



Legislative Update

April 17, 2012

JOBS Act Eases Regulatory Burdens on Capital Raising

President Obama signed the Jumpstart Our Business Startups Act (the "JOBS Act") on April 5, 2012, making significant changes to U.S. federal securities laws and rules that govern the capital formation process in this country. Primarily, the purpose of the JOBS Act is to help ease the regulatory burden of capital raising for startups and smaller companies leading to increased economic growth and job creation.

While several of the JOBS Act provisions are effective immediately, many provisions require the Securities and Exchange Commission (the "SEC") to conduct studies on certain key topics, and issue or amend implementing rules or regulations within the next 90 - 360 days. Consequently, the timing of some rule proposals is uncertain and the full impact of the JOBS Act will remain unknown until all rules and regulations are finalized.

Emerging Growth Companies

Effective immediately, the JOBS Act creates a new class of issuers, labeled "emerging growth companies," that are exempt from certain federal securities regulations. An emerging growth company is one with less than \$1 billion in total annual gross revenues during its most recently completed fiscal year. This status applies to companies with IPOs that occurred after December 8, 2011.

A company's status as an emerging growth company terminates upon the earliest of:

- the first fiscal year following the fifth anniversary of its IPO;
- the first fiscal year after its annual gross revenues are \$1 billion or more;
- the date which it has, during the previous three-year period, issued more than \$1 billion in non-convertible debt; or
- the first fiscal year in which it is deemed to be a "large accelerated filer."

IPO On-ramp Provisions

An emerging growth company may take advantage of the JOBS Act's easier and less expensive process of going public through "IPO on-ramp" provisions that exempt these companies from certain regulations. Once public, an emerging growth company will benefit from reduced regulatory requirements for up to five years or until its status as an emerging growth company is terminated. The IPO on-ramp provisions are effective immediately.

The IPO on-ramp provisions, for example, exempt emerging growth companies from certain federal securities laws regulations. These include the Dodd-Frank Act requirement to have advisory votes on executive compensation and Sarbanes-Oxley's requirement to have an auditor's attestation of internal controls and procedures.

Also, emerging growth companies will only need to provide two instead of three years of audited financials in their IPO registration statements and will be exempt from any future PCAOB rules regarding mandatory audit firm rotation or an expanded auditor report.

The JOBS Act also prohibits certain restrictions on research analysts reporting on emerging growth companies both before and after completion of the IPO. In addition, an emerging growth company may confidentially submit its registration statement to the SEC for review prior to officially filing with the SEC and may also "test the waters" before or after filing by engaging in oral or written communications with potential investors that are either qualified institutional buyers or accredited investors.

General Solicitation and General Advertising

Currently, issuers are prohibited under Rule 506 of Regulation D and Rule 144A under the Securities Act from engaging in general solicitation and advertising in private offerings. The JOBS Act requires the SEC to amend Regulation D to remove the prohibition as it applies to offerings under Rule 506. Also, the SEC will be required to amend Rule 144A to permit securities sold under Rule 144A to be offered to qualified institutional buyers. The SEC must make these revisions within 90 days after

enactment.

These amendments will allow companies to engage in general solicitation and use general advertisements for private offerings made to accredited investors under Rule 506 and for private offerings made to qualified institutional investors under Rule 144A. However, companies must take reasonable steps to ensure the purchaser is either an accredited investor or qualified institutional buyer.

At this time, it appears that the easing of restrictions on general solicitation and advertising will be limited to Rule 506 and Rule 144A offerings and will not apply to Section 4(2) private offerings in general.

Crowdfunding

The JOBS Act creates a new registration exemption under Section 4 of the Securities Act to allow for “crowdfunding,” an avenue for eligible companies to raise capital by selling unregistered securities to an unlimited number of investors up to \$1 million in a 12-month period. These sales are typically conducted through the Internet. The SEC will be required to issue rules to implement crowdfunding within 270 days after enactment.

While companies would be able to raise capital from investors not meeting the “accredited investor” requirements, those investors would be subject to caps based on their annual income or net worth. The aggregate amount of unsecured securities sold to an investor must not exceed:

- the greater of \$2,000 or 5 percent of the annual income or net worth of the investor if either is below \$100,000; or
- 10 percent of the annual income or net worth of the investor if either is above \$100,000.

A company must still make relevant disclosures to investors about itself and the crowdfunding offering, and conduct the crowdfunding transaction through a registered broker-dealer or funding portal (an SEC registered intermediary for the offer or sale of securities). In addition, the company will be required to file basic information with the SEC.

Exemption of Certain Securities

The JOBS Act creates a new registration exemption under Section 3(b) of the Securities Act for certain types of securities (similar to the existing Regulation A exemption). The aggregate amount of exempted securities issued within the past 12 months must not exceed \$50 million and must be in compliance with the SEC’s terms and conditions it deems necessary to protect investors. The securities may be offered and sold publicly and will not be considered restricted securities but rather will be considered covered securities under Section 18(b)(4) of the Securities Act and thus exempt from state blue sky registration requirements if they are offered or sold on a national exchange or to qualified purchasers. The JOBS Act does not specify a timeline when the SEC must issue its new rules and regulations on this provision.

Raised Threshold of Registration

The JOBS Act amends Section 12(g) of the Exchange Act to increase the threshold of holders of record to 2,000 only 500 of whom can be non-accredited investors. Previously, a company would be required to file periodic reports with the SEC if it reached \$10 million in assets and had 500 shareholders and could deregister if the record holder count fell below 300. Securities held by employees who received them under an employee compensation plan or securities issued under the new crowdfunding exemption are excluded from the threshold. The registration provisions apply to banks and bank holding companies but there is no limit on non-accredited investors. The threshold for deregistration once registered will be increased to 1,200 record holders for banks and bank holding companies, but remains unchanged for other companies. The changes will apply to bank and bank holding companies only after the SEC issues the final rules but will apply to other companies immediately.

If you need assistance with any requirements under the JOBS Act or have any questions about this new legislation, the Armstrong Teasdale Corporate Services Group invites you to contact:

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