

## **PRESIDENT OBAMA SIGNS INTO LAW THE JUMPSTART OUR BUSINESS STARTUPS ACT**

### **JOBS Act to have Major Impact on IPO Process, Private Placements and Crowdfunding**

**April 6, 2012**

Yesterday President Obama signed into law the Jumpstart Our Business Startups Act (the “JOBS Act” or the “Act”).<sup>1</sup> The JOBS Act’s stated purpose is to increase job creation and economic growth by improving access to public capital markets for emerging growth companies. The JOBS Act relaxes the disclosure requirements for certain companies going public, provides alternative ways for private companies to raise capital and allows some companies to stay private longer.

#### **Immediate and Significant Reduction in Regulatory Burden for Emerging Growth Companies – IPO Process and Exchange Act Reporting**

The JOBS Act relaxes the initial public offering (“IPO”) procedural process for “Emerging Growth Companies” (“EGCs”) (as defined below) and provides them with a phase-in period for compliance with certain Securities and Exchange Commission (the “SEC”) requirements. In addition, EGCs may capitalize on scaled-back disclosure requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The provisions related to EGCs in the Act are effective immediately.

An EGC is a company that:

- has completed an IPO after December 8, 2011; and
- has less than one billion dollars of total revenue (subject to an adjustment for inflation every five years) in the most recently completed fiscal year.

A company will cease to qualify as an EGC upon the earlier of:

- the last day of the fiscal year when the company has annual gross revenues in excess of \$1 billion;
- the last day of the fiscal year following the 5th anniversary of the company’s IPO;

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<sup>1</sup> The full text of the JOBS Act is available at: <http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf>.

- the date upon which the company issues more than \$1 billion in non-convertible debt during the previous three-year period; or
- the date the company qualifies as a “large accelerated filer” under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) (i.e. the company has a public float of at least \$700 million).

Prospective EGCs may submit a draft of their IPO filings to the SEC for confidential review by its staff, provided that the submissions and all amendments are filed publicly at least 21 days before the EGC begins its road show.

EGCs are afforded relief from certain regulatory burdens currently borne by public companies.

- EGCs need only include two years of audited financials in their IPO registration statements instead of three (and two years of management discussion and analysis and selected financial information). Future periodic reports and registration statements may exclude any financial data from any period earlier than that covered by the IPO registration statement.
- EGCs are not required to hire an auditor to attest to management's assessment of internal control over financial reporting required under the Sarbanes-Oxley Act of 2002.
- EGCs are also exempt from certain accounting requirements, including the mandatory audit firm rotation rules and the rules which require a supplement to the auditor's report.
- EGCs are not required to comply with new or revised audit standards until these standards are also applicable to private companies.

EGCs are also temporarily exempt from soliciting “say-on-pay,” “say-on-frequency” and “say-on-golden parachute” advisory shareholder votes on executive compensation. These issuers will be required to solicit such shareholder votes within three years post-IPO (for issuers that qualified as an EGC for less than two years) and within one year of having lost EGC status (for other issuers). EGCs are also exempt from the CEO pay versus financial performance ratio and CEO compensation to median employee ratio compensation disclosure rules mandated by Section 951(b)(1) of the Dodd-Frank Act, although these provisions have not been adopted by the SEC to date.

EGCs have the option of complying with the scaled-back disclosure requirements for smaller reporting companies regarding executive compensation. This election will, among other things, reduce the number of executive officers for whom compensation disclosure is required to three (instead of five), and exempt an EGC from the requirement to provide a compensation discussion and analysis.

The JOBS Act also reduces or eliminates many restrictions that would otherwise apply to securities offerings by EGCs.

- EGCs may “test the waters” by communicating orally or in writing with potential investors that are qualified institutional buyers and institutions that are accredited investors before and after the filing of a registration statement for the offering.
- Brokers and dealers are permitted to publish and distribute research reports about an EGC that is the subject of a public offering, even if the broker or dealer is underwriting the EGC's public offering.

- The conflict of interest rules generally applicable to the marketing of IPOs and communication between research analysts, investment banking personnel and management do not apply to EGCs.
- Research reports relating to EGCs may be published and distributed during any post-IPO quiet or lock-up periods.

