LEGAL UPDATES

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SEC Proposes Rules That Make It Easier to Stay Private

Service

Securities & Corporate Governance

On December 17, 2014, the U.S. Securities and Exchange Commission (SEC) issued proposed rules implementing Title V and Title VI of the Jumpstart Our Business Startups Act (JOBS Act) as mandated by Congress, amending Section 12(g) of the Securities Exchange Act of 1934 (Exchange Act).

What This Means to You

The rules proposed by the SEC will allow private companies to remain private for a longer period of time while continuing to access capital markets and compensating employees through various forms of equity awards.

The SEC has requested public comments on various aspects of these proposed rules. Comments are due by March 2, 2015.

The Proposed Rules

The proposal would implement the JOBS Act mandate by, among other things:

Amending Rules 12g-1 through 12g-4 and 12h-3, which govern the procedures relating to registration and termination of registration under Section 12(g), as well as suspension of reporting obligations under Section 15(d) to reflect the new thresholds established by the JOBS Act.

Applying the definition of "accredited investor" in Rule 501(a) under the Securities Act of 1933 (Securities Act) to determinations as to which record holders are accredited investors for purposes of the new thresholds in Exchange Act Section 12(g)(1). The accredited investor determination would

be made as of the last day of the fiscal year.

Amending the definition of "held of record" in Rule 12g5-1 to provide an exclusion for persons receiving shares pursuant to an employee compensation plan or pursuant to an offering that satisfies the conditions of Rule 701(c).

Increased Thresholds for Registration and Reporting Obligations

The JOBS Act revised Exchange Act Section 12(g) to raise the threshold at which an issuer is required to register a class of equity securities. Prior to the JOBS Act, an issuer was required to register a class of equity securities under the Exchange Act if it had more than $10 million of total assets and a class of equity securities held of record by 500 or more persons. Under the revised threshold, an issuer that is not a bank or bank holding company is required to register a class of equity securities under the Exchange Act if it has more than $10 million of total assets and the securities are "held of record" by either 2,000 persons or 500 persons who are not accredited investors. The threshold for termination and suspension of registration for issuers other than banks or bank holding companies remains unchanged at 300.

Application of the Increased Threshold for Accredited Investors

To rely on the new, higher threshold established by the JOBS Act, as discussed above, an issuer must be able to determine which of its record holders are accredited investors.

Rather than propose a new definition of "accredited investor" for purposes of the new thresholds in Exchange Act Section 12(g), the SEC proposes to use the definition in Rule 501(a) of Regulation D, which is commonly relied on by issuers in unregistered offerings. Under the proposed rules, the accredited investor determination would be made as of the last day of the year rather than at the time of the sale of the securities. As part of this determination, the SEC proposes to permit issuer's to rely upon prior information received by the issuer to form a reasonable basis for believing that the security holder continues to be an accredited investor as of the last day of the fiscal year. We expect this to be an area of interest for commentators seeking clarification of how this can be accomplished.

Exclusion of Shares Issued Under Employee Compensation Plans from the Registration Threshold

Exchange Act Section 12(g)(5), as amended by Section 502 of the JOBS Act, provides that the definition of "held of record" shall not include securities held by persons who received them pursuant to an "employee compensation plan" in transactions exempted from the registration requirements of the Securities Act. This provision, which is substantially broader than the SEC's current rules

exempting compensatory employee stock options from Section 12(g) registration, does not define the term "employee compensation plan." Section 503 of the JOBS Act instructs the SEC to amend the definition of "held of record" as discussed above and to adopt a safe harbor that issuers can use when determining whether holders of their securities received them pursuant to an employee compensation plan in exempt transactions.

The SEC proposes to amend the definition of "held of record" in Rule 12g5-1 to provide that, when determining whether an issuer is required to register a class of equity securities with the SEC pursuant to Exchange Act Section 12(g)(1), an issuer may exclude securities that are either:

Held by persons who received the securities pursuant to an employee compensation plan in transactions exempt from the registration requirements of the Securities Act or that did not involve a sale within the meaning of Section 2(a)(3) of the Securities Act; or

Held by persons eligible to receive securities from the issuer pursuant to Rule 701(c) who received the securities in a transaction exempt from the registration requirements of the Securities Act in exchange for securities excludable under proposed Rule 12g-5-1(a)(7).

The SEC also proposes to adopt a non-exclusive safe harbor under proposed Rule 12g5-1(a)(7) that would provide that a person will be deemed to have received the securities pursuant to an employee compensation plan if such person received them pursuant to a compensatory benefit plan in transactions that meet the conditions of the SEC's exemption for offers and sales made pursuant to a compensatory benefit plan in Rule 701(c).

Contact Us

For more information, please contact an attorney in Husch Blackwell's Securities and Corporate Governance group.