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Management Alert

Securities and Exchange Commission Publishes Guidance on JOBS Act

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the "JOBS Act"). The new law eases or eliminates several restrictions on the offer and sale of securities, expands current standards that exempt a company from becoming subject to public reporting and disclosure rules under the federal securities laws, and creates a new category of "emerging growth" companies that may now conduct initial public offerings of stock while being exempt from certain financial disclosure and governance requirements for up to five years. The Securities and Exchange Commission (the "Commission") has published a series of Frequently Asked Questions and interpretative guidance relating to transition rules and the implementation schedule for Commission rulemaking under the JOBS Act. The Commission releases are available online at *http://sec.gov/divisions/corpfin/cfjobsact.shtml*. This alert summarizes the provisions of the JOBS Act and the Commission's guidance with respect to certain transition matters.

Emerging Growth Companies

The JOBS Act defines an Emerging Growth Company (an "EGC") to mean a public company that completes an initial public offering (an "IPO") of its common equity securities after December 8, 2011 pursuant to a registration statement under the Securities Act of 1933, as amended (the "Securities Act"), with "total annual gross revenues" of less than $1 billion. The Commission has issued interpretative guidance clarifying that "total annual gross revenues" means total revenues as presented in the most recent audited, annual income statement in accordance with U.S. GAAP. Foreign private issuers who report revenues in their domestic currency should calculate the amount in U.S. dollars based on the exchange in effect on the last day of the issuer's fiscal year. In addition, the Commission has stated that a company's IPO registration statement under the JOBS would include both a traditional IPO on Form S-1 as well as any other Securities Act registration statement, such as a Form S-8 registering securities to be issued under a compensatory benefit plan or arrangement.

Under the new law, an EGC is only required to include two years of audited financial statements in its IPO registration statement and limits any selected financial data disclosure requirements in periodic reports or registration statements after the IPO to no earlier than the earliest period covered in the IPO registration statement. An EGC also will be exempt from having to solicit advisory say-on-pay, say-on-frequency and say-on-golden-parachute shareholder votes on executive compensation under Section 14A of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and may elect smaller reporting company scaled back disclosure under Item 402 of Regulation S-K with respect to executive compensation disclosures. Notably, this will reduce the number of named executive officers for whom compensation disclosure is required from five to three and also eliminates the requirement for an EGC to provide a compensation discussion and analysis in its proxy statement. The new law also exempts EGCs from the CEO pay versus performance and pay ratio disclosure rules mandated by Section 951(b)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which have not yet been adopted by the Commission.

The Commission has clarified in interpretative guidance that a company that completed its first sale of common equity securities after December 8, 2011 but before April 5, 2012 will qualify as an EGC and may immediately begin to avail itself of the alternative disclosure options for EGCs. In addition, the Commission has stated that it would not object if an EGC that is required to provide 3 years of audited financial statements of a significant subsidiary or acquisition pursuant to Rules 3-05 or 3-09 of Regulation S-X instead elects to only provide two years of such financial statements.

The JOBS Act further provides that the independent auditor of an EGC will not be required to issue the audit attestation report on management's internal control over financial reporting required by Section 404(b) of the Sarbanes-Oxley Act of 2002. In addition, the new law prospectively exempts EGCs from any future audit firm rotation rules that may be adopted by the Commission unless there is a determination by the Commission that application of such rules to EGCs is necessary.

The JOBS Act also creates a streamlined IPO review process for EGCs. Currently, a company's initial IPO registration statement and amendments filed in response to Commission staff comments are immediately publicly available when filed with the Commission. During this 3-5 month process, a company is significantly limited in its ability to communicate publicly with shareholders and is typically inundated with investor communications regarding the timing of the transaction and the status of the registration statement with the Commission. While in registration, IPO companies are often the target of claims by competitors looking to delay or stall the registration process. The new law permits an EGC to submit to the Commission the company's IPO registration statement and any amendments thereto for confidential review and comment prior to publicly filing the registration statement. After the EGC clears its registration statement with the Commission, it must file the IPO registration statement and all amendments thereto at least 21 days prior to commencing a road show for the offering. To safeguard the confidentiality of this process, the new law protects confidential IPO submissions from Freedom of Information Act requests.

A company will be deemed to be an EGC throughout the IPO process if it qualifies as an EGC at the time it files its IPO registration statement, even if it subsequently ceases to be an EGC prior to the registration statement being declared effective by the Commission. The Commission has published interpretative guidance stating that the confidential submission by an EGC of an IPO registration statement for review by the Commission staff is not deemed to be a filing date of the registration statement under Rule 401(a) of the Securities Act. Accordingly, an issuer will be subject to losing its EGC status until it makes a public filing of its IPO registration statement through EDGAR.

Under the new law, an EGC will cease to qualify as an EGC on the earlier to occur of:

- The last day of the fiscal year in which it has total annual gross revenues of $1 billion;

- The five year anniversary of the date the company completed its first sale of common equity securities pursuant to a registration statement under the Securities Act;

- The date on which the company has issued at least $1 billion in non-convertible debt during the previous three-year period; or

- The date the company becomes a large accelerated filer under the Exchange Act (i.e., the market value of its common equity held by non-affiliates is more than $700 million).

