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News Alert: President Obama Signs New Capital Formation Bill

As a service to our clients and friends, the Bilzin Sumberg Corporate & Securities Group shares the following information concerning new legislation that dramatically changes how businesses are able to raise capital.

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the "JOBS Act"). The JOBS Act is important new legislation intended to spur job creation and economic growth by improving access to capital. A summary of the JOBS Act's most significant provisions is provided below.

Relaxed Manner of Offering Restrictions on Private Placements

The JOBS Act eliminates the prohibition on widespread advertising and other forms of general solicitation in private securities offerings under Rule 506 of Regulation D or Rule 144A under the Securities Act of 1933 (the "Securities Act"), so long as all purchasers of the securities are accredited investors (under Rule 506) or qualified institutional buyers (QIBs) (under Rule 144A). Since the 1970's, advertising or general solicitation of prospective investors (for example, by publishing information about a private offering on the Internet or in any other communication that is published or broadcast) has not been permitted in private securities offerings until now. The JOBS Act adds a requirement for issuers of securities to take reasonable steps to verify that purchasers are accredited investors or QIBs, as applicable, using methods to be determined by the Securities and Exchange Commission (the "SEC"). Previously, issuers were permitted to rely on investors self-certifying that they qualify as an accredited investor or QIB. The JOBS Act directs the SEC to amend its rules to effectuate these changes by July 4, 2012 (within 90 days after enactment).

Related to the relaxed manner of offering restrictions on private placements, the JOBS Act clarifies that Internet-based and other platforms that match prospective investors with businesses raising capital will not be required to register as a securities broker due to their matching services in connection with securities offered and sold in compliance with Rule 506. However, this exemption is available only if the matching service and its associated persons do not receive compensation in connection with the purchase or sale of securities, do not hold customer funds or securities and are not subject to "bad actor" disqualifications.

Crowdfunding

Pursuant to a new exemption under Section 4 of the Securities Act, issuers will, without Securities Act registration, be able to publicly offer and sell up to $1 million (subject to inflation adjustments by the SEC every five years) of securities in "crowdfunding" transactions within a 12-month period, subject to the restrictions described below. "Crowdfunding" or "crowdsourced funding" is a new outgrowth of social media that allows businesses to raise money from investors over the Internet, whether or not they qualify as accredited investors.

- The issuer must be organized under the laws of a U.S. state or territory and must not be a public company or an investment company.

- The amount any individual investor may invest must not exceed (1) the greater of $2,000 or 5% of the annual income or net worth of the investor, as applicable, if either the annual income or net worth of the investor is less than $100,000, and (2) 10% of the annual income or net worth of the investor, as applicable, not to exceed a maximum aggregate investment of $100,000 by the investor, if either the annual income or net worth of the investor is equal to or more than $100,000. These dollar amounts are subject to inflation adjustments by the SEC every five years.

- An intermediary, either a securities broker or "funding portal," must be used in the transaction and the intermediary must, among other things, be registered as such with the SEC, be registered with any applicable self-regulatory organization, ensure that investors understand the risks of the investment and ensure that investors can bear the burden of possibly losing all of his or her investment, conduct a background check on officers, directors and significant equity holders of the issuer, ensure that no investment limits are exceeded and comply with any other requirements the SEC may prescribe. Funding portals in crowdfunding transactions will not be required to register as securities brokers so long as they remain subject to the authority of the SEC, are a member of a national securities association and meet additional requirements to be determined by the SEC.

- Issuers who engage in crowdfunding will have to file with the SEC and provide to potential investors and the intermediary certain specified information, including a description of the issuer's business and anticipated business plan, a description of the issuer's financial condition, financial statements (which must be either certified by the issuer's principal executive officer, reviewed by an independent accountant or audited, depending on amount being raised), a description of the intended use of proceeds and a description of the ownership and capital structure of the issuer. Issuers will need to specify a target offering amount and a deadline to reach the target offering amount, and will need to provide regular updates on their progress in meeting the target offering amount.

- Investors who purchase securities offered pursuant to the crowdfunding exemption have a private right of action for rescission for material misstatements or omissions. "Issuers" for liability purposes includes directors or partners of the issuer, the principal executive officers, principal financial officer, controller or principal accounting officer and any person who offers or sells securities in the offering.

- Issuers must not advertise the terms of the offering, except for notices that direct investors to the intermediary. Issuers may not compensate anyone for promoting the offering through the intermediary's communication channels without taking such steps as the SEC will determine by rule in order to ensure that the promoter's compensation is disclosed to investors.

