, an issuer and its intermediaries must obtain the consent of investors to the electronic delivery of the following materials, or otherwise be able to evidence actual electronic receipt of these documents:

- The preliminary offering circular and information other than the final offering circular when the issuer sells securities based on the preliminary offering circular.
- All documents and information, including the final offering circular, when the issuer sells securities based on offers made during the post-qualification period using a final circular.

2. Non-public Submission of Offering Statements

The new rules provide for the submission of non-public draft offering statements, enabling issuers to make non-public filings when they want to test the waters or otherwise temporarily keep certain information from becoming public. This non-public review by the SEC is only available to issuers whose securities have not been previously sold pursuant to a qualified offering statement or any public registration statement.

A non-publicly submitted offering statement must be "substantially complete" and the submission, along with all related non-public materials, must become publicly available not less than 21 calendar days before the SEC will qualify the offering.

The SEC cautioned issuers that rely on non-public submissions that the SEC could "be compelled to provide such materials to a requesting party" by legal process.

3. Form and Content Requirements

With regard to permitted forms of disclosure in the offering statement, the SEC eliminated the Model A "question and answer" format as an option in Form 1-A applicable to Regulation A+ offerings, and they updated the rules on disclosure for Model B narrative formats. Recognizing that some issuers might wish to follow a familiar public registration format, the SEC also continued to permit narrative disclosures in a Form S-1 format for public registrations.

The notification in Part 1 of Form 1-A will require:

- Item 1 disclosures about the issuer, its industry, number of employees, financial statements, capital structure and contact information.
- Item 2 issuer eligibility data.
- Item 3 certifications relating to bad actor disqualifications.
- Item 4 summary information regarding the type of offering, amount of securities being offered, anticipated offering fees and related data.

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- Item 5 information about jurisdictions in which the securities are being offered.

- Item 6 disclosures about unregistered securities issuances or sales within the last year.

Part II of Form 1-A will require presentation of the:

- Basic information about the issuer, the offering, underwriters and underwriting discounts or commissions.

- Summary of risk factors.

- Disclosures regarding dilution due to any disparity between the offering price and effective cash costs for shares acquired by insiders.

- Plan of distribution for the offering and disclosure regarding selling security holders.

- Disclosures concerning the use of proceeds.

- Statement of business operations for the prior three fiscal years, or since inception.

- Description of issuer property.

- Management discussion and analysis of financial conditions and results of operations ("MD&A").

- Directors, executive officers and significant employees with disclosures concerning family relationships, business experience and certain legal proceedings.

- Group level executive compensation disclosures for the three highest paid officers or directors (with Tier 2 requiring individual level disclosures).

- Beneficial ownership disclosures for officers, directors and 10 percent equity holders.

- Related party disclosures for certain transactions.

- Material terms of the securities being offered.

- Disclosures regarding certain disqualifying events.

For those issuers concerned about the burdens associated with detailed MD&A, the SEC designed related offering circular requirements for Regulation A+ to be less extensive than what is required by Item 303 of Regulation S-K for public companies. For instance, there is no required disclosure for off-balance sheet arrangements or table of contractual obligations.

Issuers will also be permitted to incorporate by reference any documents publicly submitted or filed on EDGAR.

3a. Form and Content Requirements for Financial Statements

The final Regulation A+ rules require both Tier 1 and Tier 2 issuers to file balance sheets and other required financial statements as of the two most recently completed fiscal year ends (or for such shorter time as an issuer has been in existence) but only Tier 2 issuers must file audited statements in all Regulation A+ offerings.

Issuers in Tier 1 offerings must follow the financial statement requirements set forth in Part F/S of Form 1-A, which is a scaled down version of public reporting requirements, but Tier 2 issuers must follow the requirements of Article 8 of Regulation S-X applicable to smaller public reporting companies.

The final rules extend the permissible age of financial statements filed in Form 1-A to nine months before the date of offering qualification by the SEC.