General Solicitation in Rule 506 and 144A Offerings

Currently, Rule 506 of Regulation D under the Securities Act permits a company to complete a private placement of an unlimited amount of securities so long as the number of non-accredited investors participating in the offering does not exceed 35 persons. Similarly, Rule 144A provides for the offer and sale of securities to only those persons who are qualified institutional investors ("QIBs"). One of the conditions of any Regulation D or Rule 144A offering is that it be completed without any general solicitation or advertisement of investors. The JOBS Act requires the Commission, within 90 days of

enactment, or July 5, 2012, to amend Regulation D to allow general advertisements or solicitations in connection with Rule 506 offerings so long as the only purchasers in the offering are accredited investors. Within that same 90 day time period, the Commission also must amend Rule 144A to permit general advertisements or solicitations, including to persons who may not be QIBS, provided that sales may be made only to purchasers who are QIBs.

The new law also provides relief for so-called "angel networks" in the form of an exemption from the broker-dealer requirements for persons that do not receive compensation, do not take possession of investor funds or securities in an offering, and are not otherwise an ineligible person under applicable "bad boy" provisions. As long as the conditions are met, a person will not become required to register as a broker-dealer solely because that person (i) helps maintain a platform or mechanism that permits such offer or sale, permits general solicitation, general advertising or similar or related activities by issuers of such securities, (ii) co-invests in such securities, or (iii) provides certain ancillary services only with respect to such securities.

The new law only applies to sales to accredited investors only in a Rule 506 exempt transaction, and does not apply to other exempt transactions pursuant to Regulation D or Section 4(2) of the Securities Act. The JOBS Act also intends for new Rule 506 offerings that involve general solicitations and advertisements to be within the federal preemption of covered securities under Section 18(b)(4)(iv) of the Securities Act, which preempts state regulation of offerings pursuant to Commission rules or regulations issued under Section 4(2) of the Securities Act.

Communications in Connection with an Emerging Growth Company IPO

Title V of the Sarbanes-Oxley Act of 2002 and rules promulgated thereunder currently provide that during the time period leading up to a company's IPO, securities analysts working for the firm performing the IPO are prohibited from publishing or distributing research reports relating to the security or the issuer of the security. The new JOBS Act exempts from this prohibition research reports relating to EGCs and also prohibits the Commission and national securities exchanges from adopting rules restricting any broker or dealer from publishing such reports or making public appearances with respect an EGC after the completion of an IPO by the EGC. The new law further prohibits the Commission and national securities exchanges from adopting any rules restricting the ability of analysts from communicating with management of an EGC or potential investors in an EGC in connection with the EGC's IPO.

In addition, the new law provides that an EGC or any person authorized to act on its behalf (presumably, an underwriter or placement agent), either before or after the filing of a registration statement with the Commission, may engage in oral or written communications with persons who are either QIBS or accredited investors, as such terms are defined in Rules 144A and 501 under the Securities Act, respectively.

Crowdfunding

The JOBS Act creates a new Section 4A of the Securities Act for crowdfunding offerings by private companies. Current public companies subject to reporting under Sections 13 and 15 of the Exchange Act may not rely on the crowdfunding exemption. These types of offerings, which are most commonly used in connection with internet offerings, generally involve investments of small amounts of capital by large numbers of investors. The new exemption applies to offerings that do not exceed $1 million in any 12-month period. If the company is selling between $100,000 and $500,000 in securities pursuant to this exemption, then the company must provide investors with financial statements that have been reviewed by an independent auditor. Companies seeking more than $500,000 in crowdfunding would be required to provide investors with audited financial statements.

The aggregate amount of securities that may be sold to an investor in reliance on the crowdfunding exemption during any 12-month period is limited based on the annual income and net worth of the investor. If either the investor's annual income or net worth (excluding the value of the investor's residence) is less than $100,000, then sales to that investor under the crowdfunding exemption may not exceed the greater of (i) $2,000, or (ii) 5 percent of the investor's annual income, or net worth (excluding the value of the investor's primary residence). If both the investor's annual income and net worth (excluding the value of the investor's residence) is greater than $100,000, then sales to that investor under the crowdfunding exemption

are capped at the greater of (i) $100,000, or (ii) 10 percent of the investor's annual income, or net worth (excluding the value of the investor's primary residence).

Investors who acquire a company's securities pursuant to a crowdfunding exemption will be restricted from reselling those securities for a period of one year except with respect to sales to an accredited investor or the company.

In addition, the new law also expands the definition of federal covered security under Section 18(b)(4) of the Securities Act to include securities issued pursuant to a crowdfunding exemption, thereby preempting state regulation of crowdfunding offerings.

