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JOBS Act Promises to Improve Access to Capital

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KIRSTIN P. SALZMAN
KANSAS CITY:
816.983.8316
KIRSTIN.SALZMAN@
HUSCHBLACKWELL.COM

Earlier today, President Barack Obama signed the Jumpstart Our Business Startups (JOBS) Act, which has been heralded as a catalyst for "job creation and economic growth by improving access to the public capital markets for emerging growth companies." With national attention focused on job creation, the Jobs Act promises to encourage entrepreneurship by reducing the regulatory burdens on companies seeking to raise capital in U.S. markets. Although certain provisions will take effect immediately, many require the SEC to adopt rules to implement them. Given the backlog on the SEC's current rulemaking docket associated with Dodd-Frank mandates, among others, we do not expect the Security and Exchange Commission (SEC) to act on these new assignments until well into 2013.

Emerging Growth Companies

The JOBS Act seeks to reverse the decade-old decline in initial public offering (IPO) activity by establishing a new category of issuers under the Securities Act of 1933 (Securities Act) and the Securities and Exchange Act of 1934 (Exchange Act) called "emerging growth companies" (EGCs) and to relieve them of the more burdensome restrictions and requirements. An EGC is defined as an issuer with total annual gross revenues of less than $1 billion (indexed for inflation every five years) as of the end of its most recently completed fiscal year. An issuer can remain an EGC until the earliest of (1) the last day of the fiscal year during which it had total annual gross revenues of $1 billion or more, (2) the last day of the fiscal year following the fifth anniversary of its IPO, (3) the date on which it has, in the preceding three years, issued more than $1 billion in non-convertible debt, or (4) the date on which it becomes a large accelerated filer under the Exchange Act.

A company that qualifies as an EGC is eligible for more relaxed regulatory requirements as it prepares for an IPO and in subsequent filings:

Confidential Review of Draft Registration Statements: EGCs may submit draft registration statements to the SEC for confidential review prior to an IPO, as long as its registration statement and all amendments are publicly filed no less than 21 days before the EGC's road show commences.

Husch Blackwell Reaction: This will permit an EGC to consider the possibility of an IPO without disclosing sensitive competitive information until after it has decided to proceed. The recent announcements concerning additional accounting questions at Groupon Inc. have raised concerns that this provision will allow companies to resolve disagreements with the SEC without disclosing the issues to potential investors.

Reduced Audited Financial Statement Requirements and MD&A Disclosures: Under the JOBS Act, an EGC may choose to present two years of audited financial statements in its IPO registration statements and, in subsequent registration statements the management discussion and analysis (MD&A) section need only include an analysis of operations for those years covered by the financial statements. What is interesting is that the JOBS Act does not appear to permit reduced disclosures in an offering of debt securities by a private company, such as Rule 144A offerings. An EGC is also exempt from providing selected financial data pursuant to Item 301 of Regulation S-K for any period prior to the earliest audited period presented in its first registration statement that becomes effective under the JOBS Act.

Executive Compensation: The JOBS Act exempts EGCs from shareholder advisory votes on say-on-pay, say-on-frequency and golden parachute compensation. EGCs are also exempt from several executive compensation disclosures, including pay versus performance disclosure and disclosure of the ratio of the median annual total compensation of all employees to the total compensation of the CEO (which remains subject to SEC rulemaking). EGCs are subject to the same scaled disclosure of executive compensation under Item 402 of Regulation S-K as smaller reporting companies.

Sarbanes-Oxley Exemptions and PCAOB Matters: The JOBS Act exempts EGCs from compliance with the auditor's internal controls attestation under Section 404(b) of the Sarbanes-Oxley Act of 2002 (SOX). EGCs are also exempt from any mandatory audit firm rotation requirement that may be implemented and any requirement to supplement the auditor's report to provide additional information about the audit and the financial statements. EGCs are exempt from any future rules related to audits that the Public Company Accounting Oversight Board (PCAOB) might adopt, unless the SEC determines such rules are otherwise appropriate.

Delayed Application of New Accounting Standards and Opt-In: EGCs are treated as companies that are not issuers and, therefore, are exempt from complying with any new or revised financial accounting standards while they are EGCs if so elected upon becoming an EGC. If an EGC elects to comply with new or revised financial accounting standards, it must elect to comply with all of them. Once an EGC elects to comply, it must continue to do so for as long as it remains an EGC.

Permitted Investor and Analyst Communication; Analyst Research and Reports: Any person acting on behalf of an EGC may now engage in oral or written communications with potential investors that are qualified institutional buyers or institutions that are accredited investors to "test the waters" of a contemplated securities offering before or after the filing of an IPO registration statement. This allows EGCs to avoid substantial costs if they decide not to proceed with an IPO after testing the waters as well as the embarrassment of not successfully completing the offering.

Interestingly, the new law allows associated persons of a broker, dealer or member of a national securities association to arrange for communications between a securities analyst and a potential investor during an IPO. Analysts may now participate during an IPO in any communications with the management of an EGC that is also attended by any other associated person of a broker, dealer or member of a national securities association who is not a securities analyst. This could help EGCs better read the market for their securities.