- Issuers must file ongoing reports with the SEC, including financial statements, subject to rules, exceptions and termination dates to be determined by the SEC.

- Investors may not resell securities purchased pursuant to the new exemption for one year, beginning on the date of purchase, except to the issuer, to an accredited investor, as part of an SEC-registered offering or to family members or in connection with death or divorce.

The JOBS Act preempts the authority of state securities commissions to require registration and establish offering requirements for securities issued pursuant to the new crowdfunding exemption. The JOBS Act directs the SEC to issue rules implementing the new exemption and establishing bad actor disqualification provisions for both issuers and intermediaries by December 31, 2012 (within 270 days of enactment).

Expansion of Regulation A

Regulation A provides an exemption from registration requirements for public offerings of less than $5 million in any 12-month period. The exemption under Regulation A is sometimes referred to as a short form registration because it requires the filing of an offering statement with the SEC, which is subject to review by SEC Staff and must be delivered to prospective investors. The Regulation A exemption is generally available for any United States or Canadian entity that (i) has its principal place of business in the United States or Canada, and (ii) is not a public company subject to reporting obligations with the SEC. Until now, Regulation A offerings did not preempt the state securities registration laws, which required that they satisfy all applicable state securities law requirements in addition to meeting the federal requirements.

Regulation A was adopted under Section 3(b) of the Securities Act, which gives the SEC authority to exempt securities from registration requirements, provided that the aggregate amount of the securities offered to the public does not exceed $5 million. The JOBS Act amends Section 3(b) of the Securities Act to increase the dollar threshold from $5 million to $50 million, and requires the SEC to review and increase that threshold every two years if the SEC determines appropriate. The JOBS Act also provides that securities sold pursuant to SEC rules adopted under Section 3(b) of the Securities Act will preempt the state securities registration laws if (1) the securities are offered or sold on a national securities exchange, or (2) the securities are offered or sold to "qualified purchasers" (as defined by the SEC).

Higher Shareholder Threshold for Exchange Act Registration

The JOBS Act increases the number of shareholders that can invest in a private company from 500 to 2,000. Section 12(g) of the Securities Exchange Act of 1934 (the "Exchange Act") requires an issuer to register a class of equity securities with the SEC if, on the last day of the issuer's fiscal year, such class of equity securities is held of record by 500 or more persons and the company has total assets of more than $10 million. Upon a company registering a class of equity securities under Section 12(g), all of the reporting and other requirements under the Exchange Act apply with respect to that company.[1]

The JOBS Act amends the registration threshold, with specific requirements for issuers that are banks or bank holding companies and separate requirements for all other issuers. An issuer that is a bank or bank holding company will now become subject to Exchange Act requirements if, on the last day of its fiscal year, the issuer has total assets exceeding $10 million and a class of equity securities held of record by 2,000 or more persons. In the case of a bank or a bank holding company, the issuer will no longer be subject to Exchange Act requirements if the number of record holders falls below 1,200 persons. For all other types of issuers, an issuer will now become subject to Exchange Act requirements if, on the last day of its fiscal year, the issuer has total assets in excess of $10 million and a class of equity securities held of record by

[1] These reporting requirements include the requirement of the issuer to file annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and proxy and information statements on Schedules 14A and 14C, respectively, and the requirement of the issuer's insiders and significant shareholders to file beneficial owner reports.

either (i) 2,000 persons, or (ii) 500 persons who are not accredited investors. An issuer that is not a bank or a bank holding company will no longer be subject to Exchange Act requirements if the number of record holders falls below 300 persons (which did not change from the specified threshold prior to the JOBS Act).

The JOBS Act specifically amended the definition of "held of record" so as to not include securities held by persons who received their securities pursuant to an employee compensation plan in transactions exempt from federal registration requirements. The SEC is required to amend its rules to implement that change in the definition of "held of record." There is no specified time period for those rule amendments. Additionally, the JOBS Act directs the SEC to issue rules by December 31, 2012 (within 270 days of enactment) exempting securities acquired pursuant to the new crowdfunding exemption from the minimum shareholder threshold for Exchange Act registration.

IPO On-Ramp for Emerging Growth Companies

The JOBS Act creates a new category of issuer called an "emerging growth company" (an "EGC"), for which certain disclosures and other requirements will be phased in over a five-year period following the issuer's initial public offering (an "IPO"). An EGC is defined as an issuer with total annual gross revenues of less than $1 billion (subject to inflation adjustments by the SEC every five years) during its most recently completed fiscal year. All companies that qualify as EGCs will have the option to pursue an IPO process that is intended to be more streamlined than what current rules require. EGCs will have up to five years following their IPO to achieve full compliance with certain disclosure regulations and accounting and auditing standards that would otherwise currently apply. Most of the EGC provisions of the JOBS Act are effective immediately.

