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How Will the JOBS Act Affect You?

Yesterday, Congress passed the Jumpstart Our Business Startups Act (the "JOBS Act"). President Obama is expected to sign the JOBS Act into law as early as this week. The stated purpose of the JOBS Act is to drive the creation of jobs in America by easing access to public capital for emerging growth companies. The JOBS Act moved through the House and the Senate at lightning speed considering the magnitude of changes to existing securities laws, reversing the legislative stalemate leading up to this election year. While important provisions of the JOBS Act will go into effect immediately, other provisions will require further rulemaking by the Securities and Exchange Commission ("SEC"). The JOBS Act has triggered strong reactions by commentators, both positive and negative. Some champion the JOBS Act as a force that will revive the mid-cap company IPO market and strengthen the ability of start-up companies to raise capital, while others caution that the significant liberalization of key securities law provisions creates the potential for abuse and investor fraud.

This Alert provides an overview of the important changes to the securities laws to be effectuated by the JOBS Act and discusses how different categories of market participants will be affected.

Regulatory Relief for Emerging Growth Companies

The JOBS Act provides that "emerging growth companies" will be able to take advantage of relaxed disclosure rules and carve-backs from the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. These provisions will be effective immediately when President Obama signs the JOBS Act.

- Under the JOBS Act, a company will qualify as an "emerging growth company" or "EGC" if it has total annual gross revenues of less than \$1.0 billion during its most recently completed fiscal year (subject to inflationary adjustment every five years based on the Consumer Price Index). Issuers that complete (or have completed) an IPO after December 8, 2011 will be eligible to qualify as an EGC.
- A company will continue to qualify as an EGC until the earliest of (i) the last day of the first fiscal year after its annual revenues exceed \$1 billion (subject to inflationary adjustment); (ii) the last day of the first fiscal year following the fifth anniversary of its IPO; (iii) the date on which the company has, during the previous three-year period, issued more than \$1 billion in non-convertible debt; and (iv) the date it is deemed a "large accelerated filer" (requiring \$700 million of public float, among other things).
- Under the JOBS Act, EGCs will be afforded significant relief from the current regulatory and disclosure regime:
 - Up to two years of audited financial statements and the related MD&A disclosures will be required in an IPO registration statement (rather than up to three years).
 - Selected financial data in any registration statement or other report will not need to include any period prior to the earliest audit period presented in an IPO registration statement (rather than up to five years).
 - There will be no requirement to provide an auditor's attestation report on internal controls.¹
 - There will be no requirement to comply with new or revised financial accounting standards applicable to public companies until the standards are applicable to private companies.
 - There will be no requirement to comply with mandatory audit firm rotation rules or rules requiring a supplement to the auditor's report that may be adopted by the Public Company Accounting Oversight Board ("PCAOB").
 - There will be no requirement to comply with rules adopted by the PCAOB after the enactment of the JOBS Act unless the SEC determines the application of such rules is necessary or appropriate in the public interest.
 - There will be no requirement for "say on pay", "say when on pay" or "say on golden parachutes" shareholder votes on executive compensation.²
 - EGCs will have the option to comply with executive compensation disclosures by providing a reduced level of information currently required of smaller reporting companies.³
 - EGCs will benefit from exemptions from pending requirements to disclose the relationship

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between executive compensation and financial performance, and the ratio of CEO compensation to median employee compensation.⁴

- Pre-IPO EGCs will be entitled to confidentially submit a draft registration statement to the SEC for review. EGCs relying on this provision must publicly file the initial draft submission and all amendments not later than 21 days prior to the commencement of a road show.
- The application of the EGC provisions of the JOBS Act to companies that have commenced an IPO process, or completed an IPO process after December 8, 2011, raises the question of whether companies that have already filed registration statements but have not yet completed an IPO can amend their registration statements to take advantage of the EGC relief. The JOBS Act does not address what options are available to companies that qualify as EGCs but have already filed registration statements providing disclosures that would not be required of EGCs.
- EGCs may choose to forgo any exemption made available by the JOBS Act and instead comply with the requirements applicable to an issuer that is not an EGC. With respect to the extension of time to comply with new or revised financial accounting standards afforded by the JOBS Act, if an EGC chooses to comply with accounting standards without taking advantage of the accommodations of the JOBS Act, the EGC must make such choice at the time of the EGC's first SEC filing and notify the SEC of such choice, may not select standards "a la carte" but must comply with all such standards to the same extent as a non-EGC, and must continue to comply with such standards for so long as the company remains an EGC. It remains to be seen whether market pressures may encourage EGCs to voluntarily opt-in to more stringent requirements.

