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The JOBS Act…It's Not All About Crowdfunding

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In an effort to revitalize the initial public offering (IPO) market and enhance the ability of small businesses to raise capital, President Obama signed into law the Jumpstart our Business Startups Act, also known as the JOBS Act. While crowdfunding has received much attention, other aspects of the JOBS Act will have a significant positive impact on capital raising activities for both public and private companies. The JOBS Act modifies existing securities regulations in several ways, including:

- creating a new category of issuer called the "emerging growth company," which will be subject to less stringent IPO requirements;
- amending Regulation D of the Securities Act to remove the prohibition against general solicitation or advertising for sales to accredited investors under Rule 506;
- modifying Regulation A of the Securities Act to increase the maximum offering amount to $50 million and provide that securities issued under Regulation A will, in certain circumstances, be "covered securities" under the National Securities Market Improvement Act (NSMIA); and
- increasing the trigger for issuers to register under the Exchange Act from 500 to 2,000 holders of record.

The new law takes effect in various stages, as follows:

- EGCs, the IPO on-ramp and changes to the Exchange Act thresholds are effective immediately.
- Changes to Regulation D will take effect upon the Securities and Exchange Commission (SEC) adopting final rules to implement such changes. The SEC was unable to adopt final rules by July 4, 2012, which was mandated under the JOBS Act, but it has included the consideration of such rules as an agenda item at its open meeting to be held on August 22, 2012.
- Changes to Regulation A will take effect upon the SEC adopting final rules to implement such changes. The JOBS Act does not mandate any deadline for these changes.

IPO On-Ramp and Emerging Growth Companies

The JOBS Act creates a new type of category called an "emerging growth company" (EGC), which is a company that has less than $1 billion in annual revenues during its most recently completed fiscal year. An EGC will retain its status until (1) the last day of the first fiscal year in which it had $1 billion or more of annual gross revenues, (2) the last day of the first fiscal year following the fifth anniversary of its IPO, (3) the date on which it has issued more than $1 billion in non-convertible debt (over the previous three-year period), or (4) the date on which it is deemed to be a large accelerated filer.

Although many publicly traded companies meet the requirements set forth above, any company that has sold equity securities pursuant to an effective registration statement prior to December 8, 2011 is ineligible to qualify as an EGC. As a result, this will have no impact on most existing public companies.

Advantages of Being an EGC

An EGC may confidentially submit its registration statement to the SEC for review. This is a marked change from the previous practice of publicly filing all registration statements and all correspondence with the SEC prior to going effective, with any bumps in the road during the registration process being available for public view and scrutiny. Under the new confidential process, an EGC can address any issues with the registration statement before the document is made public. If the EGC chooses to proceed with the IPO, it must publicly file the registration statement at least 21 days prior to any road show.

EGCs may also "test the waters" through expanded use of pre-filing communications to qualified institutional buyers or institutional accredited investors. Under the new law, issuers can gauge institutional investors' interest in the offering prior to publicly filing a registration statement with the SEC. Although issuers will have greater ability to communicate with potential investors prior to any offering, the anti-fraud provisions of the securities laws will

continue to apply to such communications. EGCs can also take advantage of certain items applicable to smaller reporting companies, including exemptions from the mandatory "say on pay," "say on frequency" and "say on golden parachute" advisory votes, along with certain smaller reporting company scaled disclosure, including filing of two years of audited financial statements rather than three years and an exemption from the auditor attestation report. Finally, EGCs are not required to comply with any new or revised financial accounting standard until such standard becomes broadly applicable to private companies and are not subject to rules requiring mandatory audit firm rotation. EGCs are not required to take advantage of the exemptions available to them and may choose instead to "opt-in" to the disclosure requirements that are applicable to non-EGCs.

General Solicitation and Regulation D

Title II of the JOBS Act requires the SEC to remove the prohibition against general solicitation and general advertising in offerings and sales pursuant to Rule 506 under Regulation D of the Securities Act, provided that all of the purchasers of securities sold in these offerings are accredited investors. Unlike the current standard under Rule 506, which requires that issuers "reasonably believe" that each investor is accredited, the JOBS Act creates a potentially more stringent requirement by requiring issuers to take reasonable steps to "verify" that potential investors are accredited. The ramifications of this new threshold will not be known until the SEC adopts final rules implementing the new standard.

