



# A Quick Guide To The JOBS Act

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Although characterized in the press as principally addressing the needs of small and micro-cap companies, provisions in the JOBS Act are applicable to a broad range of both domestic and foreign companies. Companies without ready sources of capital in today's regulatory environment may realize significant benefits from a broadened menu of capital formation alternatives.

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In an effort to ease regulatory burdens on smaller companies and facilitate capital formation, President Obama enacted the Jumpstart Our Business Startups (JOBS) Act on April 5, 2012.

Business leaders and commentators have observed for some time that the regulatory requirements to be met in order to finance companies in the US have become overly burdensome and discourage entrepreneurship. In the aftermath of the financial crisis of 2008, national attention shifted to job creation and the backlash against over-regulation brought about by the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

The JOBS Act includes a number of measures to facilitate capital formation, including:

- An initial public offering (IPO) on-ramp for a new category of issuer, "emerging growth companies."
- Removal of the prohibition against general solicitation and general advertising in certain private placements.

- A new exemption under the Securities Act of 1933, as amended (Securities Act), for crowdfunding offerings.
- An amendment to the Securities Act (informally referred to as Regulation A+) permitting companies to conduct offerings to raise up to \$50 million through a "mini-registration" process similar to Regulation A.
- Higher triggering thresholds for Securities and Exchange Commission (SEC) reporting obligations under the Securities Exchange Act of 1934, as amended (Exchange Act).

**This article originally appeared in the May 2012 issue of *Practical Law The Journal*. For an up-to-date, detailed description of the changes implemented by the JOBS Act, see *Practice Note, Road Map to the Jumpstart Our Business Startups (JOBS) Act of 2012* (<http://us.practicallaw.com/6-518-6858>).**

This article explores some of the significant practical considerations arising from the JOBS Act. It also includes a chart summarizing the JOBS Act's key provisions (see *Chart, JOBS Act Overview*).

To view PLC's JOBS Act webinar, which was conducted with the authors of this article, see *Webinar: How the JOBS Act Affects Capital Markets Practice* (<http://us.practicallaw.com/5-518-8570>).

## JOBS ACT OVERVIEW

### EMERGING GROWTH COMPANIES (EGCS)

#### Qualifying as an EGC

- An EGC is defined as an issuer with total gross revenues of less than \$1 billion during its most recently completed fiscal year (subject to inflationary adjustment by the SEC every five years).
- An issuer will not be able to qualify as an EGC if it first sold its common stock in an SEC-registered offering before December 8, 2011.
- Foreign private issuers are included.

#### Maintaining EGC Status

An issuer remains an EGC until the earliest of:

- The last day of the first fiscal year after the issuer's annual revenues exceed \$1 billion.
- The last day of the fiscal year following the fifth anniversary of the issuer's IPO.
- The date on which the issuer has, during the previous three-year period, issued more than \$1 billion in non-convertible debt.
- The date on which the issuer qualifies as a large accelerated filer.

