BRYAN CAVE
A Broader Perspective
Bulletin

Corporate Finance and Securities Client Service Group

To: Our Clients and Friends April 6, 2012

JOBS Act Reduces Securities Law Burdens on Startups and Capital-Raising

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the JOBS Act), intended to ease securities law burdens on startups and capital-raising. Many of the Act's provisions are effective immediately. Others require SEC rulemaking, some of which must be completed as early as July 2012 with others as late as 2013. A copy of the Act can be accessed **here.** A copy of our prior client alert on the SEC's advisory recommendations for Rule 506 changes can be found **here**.

Highlights of the new Act are:

- Emerging growth companies should find it easier to go public and will have a transition period to satisfy the full requirements of reporting public companies;
- General solicitation will be permitted in Rule 506 and 144A offerings;
- Crowdfunding will be permitted, up to $1 million, subject to extensive disclosure and reporting obligations;
- A new exemption paralleling Regulation A will be added with a ceiling of $50 million (instead of $5 million); and
- The maximum number of shareholders for a private company has been increased to 2,000 (up to 500 who are not accredited investors).

Emerging Growth Companies

The Act created a new category of companies called "emerging growth companies" (EGCs) which will be exempt from certain securities requirements.

An EGC is generally defined as any issuer (but not including companies that first sold common equity pursuant to an effective registration statement on or before December 8, 2011) that has less than $1 billion of total annual gross revenues. An EGC is entitled to certain securities law exemptions for the five-year period after its IPO. An EGC will lose that status prior to the end of the five year period if it: (1) exceeds $1 billion of total annual gross revenues, (2)

becomes a large accelerated filer (i.e., $700 million + of public float) or (3) issues more than $1 billion of non-convertible debt in a 3-year period.

An EGC is exempt from a variety of requirements relating to the IPO process and the legal standards applicable to a public company, including the following:

- The Streamlined IPO Process for an EGC.

  - *Only 2 Years of Audited Financials, Instead of 3.* An EGC only needs to include two years of audited financial statements in its IPO registration statement, instead of three years. In any other future registration statement or periodic report, the EGC would not have to provide financial statements or selected financial data from periods prior to the periods included in its IPO registration statement.

  - *Certain Pre-IPO Communications Permitted.* An EGC will be permitted to "test the waters" by communicating with qualified institutional buyers (QIBs) or institutions that are accredited investors before the EGC's initial IPO registration statement is filed, something that has generally been restricted by the "gun-jumping" rules.

  - *Eased Restrictions on Research Reports.* Broker-dealers participating in the IPO of an EGC are now permitted to publish and distribute research reports without regard to black-out periods, whether before or after the registration statement has been filed or become effective, and the bank's research analysts are now permitted to join meetings between the company and the investment bankers.

  - *Confidential Initial Filing of Registration Statement.* An EGC may file its draft IPO registration statement with the SEC on a confidential basis for review by the SEC, provided that the registration statement is publicly filed at least 21 days before the company conducts a road show.

- Exemptions For the First 5 Years After an EGC's IPO.

  - *Exempt from Sarbanes-Oxley 404(b) Attestation Reports.* An EGC is exempt from Section 404(b) of Sarbanes-Oxley, which requires a company's auditor to attest to management's assessment of internal controls. Until now, this exemption was available only for smaller reporting companies and non-accelerated filers.

  - *Exempt from Dodd-Frank "Say on Pay".* An EGC does not have to hold a "say-on-pay", "say-on-frequency" or "say-on-golden parachute" shareholder vote, and it may be able to avoid such votes for up to three additional years after it loses EGC status in some cases. An EGC also will not be required to provide the "pay-for-performance" graph with respect to executive compensation nor the ratio of CEO pay to the median pay of all other employees that are currently scheduled for SEC rulemaking.

  - *Reduced CD&A Disclosure.* An EGC only needs to include in its Compensation Discussion and Analysis the level of disclosure required for a smaller reporting company, which means that the required narrative discussion of compensation will be substantially reduced.

- *Lenient Deadlines for New GAAP Measures.* If new or revised GAAP standards are adopted in the future and if private companies are afforded a delayed deadline for complying with such standards as compared to public companies, then EGCs will be afforded the same delayed deadline as private companies.

