



Legislative Proposals to Facilitate Small Business Capital Formation

In our June 2011 client memorandum,¹ we discussed H.R. 2167, the proposed bill introduced by Representative David Schweikert (R-AZ) to increase the threshold for mandatory registration for all companies under the Securities Exchange Act of 1934 (the “Exchange Act”) from 500 persons holding equity securities of record to 1,000 persons. We also discussed a related bill, H.R. 1965, introduced in the House by Representatives Jim Himes (D-CT) and Steve Womack (R-AK) to amend Section 12(g) of the Exchange Act by raising the registration threshold from 500 to 2,000 record holders if the issuer is a bank or a bank holding company. The Himes-Womack bill would also modify the threshold for deregistration under Sections 12(g) and 15(d) of the Exchange Act for banks or bank holding companies from fewer than 300 to fewer than 1,200 shareholders as well as raise the total assets threshold from \$1 million to \$10 million on the last day of the company’s first fiscal year following the passage of the bill.²

The Proposed Legislation

Since June 2011, there have been a number of legislative developments to amend the mandatory registration thresholds of Section 12(g) and related provisions. On September 21, the House Committee on Financial Services, Subcommittee on Capital Markets and Government Sponsored Enterprises (the “House Subcommittee”) held a hearing on a number of these proposals, followed, on October 5, by a House Subcommittee approval vote. The Himes-Womack bill was agreed upon by a voice vote of the House Subcommittee. The Schweikert bill, as amended, was also agreed to by a voice vote of the House Subcommittee. The amendment, offered by Representative Scott Garrett (R-NJ), removed the proposed exclusion of accredited investors from the definition of “held of record” for purposes of Section 12(g)(5). Now, the Schweikert bill excludes from the definition of “held of record” only those who receive their securities pursuant to an employee stock option or pension plan in transactions exempt from registration under Section 5 of the Securities Act of 1933 (the “Securities Act”).

During the same session, the House Subcommittee also approved three other bills. H.R. 2930, introduced in the House on September 14, 2011 by Representative Patrick McHenry (R-NC), proposes to add a “crowdfunding” exemption under both Section 4 (exempt offerings) of the Securities Act and Section 12(g) of the Exchange Act. The McHenry bill defines “crowdfunding” as an offering of securities in which the aggregate annual amount raised is \$5 million or less *and* individual investments in the securities are limited to an aggregate annual amount equal to the lesser of (i) \$10,000 and (ii) 10% of the investor’s annual income.³ The McHenry bill would amend Section 4 of the Securities Act to exempt the offering from registration under Section 5 of the Securities Act and would

¹ See <http://www.mofo.com/files/Uploads/Images/110621-Legislative-Action-on-Exchange-Act-Registration-Thresholds.pdf>.

² Note that this change merely puts into the statute the current requirements of SEC rules under Sections 12(g) and 15(d).

³ H.R. 2930 is available at <http://financialservices.house.gov/UploadedFiles/hr2930ai.pdf>.

exempt the persons acquiring securities in a “crowdfunding” offering from the calculation of holders of record under Section 12(g)(5) of the Exchange Act. The McHenry bill would also exempt holders of securities issued pursuant to the “crowdfunding” exemption from state blue sky laws and regulations. The House Subcommittee agreed to the McHenry bill by a recorded vote of 18 ayes to 14 nays.

H.R. 2940, originally introduced in the House on September 15, 2011 by Representative Kevin McCarthy (R-CA), seeks to amend Section 4(2) of the Securities Act to state specifically that general solicitation and general advertising will not affect the availability of the private placement exemption.⁴ The McCarthy bill also proposes to direct the Securities and Exchange Commission (the “SEC”) to remove the prohibition against general solicitation and advertising for securities issued pursuant to Rule 506 of Regulation D, provided that all purchasers of the securities are accredited investors and that the issuer took reasonable steps to ascertain that each holder is indeed an accredited investor. The House Subcommittee agreed to the McCarthy bill by a voice vote.

The Small Company Job Growth and Regulatory Relief Act of 2011⁵ was originally introduced in the House by Representative Stephen Fincher (R-TN).⁶ This bill seeks to amend Section 404(b) of the Sarbanes-Oxley Act of 2002, which requires accounting firms to attest to a company’s internal control over financial reporting. The Fincher bill would provide that Section 404(b) no longer applies to reports issued by companies with a total public float of less than \$350 million. The Fincher bill was agreed to by a recorded vote of 18 ayes to 14 nays by the House Subcommittee.

Reducing Regulatory Burden

Both the Himes-Womack bill and the Schweikert bill reflect a desire to reduce the burdens on small companies. At the September 21 hearing, Matthew H. Williams, on behalf of the American Bankers Association, testified about the need to increase registration thresholds so as not to overburden small banks with potentially excessive registration and periodic reporting costs. Reducing these costs, Mr. Williams noted, could enable smaller banks to focus on meeting the credit and loan needs of their communities, rather than devoting resources to meeting regulatory requirements that provide little incremental benefit to the banks, shareholders or the public.⁷

Small companies, not just banks, would also benefit from the proposed legislation. Schweikert’s bill, which would increase the registration threshold *for all companies* from 500 to 1,000 and exempt securities issued pursuant to an employee compensation plan, would have an immediate impact on the ability of emerging companies to raise capital.

The SEC has stated that it is studying “crowdfunding.” At an SEC hearing on September 15, 2011, Meredith Cross, the SEC Director of the Division of Corporation Finance, testified that one of the major areas that the SEC is looking at is “crowdfunding” in response to Chairman Shapiro’s urging the SEC Staff to “take a fresh look at some of our offering rules to develop ideas for the Commission to consider that may reduce the regulatory burdens on small business capital formation in a manner consistent with investor protection.”⁸ It will be interesting to see, should the McHenry bill move forward, whether any amendments will be attached to the bill that harmonize the endeavors of the SEC and Congress in relation to a “crowdfunding” exemption.

⁴ H.R. 2940 is available at <http://financialservices.house.gov/UploadedFiles/hr2940ai.pdf>.

⁵ No bill number has been assigned yet.

⁶ See <http://financialservices.house.gov/UploadedFiles/fincherjobbill.pdf>.

⁷ See <http://www.aba.com/NR/rdonlyres/222CE044-577A-11D5-AB84-00508B95258D/73516/FinalMatthewWilliamsHouseCapMkts500Shareholder9211.pdf>.

⁸ See <http://www.sec.gov/news/testimony/2011/ts091511mbc.htm>.

Next Steps

Having been agreed to by the House Subcommittee, all five bills discussed above will be sent to the House Committee on Financial Services for further review and markup before being presented to the entire House of Representatives. There has been no date scheduled as of yet for markup nor is there any indication that any or all of these bills will even make it out of Committee review. As we noted in our previous client memorandum on the subject,⁹ these are not the first attempts to amend the registration thresholds. However, there does appear to be a renewed fervor, both in Congress and from the administration,¹⁰ to find ways to help emerging companies raise capital.

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⁹ See <http://www.mofo.com/files/Uploads/Images/110621-Legislative-Action-on-Exchange-Act-Registration-Thresholds.pdf> at page 3.

¹⁰ See <http://www.whitehouse.gov/the-press-office/2011/09/08/fact-sheet-and-overview>.