**EMERGING GROWTH COMPANIES (EGCS)**

IPOs by EGCs	<ul style="list-style-type: none"> <li>■ EGCs may confidentially submit a draft IPO registration statement to the SEC for nonpublic review.</li> <li>■ An issuer that was in registration before the JOBS Act that qualifies as an EGC may switch to the confidential submission process for future amendments.</li> <li>■ Initial confidential submission and all following amendments must be filed publicly at least 21 days before the roadshow.</li> <li>■ Two years of audited financials are required (instead of three).</li> <li>■ In any other registration statement or periodic report, EGCs do not need to include financial information in selected financial data or in MD&amp;A disclosure for periods before those presented for the IPO.</li> <li>■ EGCs may elect to rely on certain scaled disclosures available to smaller reporting companies (such as for executive compensation).</li> <li>■ EGCs and their agents may test the waters with qualified institutional buyers and institutional accredited investors to gauge interest before or after filing.</li> </ul>
Governance and Disclosure Exemptions	<p>EGCs are exempt from:</p> <ul style="list-style-type: none"> <li>■ The advisory vote on golden parachute payments.</li> <li>■ Disclosing the relationship between executive compensation and financial performance.</li> <li>■ Disclosing the CEO pay-ratio.</li> <li>■ Auditor attestation of internal controls under Section 404 of Sarbanes-Oxley.</li> </ul>
Phase-in of Governance and Disclosure Requirements	<ul style="list-style-type: none"> <li>■ The say on pay requirement phases-in as follows:             <ul style="list-style-type: none"> <li>■ in the case of an issuer that was an EGC for less than two years, by the end of the three-year period following its IPO; and</li> <li>■ for any other EGC, within one year of having lost its EGC status.</li> </ul> </li> <li>■ EGCs are not required to comply with any new or revised accounting standard until the date the standard becomes broadly applicable to private companies.</li> <li>■ EGCs are not subject to any PCAOB rules requiring audit firm rotation or modified audit report requirements unless the SEC determines it is necessary.</li> </ul>
Opting Out of EGC Status	<p>An EGC may opt out of any exemption and instead comply with the requirements that apply to other issuers. However, if it elects to forego the exemption from compliance with new or revised accounting standards, it must:</p> <ul style="list-style-type: none"> <li>■ Comply with all standards and cannot selectively opt in or out of accounting standards.</li> <li>■ Make this election at the time it files its first registration statement or Exchange Act report.</li> </ul>
Permitted Communications	<ul style="list-style-type: none"> <li>■ Research reports on EGCs that propose to register or are in registration are not offers under the Securities Act even if the broker-dealer participates in the offering.</li> <li>■ Research reports on EGCs are not subject to quiet period or lock-up period restrictions.</li> </ul>
Conflicts, Separation and Disclosures	<ul style="list-style-type: none"> <li>■ Research reports are subject to required conflicts disclosures and certifications.</li> <li>■ Separation/chaperoning requirements are modified in connection with certain activities for EGCs.</li> </ul>
Effective Dates	<p>Title I of the JOBS Act became effective on enactment.</p>

**GENERAL SOLICITATION**

Rule 506 Offerings	<p>General advertising and general solicitation is permitted, provided that the issuer verifies purchasers are all accredited investors.</p>
Platforms/Matching Services	<p>Will not be required to register as broker-dealers solely as a result of participation or involvement in Rule 506 offerings that use general solicitation or general advertising, provided that the platform does not receive transaction-based compensation, handle customer funds or securities or participate in documentation.</p>
Effective Dates	<p>The SEC must enact rules to carry out the removal of the general solicitation prohibition in Rule 506 and Rule 144A offerings by July 4, 2012 (within 90 days of enactment of the JOBS Act).</p>