The JOBS Act requires the SEC to conduct a comprehensive review of Regulation S-K, the primary source of public company disclosure requirements, to determine how such requirements can be updated to modernize and simplify the registration process and reduce the costs and other burdens of disclosures for EGCs. The SEC must report to Congress on this review within 180 days of the enactment of the JOBS Act.

Regulatory Relief for Private Companies

The JOBS Act will make it easier for companies to raise money privately and will allow private companies to stay private longer. As described below, many of these provisions remain subject to further SEC rulemaking and accordingly will not be effective immediately when President Obama signs the JOBS Act.

General Solicitation and Advertising will be Permitted in Certain Private Placements

The JOBS Act provides that the SEC will have 90 days to revise Rule 506 of Regulation D and Rule 144A to eliminate the prohibitions on general solicitation and general advertising in private offerings conducted pursuant to these rules.⁵ All purchasers of securities under the revised rules must be accredited investors (for Rule 506 offerings) or qualified institutional buyers ("QIBs") (for Rule 144A offerings). The revised rules will require companies to take reasonable steps to verify that purchasers are accredited investors or QIBs, as applicable.

The Ability to Make Exempt Offerings will be Expanded

Regulation A currently provides an exemption from registration under Section 3(b) of the Securities Act of 1933, as amended (the "Securities Act"), for "mini-offerings" of up to \$5 million that meet the criteria set forth in Regulation A. Companies choosing to rely on the Regulation A exemption must file an offering statement, consisting of a notification, offering circular, and exhibits, with the SEC for review, and may "test the waters" by using general solicitation and advertising prior to filing an offering statement with the SEC. Companies do not become subject to the full set of public reporting obligations under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), solely by virtue of making a Regulation A offering.

The JOBS Act requires the SEC to make material changes to the Regulation A offering exemption, as described below.

- An aggregate of \$50.0 million of securities may be sold in reliance on Regulation A during a 12-month period. This amount must be reviewed by the SEC every two years and if the SEC determines not to increase such amount, it must report to Congress on its reasons for not increasing the amount.
- Companies relying on the exemption must file audited financial statements with the SEC on an annual basis.
- The SEC may determine to require a company relying on the new exemption to make available to investors and file with the SEC periodic disclosures regarding its business operations, financial condition and corporate governance.
- The JOBS Act clarifies that the Regulation A securities will not be subject to restrictions on resale.

In addition, the SEC must conduct a study on the impact of State "Blue Sky" laws regulating securities offerings on Regulation A offerings, and report to Congress on the results of this study not later than three months after the enactment of the JOBS Act.

Liberalization of the Shareholder Cap Rules Will Allow Companies to Stay Private Longer

The JOBS Act will amend Section 12(g) of the Exchange Act to increase the shareholder cap limits that trigger public company reporting requirements. The JOBS Act also provides that certain shareholders do not "count" toward the shareholder cap.

- Currently, companies must register under the Exchange Act once their assets exceed \$1.0 million and their shares are held of record by more than 500 persons. The JOBS Act will increase this cap to \$10.0

million in assets and shares held of record by 2,000 persons or 500 unaccredited investors.

- The JOBS Act will provide that shareholders who acquire securities in a crowdfunding transaction and shareholders who acquire securities pursuant to an employee compensation plan in an exempt transaction will not be counted against the shareholder cap.
- The SEC will be required to examine whether new enforcement tools are required to enforce the anti-evasion provisions contained in the rules implementing the shareholder cap limits. These provisions allow beneficial owners of securities to be deemed the record owners for the purpose of counting against the shareholder cap in cases when the issuer knows or has reason to know that the form of holding securities of record is used primarily to circumvent the shareholder cap. The SEC must provide its recommendations to Congress within 120 days of enactment of the JOBS Act. We expect that special purpose vehicles will be scrutinized.