3b. Form and Content Requirements for Exhibits

Under Regulation A+ rules, issuers must file with their offering statements: the underwriting agreement; charter and by-laws; instruments defining security holder rights; any subscription agreements; voting and trust agreements; all material contracts; any plans of acquisition, reorganization, arrangement, liquidation or succession; escrow agreements; consents; opinions regarding legality; "testing the waters" materials; appointments of agents for service of process; and any additional items the issuer wishes to include.

The SEC will allow issuers to exclude schedules to material contracts if not material to an investment decision or otherwise disclosed elsewhere, and will permit issuers to incorporate by reference certain exhibit information already available on EDGAR.

4. Continuous or Delayed Offerings and Supplemental Disclosure

The former Regulation A allowed for continuous or delayed offerings of securities if permitted by Rule 415 (except for certain prohibited shelf offerings). The new rules explicitly

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permit the following types of continuous or delayed Regulation A offerings:

- Securities offered or sold by or for someone other than the issuer or its subsidiary or a person of which the issuer is a subsidiary.
- Securities offered or sold pursuant to a dividend or interest reinvestment plan or an employee benefit plan of an issuer.
- Securities issued upon the exercise of outstanding options, warrants, or rights.
- Securities issued upon conversion of other outstanding securities.
- Securities pledged as collateral.
- Securities that are part of an offering commencing within two days after qualification, offered on a continuous basis, offered for a period in excess of 30 days from qualification and offered in an amount that is reasonably expected to be sold within two years from the qualification date.

Changes in information contained in an issuer's offering statement will no longer automatically trigger an obligation to amend a filing, but issuers will have to requalify offering statements annually to include updated financial statements. The SEC Release also states that issuers in the future must file amendments and requalify at other times "as necessary to reflect facts or events arising after a qualification which, in the aggregate, represent a fundamental change in the information set forth in the offering statement."

SOLICITATIONS OF INTEREST AND TESTING THE WATERS

Regulation A+ will permit issuers to "test the waters" with potential investors by using solicitation materials both before and after an offering statement is filed with the SEC, subject to compliance with rules regarding sales disclaimers and filings.

All solicitation materials must be filed as an exhibit to any offering statement that is either submitted for non-public review or otherwise filed with the SEC, but issuers will no longer be required to submit solicitation materials at or before their first use.

Issuers must also deliver a final offering circular to investors no later than two business days after sale of a security, and within the minimum 21-day filing requirement for non-public submissions.

ONGOING REPORTING OBLIGATIONS

The SEC opted not to impose ongoing reporting obligations on Tier 1 issuers when they are not otherwise subject to such obligations. They did, however, impose continued reporting requirements on Tier 2 issuers, which must file annual reports, semiannual reports and certain current event reports.

In addition, the rules will require Tier 1 issuers to file supplemental information on Part I of new Form 1-Z not later than 30 calendar days after termination or completion of an offering. Tier 2 issuers will be able to provide such information on either Form 1-Z or in their Form 1-K annual report, whichever is filed first.

The disclosure requirements in Part I of Form 1-Z or Form 1-K, as applicable, include:

- The date the offering was qualified and commenced.
- The amount of securities qualified.
- The amount sold and the price of the securities.
- The portions of the offering sold on behalf of the issuer and selling security holders.
- The fees associated with the offering.
- The net proceeds to the issuer.

The rules require an issuer to fill out information related to the conclusion of the offering only once, but Part II of Form 1-K must be filed with the SEC on an ongoing basis.

1. Ongoing Annual Reports

Tier 2 issuers will have to file annual reports on Form 1-K with the SEC, and each annual report will be divided into two parts.

Part I of each annual report will consist of a notification that includes basic information about the issuer.

Part II of Form 1-K will require issuers to disclose information about themselves and their businesses based on the financial

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statement and narrative disclosure requirements of Form 1-A. Each year, issuers must update the required MD&A section for the two most recently completed fiscal years using cross-references to requirements of Form 1-A.