## CROWDFUNDING

Offering Threshold	The aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, must not exceed \$1 million.
Investment Threshold	The aggregate amount sold to any investor by the issuer, including any amount sold in reliance on the crowdfunding exemption during the 12-month period preceding the date of the transaction, must not exceed: <ul style="list-style-type: none"> <li>■ The greater of \$2,000 or 5% of the annual income or net worth of the investor, as applicable, if either the annual income or the net worth of the investor is less than \$100,000.</li> <li>■ 10% of the annual income or net worth of the investor, as applicable, not to exceed a maximum aggregate amount sold of \$100,000, if either the annual income or net worth of the investor is equal to or more than \$100,000.</li> </ul>
Information	Issuers must file with the SEC and provide to investors and selling intermediaries information about the issuer, including: <ul style="list-style-type: none"> <li>■ Financial statements, which would be reviewed or audited depending on the size of the target offering amount.</li> <li>■ Officers, directors and greater than 20% stockholders.</li> <li>■ Risks relating to the issuer and the offering.</li> <li>■ Target amount, deadline to reach the target amount and regular updates regarding progress.</li> <li>■ At least annually, reports of the results of operations and financial statements and other information the SEC requires by rule.</li> </ul>
Manner of Offering	<ul style="list-style-type: none"> <li>■ The transaction must be conducted through a broker or funding portal.</li> <li>■ Issuers cannot advertise the terms of the offering, other than to provide notices directing investors to the broker or funding portal, along with disclosure of amounts paid to compensate solicitors promoting the offering through the broker or funding portal.</li> </ul>
Broker and Funding Portal Requirements	<ul style="list-style-type: none"> <li>■ Register with the SEC as a broker or funding portal.</li> <li>■ Register with any applicable self-regulatory authority.</li> <li>■ Provide disclosures to investors, as well as questionnaires, regarding the level of risk involved with the offering.</li> <li>■ Ensure that all offering proceeds are only provided to issuers when the amount equals or exceeds the target offering amount, and allow for cancellation of commitments to purchase in the offering.</li> <li>■ Ensure that no investor exceeds the investment threshold.</li> <li>■ Must not compensate promoters, finders or lead generators.</li> <li>■ Prohibit insiders from having any financial interest in an issuer using that intermediary's services.</li> </ul>
Transferability	Securities are not transferrable for a one-year period beginning on the date of purchase, except in certain limited circumstances.
Liability	A purchaser could bring an action against an issuer for rescission under Section 12(a)(2) of the Securities Act in the event that there are material misstatements or omissions in connection with the offering (liability normally reserved for public offerings).
Blue Sky Status	Crowdfunding securities are covered securities, exempting them from state blue sky registration requirements. However, some state enforcement authority and notice filing requirements are retained.
Other Conditions	<ul style="list-style-type: none"> <li>■ The crowdfunding exemption is only available for domestic issuers that are not reporting companies under the Exchange Act and that are not investment companies.</li> <li>■ Bad actor disqualification provisions similar to those required under Regulation A are required.</li> </ul>
Effective Dates	The SEC must issue rules to carry out the crowdfunding exemption within 270 days of enactment, or December 31, 2012. Before that time, the crowdfunding exemption is not available.

### REGULATION A+ REQUIREMENTS

Offering Threshold	<ul style="list-style-type: none"> <li>■ \$50 million of issuer's securities in a 12-month period.</li> <li>■ The SEC may increase this amount every two years.</li> </ul>
Required Disclosure	<ul style="list-style-type: none"> <li>■ Issuers must file audited financial statements with the SEC annually.</li> <li>■ The SEC may impose other requirements deemed necessary for investor protection, including requiring an offering disclosure statement and periodic reports to be filed with the SEC and distributed to investors.</li> </ul>
Manner of Offering	<ul style="list-style-type: none"> <li>■ Securities may be offered and sold publicly.</li> <li>■ The issuer may test the waters to gauge interest prior to filing any offering statement.</li> </ul>
Transferability	Securities are not restricted, meaning there would be no holding period or restrictions on resales.
Liability	A purchaser could bring an action against an issuer for rescission under Section 12(a)(2) of the Securities Act, in the event that there are material misstatements or omissions in connection with the offering (liability normally reserved for public offerings).
Blue Sky Status	The securities are covered securities, exempting them from state blue sky registration requirements, if the securities are either: <ul style="list-style-type: none"> <li>■ Offered or sold on a national securities exchange.</li> <li>■ Offered or sold by broker-dealers only to qualified purchasers (to be defined by the SEC).</li> </ul>
Other Conditions	The SEC has broad authority to impose additional conditions necessary for investor protection.
Effective Dates	There is no deadline for SEC rulemaking.