- *Lenient Deadlines/Applicability for New PCAOB Measures.* If the PCAOB issues new rules in the future requiring mandatory audit firm rotation or requiring a supplement to the auditor's report providing additional information about the audit and the financial statements, then EGCs shall be exempt from such rules. Further, future PCAOB rules will not apply unless the SEC determines otherwise "after considering the protection of investors and whether the [rule] will promote efficiency, competition, and capital formation."

The provisions of the Act relating to EGCs are effective immediately.

General Solicitation Will Be Permitted in Rule 506 and 144A Offerings

The Act requires the SEC to revise Regulation D to lift the ban on "general solicitation or general advertising" for offers and sales made pursuant to Rule 506 under Regulation D, provided that all purchasers of the securities are accredited investors.

Among the provisions of the Act regarding these changes are the following:

- Issuers will be required to take reasonable steps to verify that purchasers are accredited investors.

- Rule 506 will continue to be treated as a regulation issued under section 4(2) of the Securities Act of 1933.

- A third party maintaining a platform or website for purposes of advertising, offering and selling securities pursuant to a valid Rule 506 offering will not be required to register as a broker-dealer, provided that the third party does not receive compensation in connection with the sale of securities, does not possess customer funds or securities in connection with the offering and has not run afoul of certain "bad boy" disqualifying provisions.

- Similar changes will be required to be made to Rule 144A to allow general solicitation and general advertising, including to investors other QIBs, provided that securities are sold only to investors that the issuer reasonably believes are QIBs.

The elimination of the ban on general solicitation may be the most important provision of the Act. Rule 506 already contains no dollar limitation, is available to both public and private companies, requires no specific disclosure to accredited investors (although anti-fraud rules apply) and is one of the most common methods of conducting a private placement. The ban on general solicitation generally meant that companies had to rely on raising capital only from accredited investors with whom they had a pre-existing relationship and had to be very careful to avoid the vaguely defined bans on "general advertising" and "general solicitation." As a result of the change, Rule 506 offerings should become even more accessible.

The SEC is required to issue an updated Rule 506 and Rule 144A to implement these provisions within 90 days.

Crowdfunding

The Act creates a new, limited exemption under Section 4(6) of the Securities Act of 1933 from registration for domestic, private companies for "crowdfunding", which generally refers to the process of raising money by obtaining small investments from a large number of investors. Significantly, the exemption is not available to existing reporting public companies or investment companies. Under the exemption, an issuer may now raise up to $1 million in any 12-month period from an unlimited number of investors, in small amounts, whether or not such investors are accredited, through an intermediary such as a registered funding portal. The exemption has extensive requirements and limitations.

Key provisions of the exemption, include the following:

- *Issuers limited to $1 million in 12 months.* The aggregate amount sold by the issuer in a 12-month period may not exceed $1 million.

- *Investors limited to small amounts.* No investor may purchase more than a certain dollar amount (whether or not from the same issuer) in any 12-month period, determined as follows:

    - For investors with an annual income or net worth of $100,000 or less, each such investor is limited to investing the greater of $2,000 or 5% of his or her annual income or net worth; and

    - For investors with an annual income or net worth more than $100,000, each such investor is limited to investing 10% of his or her annual income or net worth, but not more than $100,000.

- *Transaction must be through intermediary.* The offering must be conducted through an intermediary—either a registered broker or a registered funding portal. The intermediary must provide certain disclosure about the offering as the SEC may determine and it must take affirmative steps to, among other things, ensure investor education, eligibility and suitability, as well as to reduce the risk of fraud by the issuer.

    - An intermediary that is a registered funding portal cannot offer investment advice, solicit sales of securities or compensate its salespeople based on sales of securities; hold, manage, possess or otherwise handle investor funds or securities; or engage in any other activities that the SEC determines by rule.

- *Issuer requirements.*

    - Significant disclosure requirements. The issuer must file with the SEC and make available to the intermediary and potential investors certain information, including a business plan, disclosure on use of proceeds, targeted offering amount and deadline for reaching the target, regular updates on the progress towards reaching the target, offering price, risks to investors, description of the ownership and capital structure, terms of the securities offered and other information required by SEC rules.

- Financial information. The issuer must file with the SEC and make available to the intermediary and potential investors the following financial information:

    - Where the targeted offering amount (including other offerings under the exemption in the prior 12 months) is $100,000, or less, the issuer must provide its (i) tax returns for the most recent year and (ii) financial statements, which shall be certified by the CEO;

    - Where the targeted offering amount is more than $100,000, but not more than $500,000, the issuer must provide financial statements reviewed by an independent public accountant; and

    - Where the targeted offering amount is more than $500,000, the issuer must provide audited financial statements.