### **Private Placements - General Solicitation and General Advertising Now Permitted in Some Rule 506 and 144A Offerings**

The JOBS Act removes prohibitions on general solicitation and general advertising when private companies conduct offerings under Rule 506 of Regulation D and Rule 144A of the Securities Act of 1933, as amended (the “Securities Act”). The SEC is required to modify Rule 506 of Regulation D and Rule 144A to eliminate the ban on general solicitation and general advertising in private offerings conducted under those rules if all purchasers of securities are accredited investors (for Rule 506 offerings) or qualified institutional buyers (for Rule 144A offerings). The modified rules will require companies to take reasonable steps to verify accredited investor or qualified institutional buyer status. The verification methods companies must use will be determined by the SEC. The JOBS Act also provides that individuals who maintain “platforms or mechanisms” that facilitate private placements under Rule 506 and engage in general solicitation or advertising, co-invest in securities or provide certain “ancillary services” are not required (solely because they maintain a “platform or mechanism”) to register as broker-dealer registration under the Exchange Act, subject to certain conditions.

### **The New Crowdfunding Exemption**

“Crowdfunding” is a method of raising capital in which the Internet is used by non-public domestic companies to publicly solicit a large number of small investments from individual investors. The JOBS Act creates a new crowdfunding exemption from registration under the Securities Act. Companies using this exemption must provide information on their financial status, business plan, risks to shareholders and other matters. Significant requirements also are imposed on intermediaries in these offerings. Key conditions to this exemption include, among others:

- The aggregate amount sold to all investors, including amounts sold in reliance on the crowdfunding exemption during the preceding 12 month period, may not be more than \$1 million.
- The aggregate amount sold to any investor, including amounts sold in reliance on the crowdfunding exemption during the preceding 12 month period, does not exceed:
  - For an investor with either an annual income or net worth less than \$100,000, the greater of \$2,000 or 5% of the annual income or net worth of such investor, and
  - For an investor with either an annual income or net worth of equal to or greater than 100,000, 10% of the annual income or net worth of such investor, not to exceed \$100,000.
- Securities issued in a crowdfunding transaction will be “covered securities” and exempt from state blue-sky registration requirements.
- Securities issued in a crowdfunding transaction will be subject to transfer restrictions (with limited exceptions) for one year.

- The issuer may not advertise the offering, although it may issue notices that direct potential investors to the issuer’s designated broker or funding portal.

The SEC must adjust the dollar limitations at least once every five years. The company and brokers or funding portals must also comply with additional requirements that will be laid out by supplementary SEC rulemaking.

In order to rely on the crowdfunding exemption, issuers must file, 21 days in advance of sales, with the SEC and make available to investors and provide to intermediaries basic information about the issuer’s business, including the names of each of its directors and officers and of each individual holding more than 20% of its equity securities, a description of its business, anticipated business plan and financial condition including income tax returns and, for issuers seeking more than \$500,000 in crowdfunding, audited financial statements. An issuer must also provide to investors and the intermediary information about the transaction, including the target offering amount, the deadline to reach the target amount, regular funding progress reports related to the issuer’s progress in reaching the target amount, as well as the final price of the security and a description of the intended use of proceeds. In addition, issuers must also file specified reports with the SEC after the offering has completed.

A crowdfunding transaction must be conducted through an intermediary that is registered with the SEC as a broker or as a “funding portal” (which is defined as any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others pursuant to this exemption that meets certain conditions (including not offering investment advice or recommendations, not handling investor funds, not soliciting purchases, sales or offers to buy securities offered or displayed on its website or portal and not compensating employees, agents and others for such solicitation or based on the sale of securities)) and an applicable self-regulatory organization.

Brokers and funding portals acting as intermediaries in crowdfunding transactions must also comply with considerable disclosure requirements related to risk and other investor education materials and provisions for investor protection, the details of which will be determined by additional SEC rulemaking.

