

Securities Law

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News Alert: Signing of JOBS Act Brings Wholesale Reform to Securities Laws With Hope of Facilitating Capital Raising

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Today, April 5, 2012, President Obama signed into law the Jumpstart Our Business Start-ups Act (JOBS Act). This significant legislation substantially changes and liberalizes the landscape for both public and private companies seeking to raise capital. The following is a summary of the major components of the new law. While the Securities and Exchange Commission (SEC) will have the opportunity to shape the implementation of some of the provisions of the JOBS Act through rule and regulation, the JOBS Act will still stand as one of the most significant liberalizations of the securities laws in modern times.

The New Landscape for Emerging Growth Companies and IPOs

Title I of the JOBS Act creates regulatory relief for a new type of issuer—the so-called “emerging growth company” (EGC). An EGC is defined as any issuer with gross revenues of less than \$1 billion during the prior fiscal year. Only companies that have gone public after December 8, 2011, are eligible to be considered EGCs.

EGCs are exempt from:

- Proxy rules requiring shareholder approval of executive compensation pursuant to Section 14A of the Exchange Act;
- Disclosures relating to the relationship between executive compensation actually paid and the financial performance of an EGC;
- Executive compensation disclosures required under the Dodd-Frank Act;
- The requirement of three years of financial statements for initial public offerings, or IPOS (rather, EGCs can present two years of audited financial statements). In addition, EGCs need not provide selected financial data or certain other financial information required of other issuers for any period prior to the earliest audited financials presented in connection with an IPO;
- Compliance with new or revised financial accounting standards until such standards apply to private companies;
- Obtaining a public accounting firm's attestation on management's assessment of internal control evaluation and reporting under Section 404(b) of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley); and
- Mandatory audit firm rotation or supplements to the auditor's report for auditor discussion and analysis under Sarbanes-Oxley.

EGCs also benefit from the other portions of the securities laws applicable to smaller reporting companies, including less robust disclosure requirements than those for larger public companies. EGCs

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are also entitled to permit publication or distribution of research reports by brokers or dealers about the EGCs' initial public offerings without such publications being deemed to be "sales" or "offers to sell" a security, even if the broker or dealer is participating in the registered offering.

In addition, an EGC may communicate with qualified institutional buyers or institutions that are accredited investors in order to determine interest in an IPO either before or after the filing of a registration statement, and an EGC may confidentially submit to the SEC a draft registration statement for confidential nonpublic review, as long as such filings are made no later than 21 days prior to the EGC's first offering road show. This "testing of the market" proposition allows an EGC to both see if an IPO would be successful and obtain initial indications of interest of the potential pricing of an IPO.

An EGC retains its status as an EGC until the earliest of:

- The end of the first year in which it surpasses \$1 billion in gross revenues;
- The end of the fifth year following its sale of common equity securities pursuant to an effective registration statement under the Securities Act;
- The date upon which, over the prior three-year period, it has issued more than \$1 billion of non-convertible debt; or
- The date upon which the issuer is deemed to be a "large accelerated filer" under the Exchange Act.

Liberalizing Communications in Private Offerings

Title II of the JOBS Act relaxes the rules on general solicitation in connection with Rule 144A and Rule 506 of Regulation D offerings. Under current rules, issuers can offer securities in private placements to qualified purchasers and accredited investors without violating the Securities Act so long as, among other things, issuers do not resort to general solicitation of prospective purchasers of securities in their offerings.

The JOBS Act directs the SEC to revise its regulations to permit general solicitation or general advertising of Rule 506 offerings, provided that all the ultimate purchasers of the securities are accredited investors. Further, the SEC is directed to revise Rule 144A of the Securities Act to provide that securities sold under the revised exemption may be offered to persons other than qualified institutional buyers (QIBs) through general advertising and solicitation, as long as securities are sold only to parties that the issuer reasonably believes are QIBs. Persons conducting general solicitation or advertising in accordance with the new exemption are also excluded from having to register as a broker or dealer, subject to standard limitations, such as such person not receiving compensation in connection with the purchase or sale of the offered securities.