To qualify for the crowdfunding exemption, a company must not offer investment advice and must disclose on its website its interest in the offering and information about how investors may communicate with the company about the offering and how the company intends to communicate with investors about the offering. In addition, a company must:

- Provide adequate disclosure of the speculative nature of investments in startups, emerging businesses and small issues and the restrictions on resale and illiquidity due to a lack of a secondary market;

- Take reasonable steps to reduce the risk of fraud;

- Obtain an investor questionnaire from prospective investors that will demonstrate an investor's understanding of the investment risks;

- Disclose a target offering amount;

- Provide for a third party custodian to hold investment proceeds in escrow until at least 60 percent of the target amount has been raised;

- Provide notice to the Commission no later than the first day a crowdfunding offering is commenced setting forth the purpose and use of proceeds, the target offering amount and the deadline to reach it, and the company's address, website and names of principals and employees;

- Provide the Commission with continuous investor-level access to the company's website; and

- Notify the Commission when the offering has been completed and indicate the number of investors and the aggregate offering amount.

If a company engages a third party intermediary to host a crowdfunding offering for the company on the intermediary's website, then the intermediary is likewise prohibited from offering investment advice and must do the following to meet the requirements of the exemption:

- Provide on its website adequate disclosure of the speculative nature of investments in startups, emerging businesses and small issues and the restrictions on resale and illiquidity due to a lack of a secondary market;

- Take reasonable steps to reduce the risk of fraud;

- Obtain an investor questionnaire from prospective investors that will demonstrate an investor's understanding of the investment risks;

- Provide the Commission with the intermediary's address, website and the names of its employees;

- Provide the Commission with continuous investor-level access to the intermediary's website;

- Require the issuer to disclose a target offering amount;

- Provide for a third party custodian to hold investment proceeds in escrow until at least 60 percent of the target amount has been raised;

- Conduct a background check on the issuer's principals;

- Provide notice to the Commission no later than the first day a crowdfunding offering is commenced setting forth the name, address and website of the issuer, the names of the issuer's principals, the purpose and use of proceeds of the offering and target offering amount and deadline to reach the target;

- Make available on the intermediary's website a method of communication that permits the issuer and investors to communicate with one another; and

- Notify the Commission when the offering has been completed and indicate the number of investors and the aggregate offering amount.

New Section 12(g) Thresholds for Registration

Currently, Section 12(g)(1) of the Exchange Act requires a company to register with the Commission and file periodic reports with the Commission if the company has assets of at least $10 million and a class of equity securities held by more than 500 shareholders of record at the end of a fiscal year. The JOBS Act preserves the $10 million asset component of this standard but amends Section 12(g) of the Exchange Act to raise the shareholder threshold to either 2,000 total shareholders of record or 500 shareholders of record that are not accredited investors. Employees who receive their shares pursuant to an equity compensation plan pursuant to a registration exemption, such as Rule 701 under the Securities Act, would not count toward these limits. The Commission has clarified in interpretative guidance that such holders would continue to be exempt from counting toward the Section 12(g) limits even after they cease to be employees of the issuer. In addition, accredited investors who hold shares that were issued pursuant to the new crowdfunding exemption under new Section 4A of the Securities Act also will not count toward these limits. It is noteworthy that the Commission's interpretative guidance to date does not address when a company is required to determine the accredited investor status of a holder of record of its stock under the amended Section 12(g). Specifically, a company will need to know whether it can rely on a shareholder's certification of accredited investor status at the time the person becomes a shareholder or whether the company must reassess the accredited investor status of its shareholders on an annual basis. Although the legislation covers holders of shares issued pursuant to the new exemption, as written, the exemption would apply to successor transferees in perpetuity.

In addition, currently a company is permitted to deregister its securities with the Commission and "go dark" under Section 12(g)(4) of the Exchange Act if the number of record holders of a class of its equity securities is reduced to less than 300 persons. The JOBS Act amends Section 12(g)(4) to permit banks or bank holding companies to deregister if the number of record holders of a class of its equity securities is reduced to less than 1,200 persons.

Regulation A Limit Increased to $50 million

Currently, a company may conduct an offering of up to $5 million pursuant to an abbreviated offering statement under Regulation A under the Securities Act. The Regulation A offering statement, often referred to as a "mini registration statement," must be filed with the Commission and delivered to investors and must contain certain business and financial information about the company that is substantially less cumbersome than the comparable disclosures required in a registration statement under the Securities Act, such as Forms S-1 or S-3.

The JOBS Act increases the offering limit under Regulation A from $5 million to $50 million and amends Regulation A to permit a company to solicit offers prior to filing the offering statement with the Commission. In addition, the new law expands the definition of federal covered security under Section 18(b)(4) of the Securities Act to include securities issued in a Regulation A offering, thereby preempting States from requiring separate registration of Regulation A offerings that are often currently required.

Although a company will not become subject to periodic reporting with the Commission by virtue of completing a Regulation A offering as is currently the case, the JOBS Act will require a company to file with the Commission annual, audited financial statements after it has completed a Regulation A offering. In addition, the new law also codifies under Regulation A the "bad boy" disqualifications under Regulation D under the Securities Act that were adopted pursuant to Section 926 of the Dodd-Frank Act.

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