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The Jumpstart Our Business Startups (JOBS) Act

This past Tuesday, Congress passed the Jumpstart Our Business Startups Act (JOBS Act). President Obama is expected to sign the JOBS Act into law in the coming days. The JOBS Act's purpose is to drive the creation of jobs in America by removing access barriers for U.S. and non-U.S. Companies to capital from both public and private sources. The JOBS Act makes significant changes to the securities laws and focuses on streamlining the initial public offering (IPO) process by reducing some of the costs and burdens of going public. 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).

This Client Alert provides an overview of the important changes to the securities laws to be affected by the JOBS Act.

Streamlined IPO Process

The JOBS Act will significantly streamline the IPO process making it more attractive for "emerging growth companies" (EGCs) to go public. An EGC is a company with less than \$1 billion in annual gross revenue during its most recent fiscal year (other than any such company that first sold common equity securities in a transaction registered with the SEC prior to December 8, 2011). It should be noted that, in addition to not necessarily being "emerging" or "growing", EGCs are not particularly small companies. According to industry sources, over 90% of the companies that conducted IPOs in 2012 had annual revenues of less than \$1 billion.

Under the JOBS Act, EGCs will benefit from the following changes to the IPO process:

- EGCs will be able to make pre-filing (oral or written) solicitations of interest to qualified institutional buyers and accredited investors (within the meaning of Rule 144A and Regulation D, respectively) to determine whether such investors might have an interest in a contemplated IPO or other securities offering;
- EGCs will be permitted to submit "quiet" draft registration statements to the SEC for a confidential nonpublic review, provided that such draft registration statements are publicly filed no later than 21 days before the date on which the issuer conducts a road show;

- EGCs will need only two (rather than three) years of audited financial statements in their registration statements to go public; and
- brokers or dealers will be permitted to publish/distribute research reports covering an EGC prior to or following the filing of a registration statement even if the broker or dealer will participate in the offering.

The JOBS Act also requires the SEC, within 180 days of the Act's adoption, to conduct a review of the disclosure rules contained in Regulation S-K, in order to update, modernize, and simplify the requirements of the IPO registration process for EGCs.

IPO "On-Ramp" for EGCs

The JOBS Act will also create a simplified "on-ramp" to access the public capital markets for EGCs by phasing in certain public company disclosure requirements over time. Once public, an EGC will have a limited transition period of one to five years (depending upon the size of the EGC) during which the regulatory requirements will be relaxed in order to reduce the cost of compliance. During such transition period, an EGC will be:

- exempt from Section 404(b) of the Sarbanes-Oxley Act of 2002, which requires auditor attestation of internal control over financial reporting on Form 10-K;
- exempt from the detailed narrative disclosure requirements of compensation discussion and analysis;
- exempt from the executive compensation voting requirements of the Dodd-Frank Wall Street Reform Act of 2010, including the requirement for say-on-pay, say-on-frequency and say-on-golden parachute shareholder votes and the executive compensation disclosure provisions requiring the pay-for-performance graph and CEO pay ratio disclosure;
- exempt from complying with new GAAP accounting pronouncements otherwise applicable to public companies until the pronouncements become applicable to private companies;
- exempt from any rules that the Public Company Accounting Oversight Board may adopt relating to mandatory audit firm rotation and any requirement to include an auditor discussion and analysis narrative in the audit report; and
- permitted, with some exceptions, to "opt in" and comply with the disclosure rules otherwise required of issuers under the federal securities laws on an "a la carte" basis.

The "on-ramp" provisions of the JOBS Act are structured as amendments to the Securities Act of 1933 (Securities Act), and the Securities Exchange Act of 1934 (Exchange Act), which make such changes immediately effective upon signing by the President. There will likely be transition and implementation issues that EGCs and their counsel will have to address until the SEC has had an opportunity to issue interpretative guidance and update the rules currently promulgated under such acts.

Access to Private Capital

Another intention of the JOBS Act is to make it easier for private companies to raise capital by amending the Securities Act and Exchange Act and requiring the SEC to amend its rules and regulations as follows:

- the SEC is 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;
- the Securities Act will be amended to provide that trading platforms involved with the sale of securities in a Rule 506 private placement are not subject to registration as a broker or dealer as long as certain conditions are met (including the condition that no such person receives compensation in connection with the purchase or sale of securities and that the platform does not have possession of customer funds or securities in connection with the purchase or sale of securities);
- the SEC will increase the amount of securities that can be issued in a 12-month period under Regulation A from \$5 million to \$50 million (or promulgate a new Regulation A-like exemption from registration similar to Regulation A permitting such increased amounts); and
- the Exchange Act will be amended to raise the registration trigger at which private companies are required to register a class of securities and become subject to public company reporting obligations (shareholder thresholds will increase to 2,000 holders of record or 500 persons who are not accredited investors, excluding shareholders who acquired securities through an employee compensation plan or in connection with the crowdfunding exemption).

In contrast to the IPO on-ramp provisions, the private capital access provisions of the JOBS Act require the SEC to engage in rulemaking. The amendments to Rule 506 are to occur within 90 days of the JOBS Act being put into effect. There is, however, no required time period for the SEC to adopt the balance of the rules.

Crowdfunding

The JOBS Act also facilitates the practice of "crowdfunding" in which securities are publicly sold in small amounts to a large number of small investors. Companies seeking to take advantage of this capital raising technique will be required to provide information that includes their financial status, business plans and shareholder risks. Other crowdfunding changes in the JOBS Act include:

- limiting the aggregate dollar amount of securities that an issuer can sell in a crowdfunding transaction to \$1 million over a 12-month period;
- limiting the amount an issuer can sell to an individual investor in any 12-month period to the maximum of (i) the greater of \$2,000 or 5% of the annual income or net worth (for investors whose net worth or annual income is less than \$100,000), and (ii) 10%, not to exceed

\$100,000, of annual income or net worth (for investors whose annual income or net worth is equal to or greater than \$100,000);

- issuers utilizing the crowdfunding exemption to raise capital must sell the securities through an intermediary (either a registered broker or a person registered with the SEC as a “funding portal”); and
- issuers must make financial and other information available to both the SEC and investors, both in connection with the offering and on an annual basis, under a disclosure regime that enhances the disclosure and likely increases the expense with the size of the offering.

Importantly, it is unknown at this point whether use of the crowdfunding exemption will preclude an issuer from simultaneously conducting a Regulation D offering due to integration issues.

Impact of the JOBS Act

Although the JOBS Act moved quickly through Congress, it will take time to evaluate what impact it will have on investors and the scope of companies able to take advantage of its provisions. Nevertheless, the “on-ramp” established by the JOBS Act will likely make the IPO process significantly more attractive to most U.S. and non-U.S. issuers seeking to access the U.S. capital markets and should provide many newly public companies with an eased transition to the public company regulatory regime. While many capital-starved companies are very eager to take advantage of the barrier removals to private capital and crowdfunding, there is no doubt that numerous critics and implementation challenges will surface in the coming months.