Furthermore, the JOBS Act exempts publication or distribution of research reports by brokers or dealers about EGCs in the pre- and post-effective periods from the definition of an "offer for sale" or "offer to sell" a security, even when the broker or dealer is participating in the offering. Coverage by analysts could increase an EGC's profile and help support its price after an offering. However, brokers may be reluctant to provide research on EGCs until the disclosures, financial statements and accounting policies for such companies have been reviewed by the SEC. In addition, if pre-deal research is used for an IPO that trades below its IPO price, lawsuits could follow.

Husch Blackwell Reaction: We expect that a number of the advantages provided by this legislation will encourage EGCs to seek access to U.S. capital markets, including reduced costs both during and after an IPO, the ability to pre-market prior to filing an IPO registration statement and the ability to explore an IPO by filing on a confidential basis. What we won't know for some time is whether these changes will reduce investor confidence in such companies as critics claim.

General Solicitation and Broker-Dealer Registration in Certain Private Placements

The JOBS Act relaxes restrictions on private placements by requiring the SEC to modify Rule 506 to allow general solicitation and general advertisements for private placement offerings so long as all purchasers are accredited investors. Issuers would be required to take reasonable steps, as will be prescribed by SEC rulemaking, to verify that purchasers are accredited investors.

The act also requires the SEC to revise Rule 144A of the Securities Act to allow issuers to offer securities by means of general solicitation or general advertising to non-qualified institutional buyers. Actual sales of the securities, however, are restricted to persons that the seller, or anyone acting on behalf of the seller, reasonably believes is a qualified institutional buyer.

In addition, the JOBS Act amends Section 4 of the Securities Act to exempt persons who operate portals that offer and sell securities under Rule 506 from registration as a broker or dealer. The exemption applies even when the portal permits general solicitation or general advertisements, co-invests in the securities offered or sold, or provides ancillary services with respect to the securities, as long as (i) no compensation is received in connection with the purchase or sale of the securities, (ii) the portal does not take possession of customer funds or securities in connection with the purchase or sale of the securities, and (iii) the portal is not disqualified as a "bad actor."

Husch Blackwell Reaction: We believe that lifting the ban on general solicitation and advertisements and exempting portals from broker-dealer registration may give issuers, including hedge funds and private equity funds, greater freedom to market their offerings to the public and thus provide greater access to capital for both public and private companies.

Crowdfunding

A Senate amendment to the JOBS Act referred to as the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012, or the CROWDFUND Act, creates a new exemption from registration under the Securities Act for small offerings of securities to the public over the Internet. This portion of the act amends Section 4 of the Securities Act to allow the offer or sale of securities without registration if the aggregate amount of securities sold by the issuer in the preceding 12-month period does not exceed $1 million. The exemption also caps the aggregate amount of securities that can be purchased by any one investor from issuers during the preceding 12-month period at the greater of $2,000, or 5% of the investor's annual income or net worth if either the investor's annual income or net worth is less than $100,000, and 10% of the investor's annual income or net worth for investors with annual income or net worth equal to or greater than $100,000, up to a maximum of $100,000 sold to such investor.

To qualify for the CROWDFUND Act exemption, an issuer must:

file with the SEC and make available to investors and the broker or funding portal the following information: the name, legal status, physical address and web address of the issuer, names of directors and officers and 20% equity holders, a description of the business of the issuer and the anticipated business plan, a description of the financial condition of the issuer, including information varying by the size of the offering, a statement of the purpose and intended use of the proceeds of the offering, the target offering amount, deadline to reach the target offering amount, regular progress updates on reaching that target, pricing information, and a description of the ownership and capital structure of the issuer;

not advertise the terms of the offering except for notices that direct investors to the broker or funding portal;

not compensate or commit to compensate any person to promote its offerings through a broker or funding portal without ensuring that the person discloses the compensation upon each promotional communication;

impose restrictions on transfer of the securities for one year;

file and provide investors with reports of the results of operations and financial statements at least annually (the content of which the SEC will determine by rulemaking) as determined by the SEC;

not be a public company, an investment company, a foreign company or subject to "bad actor" disqualification; and

comply with any other requirements that the SEC prescribes for the protection of investors and in the public interest.

To qualify for the CROWDFUND Act exemption, intermediaries must:

register as brokers or funding portals with the SEC and any applicable self regulatory organization;

provide disclosures that the SEC deems appropriate by rule;

ensure that investors review investor-education information (to be established by SEC rulemaking) and understand and appreciate the risks of investing in start-ups;

take measures to reduce the risk of fraud (in such manner as will be prescribed by SEC rulemaking);

make information required to be provided by the issuer available to the SEC and potential investors at least 21 days prior to the first sale of the securities;

ensure that all offering proceeds are only provided to the issuer when the aggregate capital meets or exceeds the issuer's target offering amount and allow investors to cancel their commitments to invest (in such manner as will be prescribed by SEC rulemaking);

make efforts to ensure that no investor purchases securities in a 12-month period in excess of the investment limits above (in such manner as will be prescribed by SEC rulemaking);

take steps to protect investor privacy;

not compensate promoters, finders or lead generators for providing the broker or funding portal with personal identifying information of potential investors;

prohibit directors, officers or partners of the intermediaries from having any financial interest in an issuer using its service; and

meet other requirements that the SEC may prescribe by rule for the protection of investors and in the public interest.