Impact on Early-Stage and Start-Up Companies: Crowdfunding

The JOBS Act facilitates the practice of “crowdfunding” in which the Internet is used to publicly solicit a large number of small investments. Companies seeking to take advantage of this capital raising technique will be required to provide information on their financial status, business plans and shareholder risks, as well as other information. Significant requirements also will be imposed on intermediaries in these offerings. The SEC must issue rules to carry out the crowdfunding provisions of the JOBS Act within 270 days after the date of enactment of the JOBS Act.

- The JOBS Act will provide that a private company can sell securities to investors in a transaction exempt from registration subject to compliance with the requirements described below.
 - The aggregate amount sold to all investors, including amounts sold in reliance on the crowdfunding rule during the preceding 12 months, may not be more than \$1.0 million.
 - The aggregate amount sold to any investor, including amounts sold in reliance on the crowdfunding rule during the preceding 12 months, does not exceed (i) the greater of \$2,000 or 5% of the annual income or net worth of such investor, if either the annual income or net worth is less than \$100,000 and (ii) 10% of annual income or net worth of such investor, not to exceed \$100,000, if either the annual income or net worth is equal to or greater than \$100,000.
 - The company must conduct the offering through a compliant broker or funding portal.
- The company and brokers or funding portals must comply with additional requirements outlined in the JOBS Act, to be fleshed out by further SEC rulemaking. The dollar amounts described above must be adjusted by the SEC at least once every five years.
- Brokers or funding portals facilitating crowdfunding will be required to comply with significant requirements including SEC registration, disclosure requirements to be determined by further SEC rulemaking, and provisions for investor protection. Among other things, intermediaries must:
 - Ensure that investors (i) review investor-education materials, (ii) positively affirm they understand the risks of the investment, and (iii) answer questions demonstrating an understanding of the risks of such investment;
 - Take measures to reduce the risk of fraud, including obtaining background checks on directors, officers and 20% holders;
 - Make available to the SEC and potential investors any information provided by the company;
 - Ensure that all offering proceeds are only provided to the company when aggregate capital raised from all investors is equal to or greater than the target offering amount and allow all investors to cancel their commitments;
 - Make efforts, as the SEC determines appropriate, to ensure that no investor in a 12-month period has purchased securities pursuant to the crowdfunding rule in aggregate from all issuers that exceed the investment limits of the rule;
 - Not compensate promoters or finders for providing personal identifying information of any potential investor; and
 - Prohibit their directors, officers and partners from having any financial interest in a company using their services.
- A company using the crowdfunding rule will be required to file with the SEC and provide to investors and intermediaries basic information including, among other things, the names of its directors and officers and a description of its business, anticipated business plan and financial condition (including income tax returns and, for offerings of more than \$500,000, audited financial statements).
- The company will also be required to provide information relating to the offering, including, among other things, the purpose of the offering, the intended use of proceeds, the target offering amount and deadline and the price of the securities being offered. Additional information will be required on the company’s ownership and capital structure, as well as any other information the SEC may prescribe.
- Purchasers in crowdfunding offerings will be entitled to bring rescission claims against the issuer in accordance with the Securities Act provisions applicable to registered offerings. The offerings are also expressly subject to antifraud or “10b-5” type liability on the part of issuers and control persons.
- The SEC must issue rules providing for disqualification provisions under which a company would be ineligible to use crowdfunding and an intermediary would be ineligible to effect a crowdfunding transaction.
- The crowdfunding provision will preempt state securities laws, including state regulation of funding portals, subject to some retained state enforcement authority and notice filing requirements. The SEC is directed to consult with State securities commissions which may come forward to comment during the rulemaking process.