- No outside advertising. An issuer may not advertise the terms of the offering, except for notices directing investors to the intermediary.

- Limits on compensation. The issuer may not compensate any person for promoting the offering, without taking steps as the SEC may determine by rule.

- Annual SEC reporting. The issuer must file annual reports with the SEC with results of operations and financial statements as the SEC will determine by rule and must comply with the other requirements the SEC may determine by rule.

Generally, securities purchased by investors will be restricted and may not be transferred by the purchaser for one year after acquisition, with limited exceptions. Moreover, the Act clarifies that issuers and issuers' officers and directors may be subject to private rights of action by purchasers under Section 12(a)(2) under the Securities Act of 1933 in respect of crowdfunding offerings.

Although the crowdfunding portions of the Act have received considerable media attention, the significant limitations on crowdfunding outlined above call into question how widespread its use will be. We note that previously issuers were able to raise up to $1 million from an unlimited number of investors under Rule 504. Rule 504 is seldom used, however, in part because it does not preempt state blue-sky laws. In contrast, securities sold under the new Section 4(6) crowdfunding exemption will be considered "covered securities" for purposes of Section 18 of the Securities Act of 1933, thus providing pre-emption of much of state blue sky laws.

The crowdfunding portion of the Act is the portion that requires the most SEC rulemaking. Although the amendments authorizing the crowdfunding exemption are effective immediately, the new exemption will not be available, for practical purposes, until the SEC finishes its rulemaking process. The rules are required to be issued by the SEC within 270 days.

Ceiling for Regulation A Offerings Raised From $5 Million to $50 Million

The Act amends the Securities Act of 1933 to require the SEC to provide a new exemption under Section 3(b) the Securities Act of 1933 which provides a parallel exemption to traditional Regulation A offerings for an offering of equity, debt or convertible debt. Key provisions of the new exemption include the following:

- The issuer may raise up to an aggregate of $50 million in any 12-month period.

- The securities may be offered and sold publicly and will not constitute "restricted securities."

- The issuer may solicit interest in the offering prior to filing any offering statement, subject to terms and conditions as the SEC determines.

- The issuer is required to file audited financial statements with the SEC annually.

- The SEC may issue rules requiring an issuer to file periodic disclosures with the SEC regarding its business operations, financial condition, corporate governance principles and use of investor funds.

- In order for the offered securities to be exempt from certain state blue-sky laws, the securities have to be offered or sold on a national securities exchange or to a qualified purchaser.

Originally, Regulation A was intended to be a mechanism for non-reporting companies to make small offerings to the public (i.e., less than $5 million). Such companies were required to file an offering statement and certain exhibits with the SEC and wait for SEC qualification.

The availability of this parallel exemption to Regulation A depends on the issuance of relevant SEC rules. It is uncertain how soon the SEC will issue such rules, however, as Congress did not specify a deadline for issuance of SEC rules for this portion of the Act.

Maximum Number of Shareholders in Private Company Increased to 2,000

Pursuant to the Act, a private company with more than $10 million of assets will still be limited to a maximum number of shareholders before being required to register its securities and begin periodic reporting with the SEC. Now, however, the maximum number of shareholders has increased and the manner in which such maximum number is calculated has also changed. Specifically, under the Act:

- Instead of 500 shareholders of record at fiscal year end, the new limitation at fiscal year end is either 2,000 persons or 500 persons who are not accredited investors.

- No shareholder who received his or her shares pursuant to an employee compensation plan in a transaction exempt from registration under the Securities Act of 1933 will be counted toward the 2,000 or 500 limits.

- No shareholder who received his or her shares pursuant to the crowdfunding exemption will be counted toward the 2,000 or 500 limits.

The foregoing provisions of the Act are effective immediately, although the SEC will be issuing conforming rules and safe harbor provisions.

The trigger on the number of shareholders of record for banks and bank holding companies has similarly increased. Instead of 500 shareholders of record, a bank or bank holding company with 2,000 or more shareholders of record will trigger the threshold for public company registration and reporting. The SEC is required to issue final regulations within one year to implement the changes for banks and bank holding companies.

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