A broker or funding portal conducting a crowdfunding transaction must also, among other things:

- Provide such disclosures, including investor-education materials, as the SEC determines appropriate;
- Ensure that each investor (a) reviews such investor-education information, (b) positively affirms that the investor understands the risks of the investment, and (c) answers questions which demonstrate an understanding of the level of risk generally applicable to investments in startups and small issuers and the risk of illiquidity of such investments;
- Take measures to reduce the risk of fraud (which will be specified by future SEC rulemaking), including obtaining background checks on directors, officers and any person holding more than 20% of the company’s equity securities;
- Make available to the SEC and to potential investors any information provided by the issuer to investors and the intermediary, no later than 21 days prior to the first day securities are sold to any investor;
- Ensure that all offering proceeds are only provided to the issuer only after the aggregate capital raised from all investors is equal to or greater than the target offering amount and allow all investors to cancel their commitments to invest; and

- Take steps, as the SEC determines appropriate, to ensure that no investor in a 12-month period has purchased securities pursuant to the crowdfunding rule in aggregate from all issuers that exceed the investment limits of the rule.

Registered funding portals are subject to limited regulation in the state in which their principal place of business is located. Other states are prohibited from regulating registered funding portals with respect to their business as such.

The SEC must issue rules to carry out the various measures contained in this exemption within 270 days after the date of enactment of the JOBS Act.

### **Increased Regulation A Threshold for “Mini-Public Offerings” from \$5 Million to \$50 Million**

Regulation A provides an exemption from registration under Section 3(b) of the Securities Act for “mini-public offerings” of up to \$5 million that meet certain conditions set forth in Regulation A. However, Regulation A is not available to reporting companies under the Exchange Act.

The SEC must amend Regulation A or create a new exemption from registration, that has the following features:

- Exempts securities offerings of up to an aggregate of \$50 million during any 12-month period (instead of a \$5 million cap). The \$50 million limit is subject to review and increase by the SEC every two years.
- Issuers that rely on amended Regulation A or the new exemption must file audited financial statements with the SEC annually.
- The SEC may also require an issuer relying on amended Regulation A or the new exemption to file with the SEC and make available to investors, periodic disclosures regarding business operations, financial condition and corporate governance structure.
- The JOBS Act clarifies that Regulation A securities are not “restricted securities” subject to restrictions on resale. However, unlike crowdfunding offerings, unless the securities offered under this exemption are offered or sold on a national securities exchange or to qualified purchasers, offerings under the new exemption or amended Regulation A will be subject to state blue-sky securities laws.

### **Increased Shareholder Threshold for Public Reporting**

Currently, companies must register under the Exchange Act once their assets at year-end exceed \$10 million and their shares are held of record by more than 500 persons. Effective immediately, the JOBS Act will increase the threshold for shares held of record to 2,000 persons in total or 500 persons who do not qualify as accredited investors. However, under the JOBS Act, shareholders who obtained securities in a crowdfunding transaction and shareholders who acquire securities pursuant to the company’s employee compensation plans in an exempt transaction are not counted against the shareholder threshold.

The JOBS Act further requires the SEC to examine whether new enforcement tools are necessary to enforce the anti-evasion provisions contained in the rules implementing the shareholder threshold. These provisions allow beneficial owners of securities to be deemed the record owners for the purpose of counting against the shareholder threshold in situations where the issuer knows or has reason to know that the structure of holding

securities of record is used primarily to circumvent the shareholder threshold (for instance, securities held by special purpose vehicles). The SEC is required to give its recommendations to Congress within 120 days.

The JOBS Act will also increase the current shareholder threshold for banks and bank holding companies from 500 shareholders to 2,000 shareholders. Banks and bank holding companies will be permitted to terminate or suspend registration and reporting requirements if the number of shareholders of record is reduced to fewer than 1,200 shareholders of record. As with private companies, persons who received shares pursuant to crowdfunding transactions and exempt transactions under the company's employee compensation plan do not count toward the 2,000 shareholder threshold.

### **Contact Information**

We will continue to monitor SEC rulemaking concerning the various provisions under the JOBS Act. If you have any questions regarding JOBS Act, please contact Gabrielle M. Witt (<http://www.wcsr.com/lawyers/gabrielle-m-witt>), the principal drafter of this client alert, or you may contact the Womble Carlyle attorney with whom you usually work or one of our Corporate and Securities attorneys at the following link: <http://www.wcsr.com/profSearch?team=corporateandsecurities>.

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