Impact on Intermediaries - Research Analysts, Brokers, Dealers, Market Makers

Several of the provisions of the JOBS Act affect market intermediaries by removing restrictions on (i) the distribution of research reports and (ii) communications with potential investors. The changes are intended to encourage interest in offerings by smaller companies that are not yet household names.

Availability of Information Relating to EGCs:

- The JOBS Act will amend the Securities Act to provide that brokers or dealers who publish or distribute a research report on an EGC that is pursuing a public offering or that has filed a registration statement shall not be deemed an offer for sale or offer to sell the securities of such EGC, even if the broker or dealer is participating or will participate in the registered offering of such EGC.
- Brokers and dealers may arrange for communications between securities analysts and potential investors in an EGC pursuing an IPO offering and securities analysts may participate in communications with the management of an EGC alongside persons associated with brokers or dealers working for such EGC.
- Persons working on behalf of an EGC may engage in oral or written communications with potential investors that are either QIBs or accredited investors to determine whether such investors might have an interest in any public offering by the EGC.
- Brokers and dealers will not be prohibited from publishing or distributing research reports or making public appearances with respect to an offering by an EGC either within prescribed time periods before an IPO or within prescribed time periods prior to expiration of any lock-up agreement with the EGC.

SEC study on tick-size (decimalization)

- In late 2000, the NYSE moved from trading in 8ths to trading based on decimals. Critics of decimalization maintain that the change in the trading rules reduced the profitability inherent in acting as a market maker, which impacted smaller-cap companies in particular.
- The JOBS Act requires the SEC to conduct a study examining the transition to trading in one penny increments, its impact on the number of IPOs since its implementation and its impact on liquidity for small and mid-cap companies.
- The SEC has 90 days to submit a report to Congress. If the SEC finds that EGCs should be traded at increments greater than \$0.01, the SEC will have 180 days to enact a rule designating a minimum increment for EGC securities that is greater than \$0.01 but less than \$0.10.

Impact of Legislation

The JOBS Act rapidly sailed through Congress, but it will take time to evaluate what impact it will have on investors and the companies that are able to take advantage of its provisions. Many critics of the Act question whether the Act goes far enough to prevent fraud and protect investors. In a letter from the SEC to Congress, the Chairman of the SEC recognized the benefits of helping small businesses, but warned that many of the Act's provisions weaken important investor protections. The JOBS Act requires the SEC to take various actions in tight timeframes. In the SEC's letter to Congress, the SEC stated that a deadline of 18 months would be more appropriate to address the rules and studies outlined in the JOBS Act. Most of the provisions of the JOBS Act require the SEC to act in 270 days or less.

Please contact any of the attorneys listed, or your regular Lowenstein Sandler contact, for further information on the matters discussed herein.

¹ The exemption from the requirement to provide an auditor's attestation report on internal controls is currently provided to "smaller reporting companies", including issuers with a public float of less than \$75 million or an IPO registrant with annual revenues of less than \$50 million.

² Phase-in provisions under the JOBS Act will require a "say on pay" vote within three years post-IPO for issuers that were an EGC for less than two years, and within one year of having lost EGC status, for other issuers.

³ Most significantly, smaller reporting companies are not required to present a compensation discussion & analysis and only two years of compensation information is required to be presented in the summary compensation table.

⁴ These provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 remain subject to future SEC rulemaking.

⁵ Rule 506 of Regulation D provides a safe harbor for issuers to conduct private placements of any amount, to an unlimited number of accredited investors and up to 35 other purchasers, subject to prohibitions on general solicitations and advertising. Rule 144A provides a safe harbor for issuers and placement agents to conduct private placements and resales of any amount involving an unlimited number of "qualified institutional buyers" or "QIBs", subject to, among other things, prohibitions on general solicitations and advertising.

⁶ The threshold will also be amended for issuers that are banks or bank holding companies by increasing the cap to issuers with total assets exceeding \$10.0 million and a class of equity securities (other than exempted securities) held of record by 2,000 or more persons. Issuers that are banks or bank holding companies will also be permitted to terminate their registration if they can certify to the SEC that the number of holders of record of the class registered under the Exchange Act is less than 1,200 persons.

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