During the five-year phase-in or "IPO on-ramp" period, an EGC will enjoy the following exemptions from, and modifications of, disclosure requirements and accounting and auditing standards:

- Say-on-Pay – EGCs are exempt from the requirements mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") that issuers seek shareholder approval in an advisory vote on their executive compensation arrangements.

- Exemption from Pay Ratio Compensation Disclosures – EGCs will be exempt from the Dodd-Frank requirement, which remains subject to future SEC rulemaking, to disclose the ratio of the median annual total compensation of all employees other than the chief executive officer to the annual total compensation of the chief executive officer. EGCs are also exempt from making pay versus performance disclosures.

- Reduced Executive Compensation Disclosures – An EGC is allowed to provide scaled disclosures of executive compensation (similar to the disclosures currently required of smaller reporting companies, which are public companies with a market value of outstanding common equity held by non-affiliates of less than $75 million).

- Reduced Audited Financial Statement Requirements and MD&A Disclosures – In registration statements, EGCs are required to provide only two years of audited financial statements (instead of three years). In addition, an EGC need not present selected financial data in registration statements or Exchange Act reports for any period prior to the earliest audited period presented in its IPO registration statement. Similarly, an EGC

is only required to include in registration statements and Exchange Act reports Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) for the fiscal periods presented in the required financial statements.

- Delayed Application of New Accounting Standards – EGCs are not subject to any newly adopted or revised accounting standards unless and until these standards are deemed to apply to companies that are not "issuers" as defined in the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act").[2]

- Internal Controls Auditor Attestation Exemption – EGCs are exempt from the requirement under Section 404(b) of the Sarbanes-Oxley Act that an issuer's independent registered public accounting firm attest to, and report on, the assessment made by an issuer's management on the issuer's internal control over financial reporting.

- Exemption from Mandatory Audit Firm Rotation and Other PCAOB Matters – EGCs are exempt from any future mandatory audit firm rotation requirement and any rules requiring that auditors provide additional information about the audit or financial statements of the issuer (the so-called "auditor discussion and analysis"), which may be adopted by the Public Company Accounting Oversight Board (the "PCAOB"). The PCAOB is considering such rules but has not yet published any related rule proposals. Any other new auditing standards adopted by the PCAOB will not apply to audits of EGCs unless the SEC determines that application of the new requirements to audits of EGCs is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition and capital formation.

- Permitted Investor and Analyst Communications and Research – EGCs and their agents now have more freedom to communicate with potential investors that are qualified institutional buyers or institutional accredited investors, both before and after the filing of a registration statement for an offering of securities. Research analysts also now have greater ability to communicate with investors and with the EGC's management. Research analysts may now attend meetings with the EGC's management at which other broker-dealer personnel, including investment bankers participating in the EGC's IPO, are present, and they are now able to attend investor meetings arranged by investment bankers. Additionally, brokers-dealers, including underwriters participating in the EGC's IPO, are now able to publish and distribute research reports and make public appearances regarding the EGC both prior to and after filing of a registration statement for an offering of common equity securities. All of such communications and research reports were previously prohibited by SEC and self-regulatory organization rules.

- Confidential Filing of Registration Statements – EGCs are now able to submit draft registration statements to the SEC for confidential review instead of filing them publicly on the SEC's EDGAR (Electronic Data Gathering, Analysis and Retrieval) system. These confidential submissions are exempt from Freedom of Information Act requests but have to be filed publicly on EDGAR no later than 21 days before an IPO roadshow begins.

[2] The Sarbanes-Oxley Act generally defines the term "issuer" as a company that issues or proposes to issue any security, and is required to file reports with the SEC or has filed a registration statement that has not yet become effective under the Securities Act and has not been withdrawn.

Under the JOBS Act, an EGC may choose to forgo any of the foregoing exemptions and instead comply with the requirements that apply to all non-EGC issuers. However, an EGC must choose whether it will avail itself of the exemption regarding the extension of time to comply with new and revised accounting standards at the time the company is first required to file a registration statement or Exchange Act report with the SEC. Furthermore, an EGC is not permitted to cherry-pick (or choose to comply with some but not all) the non-EGC accounting standards.

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