The JOBS Act provides an exemption from broker-dealer registration requirements for persons who perform certain activities in a Rule 506 offering. These activities include maintaining online or other platforms to assist issuers in the offering of securities, co-investing in the securities and providing ancillary services, such as due diligence and document services, in connection with the offer and sale of the securities.

The anti-fraud provisions of the Securities Act remain applicable to Rule 506 offerings and all advertisements and solicitations should be made with this in mind. While the JOBS Act specifically addresses Rule 506, it remains unclear whether advertisements or general solicitation will be allowed outside of a Rule 506 offering, such as, for instance, offerings conducted under Section 4(2) of the Securities Act. The SEC failed to meet the July 4, 2012 deadline to adopt rules addressing these issues, but it has included the consideration of such rules as an agenda item at its open meeting to be held on August, 22, 2012.

Regulation A

The JOBS Act directs the SEC to amend Regulation A under the Securities Act to incentivize companies to take advantage of the small public offering exemption. Historically, Regulation A was not widely used because offerings were limited to a maximum of $5 million during any 12-month period and securities issued in Regulation A offerings were subject to compliance with often burdensome state blue sky laws.

The JOBS Act increases the maximum offering amount under Regulation A to $50 million in any 12-month period and provides for securities issued pursuant to Regulation A to be "covered securities" under NSMIA, meaning that state blue sky laws are preempted, so long as the securities are either offered or sold on a national securities exchange or to qualified purchasers, which term must be defined by the SEC.

The JOBS Act allows the SEC to set terms and conditions in connection with a Regulation A offering, including requiring issuers to prepare, distribute and file an offering statement with the SEC that provides a description of the issuer's financial condition, including audited financial statements, business operations, use of proceeds and corporate governance principles. In addition, the SEC may require periodic statements setting forth the same or similar information in addition to the audited financial statements that must be submitted to the SEC annually by each issuer that conducts an offering under Regulation A. Finally, the JOBS Act directs the SEC to identify the persons who are disqualified from relying on Regulation A, which must be substantially similar to the "bad actor" disqualification requirements in Rule 506, which the SEC is required to promulgate under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank).

Since the JOBS Act does not specify how long the SEC has to adopt rules that implement the new exemption, it remains unclear when the benefits of the newly revised Regulation A will be available.

Exchange Act Registration Thresholds

The JOBS Act increases the thresholds under the Exchange Act pursuant to which issuers that are not banks or bank holding companies are required to become a reporting company. Effective immediately, an issuer must register a class of equity securities if its total assets exceed $10 million and a class of its securities is held of record

by either 2,000 persons or 500 persons who are not accredited investors. For banks and bank holding companies, the new threshold is 2,000 or more record holders.

The definition of "held of record" has been modified to exclude (1) stockholders who received securities under an equity compensation plan in a transaction exempt from registration even if they are no longer employees of the issuer, and (2) stockholders who acquired securities under the new crowdfunding exemption provided by the JOBS Act. The threshold for issuers that are not banks or banking holding companies to de-register was not increased and remains at 300 record holders (500 if the issuer has less than $10 million assets). The threshold for banks and bank holding companies to deregister has been increased from 300 to 1200 record holders.

While the new Exchange Act threshold and modified definition of "held of record" provides significant benefits to widely held, private companies by allowing them to defer public reporting for a longer period of time, they may also present additional challenges with respect to administrative costs and stockholder relations given the greater number of stockholders and different "held of record" classifications for such stockholders.

What's Next?

Although the JOBS Act imposes significant changes to the securities laws, business will change little in the near term. The more significant changes will evolve over a period of time as issuers become more familiar with the new laws and the SEC adopts new rules. Certain aspects of the JOBS Act, such as the IPO On-ramp and the Exchange Act stockholder thresholds, took effect immediately. Others, such as the changes to Regulation D and Regulation A, will not be effective until the SEC adopts final rules to address such changes. Given that the SEC is still in the process of adopting rules to reflect the changes required by Dodd-Frank, and has already missed the July 4, 2012 deadline to adopt new rules regarding general solicitation, it appears issuers will be unable to take advantage of certain aspects of the JOBS Act for an extended period of time. SEC Chairman Mary Shapiro indicated in her recent testimony to a House committee that the SEC has made significant progress and expects to accomplish its objective "in the very near future." The SEC has included the consideration of the new general solicitation rules as an agenda item at its open meeting to be held on August 22, 2012. We will be watching these developments closely.

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