New rules will also require issuers to disclose in Form 1-K prescribed information about:

- Business operations of the issuer for the prior three fiscal years.
- Transactions with related persons, promoters and control persons.
- Beneficial ownership of voting securities held by executives, directors and 10 percent owners.
- The identities of directors, executive officers and significant employees, as well as a description of their business experience and involvement in certain legal proceedings.
- Executive compensation in the most recent fiscal year for the three highest executives or directors.
- The issuer's liquidity, capital resources, and results of operations in the two most recently completed fiscal years (as part of the MD&A section).
- Two years of audited financial statements.

An issuer must file Form 1-K within 120 calendar days after its fiscal year end.

2. Ongoing Semiannual Reports

Tier 2 issuers must also file semiannual reports with the SEC on Form 1-SA. Form 1-SA will be similar in form and content to Form 10-Q, which public issuers must file on a quarterly basis.

Unlike Form 10-Q, however, Form 1-SA will not require disclosure about quantitative or qualitative market risks, controls and procedures, updated risk factors or defaults on senior securities.

Tier 2 issuers must file Form 1-SA within 90 calendar days after the end of the first six months of the issuer's fiscal year, and the first obligation to file commences immediately after the most recent fiscal year for which full financial statements were included in the offering statement.

3. Current Reports for Certain Specified Events

In addition, the Regulation A+ rules will require every issuer to file a Form 1-U report whenever experiencing one or more of the following events (similar to a form 8-K for public issuers):

- Fundamental changes in the business.
- Bankruptcy or receivership.
- Material modifications to the rights of security holders.
- Changes to the issuer's certifying accountant.
- Non-reliance on previous financial statements or related audit reports or interim reviews.
- Changes in issuer control.
- Departure of the principal executive officer, financial officer or accounting officer.
- Unregistered sales of 10 percent or more of the issuer's outstanding equity securities.

4. Exchange Act Registration of Regulation A Offerings

The new rules also allow Tier 2 issuers wishing to register under the Exchange Act a class of their Regulation A+ securities to do so by filing a Form 8-A in conjunction with the qualification of a Form 1-A, thereby creating a gateway to public markets for their Regulation A+ securities. However, such issuers must follow Part I of Form S-1 rather than Form 1-A.

BAD ACTOR DISQUALIFICATIONS

If certain "covered persons" involved in an issuer's business or Regulation A+ offering have suffered any "disqualifying events," then the issuer may be prohibited from utilizing Regulation A+. The covered persons and disqualifying events for Regulation A+ will be substantially the same as those described in Rule 506(d) for Regulation D.

As a result, two new disqualifying events will be present in Regulation A+: (1) final orders and bars of certain state and other federal regulators; and (2) SEC cease-and-desist orders relating to violations of scienter-based anti-fraud provisions of the federal securities laws or Section 5 of the Securities Act.

The SEC also adopted a new "reasonable care" exception to the disqualification provisions consistent with Rule 506(d). Thus,

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an issuer will not lose the benefit of Regulation A+ if it is able to show that it did not know, and in the exercise of reasonable care could not have known, of a disqualifying event.

STATE SECURITIES LAWS

While the JOBS Act did not exempt Regulation A+ offerings from state law registration and qualification requirements, it added Section 18(b)(4)(D) to the Securities Act, which states that certain private offering securities are "covered securities" if they are "offered or sold on a national exchange" or "offered or sold to a qualified purchaser."

Invoking preemption of state law regulation of Tier 2 offerings, the SEC cited the limitations on sales of securities in Tier 2 offerings to "qualified purchasers" (both accredited and limited investors) as well as the desire of Congress to make Regulation A+ offerings more useful for capital raising.

The SEC also noted that federal regulatory preemption does not impact other powers that the states retain, including:

- Jurisdiction to investigate and bring enforcement actions with regard to fraudulent transactions and unlawful conduct by broker-dealers.
- The power to require issuers to file any document filed with the SEC together with a consent to service of process and a filing fee.
- The power to enforce filing and fee requirements by suspending offers and sales. ■