Issuers will be civilly liable for material misstatements and omissions under the new exemption and such statements are subject to Section 12(b) and Section 13 of the Securities Act. Additionally, CROWDFUND Act offerings are exempt from state registration, documentation and offering requirements, pursuant to Section 18(a) of the Securities Act. However, these transactions are subject to state authority to take enforcement action with regard to fraud, deceit or unlawful conduct by any issuer, broker dealer or funding portal relying on the CROWDFUND Act exemption.

Husch Blackwell Reaction: Although on its face the CROWDFUND Act appears to facilitate capital formation, we believe that crowdfunding will not become a widespread means of raising capital given the costs involved and the requirement to make certain filings with the SEC, particularly in light of the revisions to Rule 506. Some of the costs include (i) posting the offering on the portal; (ii) fees to third-party promoters (issuers are prohibited from general solicitations); (iii) audited financial statements for offerings over $500,000; (iv) annual shareholder meetings if shareholders have voting rights or the incurrence of attorneys' fees to create a non-voting class of stock, and (v) other implementation costs. With such limited regulatory oversights, some are also concerned that the number of fraudulent offerings that target the less-educated investing public will increase substantially. Some commentators have also suggested that using crowdfunding to raise capital at an early stage may make it difficult for startups to attract private equity investors at the next stage due to the number of shareholders and the reporting requirements with the SEC.

Regulation A Offerings

Title IV of the JOBS Act expands the ability of issuers to sell securities under Regulation A of the Securities Act. Specifically, the SEC is required to add a class of exempt securities that includes equity, debt and convertible debt securities, which:

may have an aggregate offering amount of up to $50 million in the prior 12-month period;

may be offered and sold publicly;

are not restricted securities; and

are subject to Section 12(a)(2) civil liability.

In addition, the exemption must allow the issuer to solicit interest in the offering prior to filing an offering statement in accordance with such rules as the SEC may prescribe in the public interest or for the protection of investors, and the SEC must adopt rules to require the issuer to file annual audited financial statements with the SEC.

The SEC may establish other terms, conditions or requirements related to the exemption that it deems necessary in the public interest or for the protection of investors, including requiring electronic filing and distribution of an offering statement and periodic disclosures and the establishment of disqualification provisions for "bad actors."

The SEC must review the aggregate offering amount every two years and may increase it if deemed appropriate. Finally, the act directs the SEC to conduct a study on state laws that regulate Regulation A offerings to analyze their impacts and to consider possible federal pre-emption of such laws.

Husch Blackwell Reaction: We will be somewhat surprised if this exemption that has been used infrequently becomes considerably more popular given that it still requires filing with the SEC the offering circular and audited financials on an annual basis. We expect other exemptions such as Rule 506 to generate more attention and activity.

Exchange Act Registration Threshold

Finally, the JOBS Act raises the asset and shareholder threshold at which a company is required to register its securities pursuant to Section 12(g)(1)(A) of the Exchange Act. An issuer must register its securities within 120 days after the end of the first fiscal year in which the issuer has total assets exceeding $10 million and more than 2,000 holders of record of its equity securities or 500 non-accredited investors. For purposes of determining whether an issuer has 500 or more non-accredited investors, holders of its equity securities exclude employees who received the securities under an employee compensation plan exempt from the registration requirements of Section 5 of the Securities Act. Persons holding securities under the CROWDFUND Act will not count as holders under Section 12(g) of the Exchange Act as determined by rules to be adopted by the SEC.

Husch Blackwell Reaction: The JOBS Act is silent on how to treat transfers of shares issued under the CROWDFUND Act or transfers by employees. As a result, determination of who qualifies as a shareholder of record at the end of each fiscal year appears to have become much more complicated.

A similar provision applies to banks and bank holding companies, except that the limitation on non-accredited investors does not apply to banks or bank holding companies. Additionally, banks and bank holding companies must only reduce the number of holders of its equity securities to 1,200 in order to terminate the registration of the class of securities.

What This Means to You

In sum, Congress has made it easier for mature start-up companies to access the capital markets and for other issuers to raise the capital necessary to grow in this economic environment. General counsel, public companies, start-up and other private companies, private equity firms, and banks and bank holding companies should consider consulting with their Husch Blackwell attorney about how they may take advantage of these new pathways to accessing capital.

Contact Info

For additional information about this or any other securities and corporate governance subject, please contact your Husch Blackwell attorney.

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