

Public Company Advisor

Practical Insights for Public Company Counsel

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King & Spalding's Public Company Practice Group periodically publishes the Public Company Advisor to provide practical insights into current corporate governance, securities compliance and other topics of interest to public company counsel.

The Jumpstart Our Business Startups Act – Important New Legislation Significantly Eases Capital-Raising Regulation and Reporting Requirements

Overview

The long-awaited Jumpstart Our Business Startups Act (known as the JOBS Act) was overwhelmingly passed by both the Senate and the House last week and is expected to be signed into law this Thursday by President Obama. The JOBS Act significantly changes the regulatory regime for financing transactions at the seed stage, through an IPO, and thereafter.

The JOBS Act seeks to spur job growth by facilitating the financing efforts of emerging growth companies (EGCs), which are generally defined as companies with revenues less than \$1 billion. Most notably, the JOBS Act provides for the following:

- **IPO On-ramp.** The Act makes it easier for an EGC to go public by relaxing initial financial disclosure requirements, allowing EGCs to file with the SEC confidentially, and phasing in the requirement for a public company's auditors to provide an attestation report on internal controls.
- **Investment Banking Research.** The Act eases limitations on investment banking research publications before, during, and after an IPO.
- **General Solicitation.** The Act allows general solicitations in private offerings as long as the solicitations are targeted to accredited investors and qualified institutional buyers.
- **Increased Numerical Threshold to Trigger Reporting Obligations.** The Act raises the threshold for triggering public company reporting requirements prior to an IPO from 500 to 2,000 holders of record or 500 unaccredited investors.
- **Crowdfunding.** The Act legalizes and provides a structure for raising funds from a large number of investors with small individual investments, often referred to as "crowdfunding."

The benefits of the legislation generally would stay in place for any EGC until the earliest of (1) the first fiscal year after annual revenues exceed \$1 billion; (2) the first fiscal year following the 5th anniversary of an IPO; (3) the date on which the issuer has (during the past 3-years) issued greater than \$1 billion in non-convertible debt; and (4) the first fiscal year when the issuer becomes a "large accelerated filer" as defined by the SEC (i.e., \$700 million of public equity float and publicly reporting for at least one year).

IPO "On-ramp"

The JOBS Act has the potential to significantly increase IPO activity, swinging the regulatory pendulum back towards the pre-Sarbanes-Oxley era and removing capital raising obstacles that

have been in place for many years. In particular, private companies (and newly public companies) with revenues under \$1 billion should pay particular attention to the changes to the IPO process and the relaxation of post-IPO public company reporting requirements mandated by the JOBS Act.

- **Confidential Filing.** EGCs can file their initial registration statement (and resolve any issues) with the SEC confidentially until 21 days before a roadshow commences. This allows an EGC to avoid the negative publicity associated with withdrawing a filing or premature disclosure of information to the public. The SEC is expected to implement a new confidential filing process.
- **Marketing.** EGCs can meet with qualified institutional buyers and institutional accredited investors to test the waters and gauge investor interest prior to filing a registration statement.
- **Audited Financial Statements.** EGCs need only provide two years of audited financial statements instead of three years. EGCs will not have to provide "Selected Financial Data" for earlier periods.
- **No Auditor Attestation.** EGCs will not be required to obtain an auditor attestation report on management's assessment of internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act.
- **No Executive Compensation Advisory Votes.** EGCs will not be required to hold "say-on-pay," "say-on-frequency" and "say-on-parachutes" advisory votes on executive compensation.
- **Delayed Applicability of GAAP and PCAOB Rules.** The Act permits EGCs to delay implementation of (i) any new or revised financial accounting standards until such pronouncements apply to private companies and (ii) PCAOB rules so long as the issuer remains an EGC.

Generally, EGCs that conduct IPOs that price (or that have priced) after December 8, 2011 will be able to take advantage of the benefits of the legislation.

Investment Banking Research

Current law prohibits an investment bank that is engaged as an underwriter in an IPO from publishing research on the IPO company in advance of the IPO, until 40 days after the offering, and for the 15 days before expiration of any lock-up agreements entered into in connection with the IPO. Additionally, research analysts were barred from participating with investment bankers in discussions with the management team of the IPO company. The JOBS Act eliminates these restrictions for EGCs.

General Solicitation of Investment to Accredited Investors and QIBs

The JOBS Act eliminates the long-standing prohibition on general solicitation of investments. Previously, issuers were limited to seeking private investments from those with whom they had a pre-existing relationship. Now, under the JOBS Act, issuers will be allowed to advertise a securities offering to the general public (including through social media, newspaper, television, radio, and web advertising) as long as all of the ultimate purchasers are accredited investors or qualified institutional buyers (QIBs). Issuers will be required to take reasonable steps to verify that each purchaser is an accredited investor or a QIB. The SEC will have 90 days to update the rules to allow for general solicitation as provided in the Act with these changes applying to all issuers (not only EGCs).

Increased Numerical Threshold to Trigger Reporting Obligations

Previously, a company would be required to file periodic reports with the SEC if it had more than 500 holders of record of a particular class of equity. The JOBS Act raises this threshold to 2,000 holders of record or 500 non-accredited investors. The Act also excludes, for purposes of determining whether the threshold has been met, securities received under employee

compensation plans and securities issued in crowdfunding transactions (described below). This threshold increase will be effective immediately upon signing of the Act into law by the President.

This increase, particularly when taken together with the general solicitation change above, means that companies will now be able to access a much larger pool of private investment capital and remain private, avoiding public company reporting obligations for a significantly longer period than previously possible.

Crowdfunding

Crowdfunding is a relatively new concept whereby large numbers of investors invest small amounts of money in a company. The JOBS Act enables EGCs to issue without registration, and these small investors to receive, securities in exchange for small contributions, subject to certain limitations, including:

- **Aggregate Maximum Investment.** The total amount of investment per issuer must be less than \$1 million in a rolling 12 month period.
- **Individual Maximum Investment.** For an investor with annual income or net worth less than \$100,000, the investor may not invest more than the greater of \$2,000 or 5% of their annual income or net worth in a single issuer. For an investor with annual income or net worth more than \$100,000, the investor may not invest more than the greater of 10% of their annual income or net worth, not to exceed \$100,000, in a single issuer.
- **Registered Broker or Funding Portal.** Any crowdfunding transaction must be conducted by a broker or through a funding portal, which will be required to register with the SEC and meet suitability requirements to be determined by the SEC.

Crowdfunding issuers will be subject to financial disclosure requirements (ranging from prior year tax returns and unaudited financials to audited financials based on offering size) to the SEC and its investors during the offering and annually going forward. The SEC has 270 days to promulgate rules facilitating this crowdfunding structure.

About King & Spalding's Public Company Practice Group

King & Spalding's Public Company Practice Group is a leader in advising public companies and their boards of directors in all aspects of corporate governance, securities offerings, mergers and acquisitions and regulatory compliance and disclosure.

About King & Spalding

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