Crowdfunding

Title III of the JOBS Act is also known as the "Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act" or "crowdfunding" portion of the JOBS Act. Under the crowdfunding rules, transactions will be exempt from the provisions of the Securities Act if the following requirements are met:

- The aggregate securities sold in a 12-month period must be less than \$1,000,000;
- The aggregate amount of securities that may be sold to any investor during a 12-month period is limited as follows:
 1. For investors with an annual income or net worth of less than \$100,000, the amount of securities sold cannot exceed the greater of \$2,000 or 5% of their annual income or net worth; and
 2. For investors with an annual income or net worth of \$100,000 or more, the amount of securities sold cannot exceed the lesser of \$100,000 or 10% of their annual income or net worth.
- The transaction must be conducted through a proper broker or funding portal.

Requirements to act as an intermediary in a crowdfunding transaction include:

- Registration with the SEC as a broker or funding portal and with applicable self-regulatory agencies; and
- Providing disclosures as required by the SEC and educating investors via standards applied by the SEC.

Requirements for issuers who offer or sell crowdfunded securities include providing certain information in connection with the offering, including information surrounding an issuer's business, insiders and the offering itself.

The issuer whose securities are offered and sold in a crowdfunding offering is also restricted from advertising the offering (other than to direct investors to the intermediary). We expect to see significant SEC regulation of funding portals and compensation of promoters for crowdfunding offerings when the SEC promulgates final crowdfunding regulations.

The JOBS Act also provides investors with express causes of action for material misstatements and omissions by issuers, similar to rights of investors arising in connection with statements in prospectuses for registered offerings.

Investors may not transfer securities purchased through crowdfunding for 12 months, other than to accredited investors or as part of a registered offering or to other standard exempted transferees.

Crowdfunding investors are also excluded from the shareholder cap under Section 12(g) of the Exchange Act, for filing under a registration statement pursuant to Section 12(b) of the Exchange Act.

Increasing the Permissible Size of Regulation A Offerings

Title IV of the JOBS Act directs the SEC to add a new securities exemption for offers and sales of equity and debt securities of up to \$50 million in a 12-month period. This so-called "Super Regulation A" exemption permits general solicitation of any type of investors, whether or not accredited, and provides that the securities issued in reliance on this exemption will not be considered restricted securities for purposes of transferability. The full scope of this exemption will not be clear until the SEC promulgates rules under Title IV, but we believe that the SEC will require a robust offering document to be filed with (and reviewed by) the SEC in advance of commencing an offering in reliance on this

exemption, including audited financial statements. In addition, issuers relying on this exemption for the SEC will have an ongoing obligation to file audited financial statements with the SEC.

Increasing the Threshold for Public Company Registration

Title V and Title VI of the JOBS Act raise the threshold for required registration of issuers under the Exchange Act (and the corresponding obligation to file annual and quarterly reports with the SEC) from 500 shareholders to:

- In the case of banks and bank holding companies (collectively, “Banks”), 2,000 shareholders of record, or
- In the case of issuers other than Banks, either (i) 2,000 shareholders of record or (ii) 500 nonaccredited shareholders of record.

In addition, for purposes of determining whether or not a person is a shareholder of record, Title V specifically excludes securities held by any person who received such securities as part of his or her participation in an employee compensation plan, whereby the original issuance of those securities was otherwise exempt under the Securities Act.

In addition, Banks would be permitted to deregister under the Exchange Act as soon as they had fewer than 1,200 shareholders of record. Issuers other than Banks would still be subject to the requirement of having fewer than 300 shareholders of record prior to being permitted to deregister. The changes in requirements for registration or deregistration do not affect any of the exchanges, including Nasdaq and the New York Stock Exchange. Accordingly, issuers (including Banks) that want to list their securities on such exchanges or retain their listing on such exchanges will have to continue to be registered under the Exchange Act.

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The JOBS Act substantially liberalizes many aspects of the securities offering and registration process for companies. The law's intent is that changes in the securities law will facilitate capital raising by companies and cause downstream growth in the job market and the economy generally. Manatt, Phelps & Phillips, LLP, stands ready to assist you in understanding the new law and to help you to take advantage of the opportunities the JOBS Act presents.

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