### EXCHANGE ACT THRESHOLDS

Issuer Is Not a Bank or Bank Holding Company	Becomes subject to Exchange Act reporting 120 days after the last day of the fiscal year ended in which the issuer had both: <ul style="list-style-type: none"> <li>■ Total assets over \$10 million.</li> <li>■ A class of equity securities (other than exempted securities) held of record by either: <ul style="list-style-type: none"> <li>■ 2,000 persons; or</li> <li>■ 500 persons that are not accredited investors.</li> </ul> </li> </ul>
Issuer Is a Bank or Bank Holding Company	Becomes subject to Exchange Act reporting 120 days after the last day of the fiscal year ended in which the issuer had both: <ul style="list-style-type: none"> <li>■ Total assets over \$10 million.</li> <li>■ A class of equity securities (other than exempted securities) held of record by 2,000 persons.</li> </ul> <p>The issuer will no longer be subject to Exchange Act reporting if the number of holders dips below 1,200 persons.</p>
Definition of Held of Record	For these purposes, held of record excludes securities: <ul style="list-style-type: none"> <li>■ Held by persons who received them under an employee compensation plan in transactions exempt from Securities Act registration. The SEC must adopt a safe harbor to qualify for this exclusion.</li> <li>■ Securities issued under the crowdfunding exemption.</li> </ul>
SEC Enforcement Authority	The SEC is required, within 120 days of enactment, to report to Congress on its assessment regarding additional enforcement tools that may be needed for it to enforce against vehicles used to evade the held of record definition.
Effective Dates	<ul style="list-style-type: none"> <li>■ The threshold for registration for non-banks is effective immediately.</li> <li>■ The thresholds for registration and deregistration for banks and bank holding companies are effective immediately.</li> <li>■ The SEC must adopt regulations under the provisions within one year of enactment.</li> <li>■ There is no specified timetable for the held of record rulemaking.</li> <li>■ The rules implementing the exclusion for crowdfunding securities must be issued with 270 days of enactment, or December 31, 2012.</li> </ul>



## IPO ON-RAMP FOR EMERGING GROWTH COMPANIES

Title I of the JOBS Act establishes a new category of issuer called an emerging growth company (EGC). An EGC has easier access to capital markets for its IPO and certain relaxed disclosure and other requirements that are phased in over time following its IPO.

### Practical Considerations

#### Issuers

For an issuer contemplating an IPO, the ability to rely on scaled disclosure and governance and proxy exemptions is likely to be appealing. An issuer that completed its first registered sale of common equity after December 8, 2011 is eligible for EGC status. This raises the possibility that an issuer that completed a registration statement on Forms S-1 or F-1 at that time presumably may elect to furnish less information in its future SEC filings, at least for certain items like compensation disclosure.

An issuer that already completed its IPO can now furnish financial information for the shorter two-year period in its subsequent filings, although the issuer may want to consider the merits of doing so. A newly public company could elect EGC status and rely on the exemptions available from Section 404(b) of the Sarbanes-Oxley Act, and from say on pay and other similar proxy disclosures.

Depending on the issuer's business and financial condition, it may be the case that underwriters encourage EGCs to furnish more information than required. Once an issuer has become more seasoned, it may choose to provide non-EGC disclosures. It will take some time to see how market practice evolves in relation to scaled disclosures.

The ability to "test the waters" presents a number of interesting possibilities. The IPO window opens and closes and, depending on market conditions, the IPO process may become quite extended (in some cases, nine months or longer). During the long road leading to an IPO, an issuer may need to conduct a private placement to raise capital to carry out its business plans and cover IPO expenses.

Over time, the SEC has provided interpretive guidance providing greater certainty for conducting private placements to institutional investors while pursuing an IPO. The ability to test the waters completes this picture. It is expected that an issuer will keep the information included in test the waters materials consistent with information in its registration statement. Any financial intermediary involved in the IPO and assisting in communications with institutional investors will likely require that the issuer make representations and warranties to this effect for any test the waters information.

#### Placement Agents and Underwriters

Financial intermediaries should think carefully about their advice to prospective IPO issuers concerning the type of information that investors expect to see about the issuer's business and financial results. If the issuer has close competitors that are already reporting companies, for competitive reasons an issuer may find that it may have to opt out and provide more robust disclosures.

Also, depending on the trends that are reflected in the issuer's business over a period longer than the two-year period, it may be appropriate or necessary to include a discussion about the issuer's business over that longer period.

These decisions will require discussion and analysis, and will be highly dependent on the particular facts and circumstances for the issuer and its market. In any event, it is expected that underwriters and their counsel will review their various forms of underwriting agreements and related documents to address many of the changes made by these regulations. Underwriters and their counsel also may want to consider including representations and warranties that address any test the waters materials, just as most underwriting agreements now address roadshow materials.

From the research perspective, the compliance groups of investment banks should review and update policies and procedures and chaperoning guidelines. Given the need to address a number of practices and, in certain cases various technology issues, it may take some time for best practices to develop. It is also not clear whether market participants will be reluctant to provide research on earlier stage companies until the disclosures, financial statements and accounting policies for those companies have been fully vetted through the course of the SEC's review process.

## REMOVAL OF PROHIBITION AGAINST GENERAL SOLICITATION

Issuers of all sizes and levels of sophistication rely on exempt offerings as part of their capital-raising efforts, especially offerings under Rule 506 of Regulation D. Rule 506 permits issuers to sell their securities in a private placement to an unlimited number of accredited investors, but prohibits general solicitation and general advertising of the offering. Many have noted that this ban has resulted in an excessive concern about offerees that may never actually purchase securities, rather than providing investor protection.

Title II of the JOBS Act requires the SEC to remove the prohibition against general solicitation and general advertising for Rule 506 offerings, as long as all purchasers in the offering are accredited investors. The SEC must also revise Rule 144A to permit the use of general solicitation and general advertising.

Issuers must take "reasonable steps" to verify that investors are accredited investors. These steps will be determined by the SEC.

### Practical Considerations

Currently, placement agents and issuers often rely on self-certification of accredited investor status. Once a transaction moves forward, the issuer generally obtains detailed representations and warranties from each purchaser regarding its accredited investor status.

Presumably, obtaining these detailed representations and warranties should be sufficient to discharge the issuer's duty. However, without SEC guidance it is not clear whether this is

sufficient. Once guidance becomes available, placement agents and issuers will need to review their practices and likely revise their documentation.

Separately, in the event that an issuer failed to satisfy the Rule 506 safe harbor it could still rely on the Section 4(2) exemption for private placements. For secondary transfers that generally meet the conditions for a private placement, participants could rely on Section 4(1½).

In the context of Section 4(2), a pre-existing substantive relationship has always been an important factor in assessing whether the transaction was a private placement. By deregulating offers, the question arises as to whether the relative weight given to the presence or absence of a pre-existing relationship will shift in connection with this type of analysis over time. In this regard, the SEC staff has noted that the JOBS Act only directs the SEC to revise Rule 506, which does not necessarily change the conditions applicable to offerings relying on Section 4(2) or Section 4(1½).

The removal of the ban on general solicitation may also make Rule 506 offerings a more attractive option for existing public companies seeking to conduct private offerings or PIPE (private investment in public equity) transactions. However, if an issuer fails to meet the conditions for Rule 506, Section 4(2) may no longer be available (for example, if general solicitation was employed before the issuer realizes the offering does not meet the Rule 506 requirements).

Notably, the JOBS Act provides entities serving as matching services with significantly more certainty about the permissible business model that may be used without registering with the SEC as a broker-dealer. This additional certainty could cause more organizations to enter this area and set up matching services, which could increase the potential sources of capital for companies.

### CROWDFUNDING EXEMPTION

Crowdfunding is a new outgrowth of social media that provides an emerging source of funding for a variety of ventures. Crowdfunding works based on the ability to pool money from individuals who have a common interest and are willing to provide small contributions toward the venture. Absent an exemption from SEC registration, crowdfunding efforts that involve sales of securities are in all likelihood illegal. Therefore, a person or venture selling securities through crowdfunding could be exposed to potential liability at the federal and state levels, and potentially in foreign jurisdictions.

Pre-JOBS Act registration exemptions are generally too cumbersome for crowdfunding and are unworkable due to the widespread use of the internet. Title III of the JOBS Act amends Section 4 of the Securities Act to add a new paragraph (6) that provides a crowdfunding exemption from registration.

### Practical Considerations

#### Issuers

For raising small amounts of capital from a broad group of investors, the crowdfunding exemption may ultimately provide a viable alternative to existing offering exemptions, given the potential cost savings and increased sources for funding. At the same time, issuers will need to weigh the ongoing costs that will arise with crowdfunding offerings, in particular the annual reporting requirement. Moreover, it is not yet known how much intermediaries, such as brokers and funding portals, will charge issuers once SEC and self-regulatory organization regulations apply to their ongoing crowdfunding operations.

#### Intermediaries

Brokers and funding portals will need to consider how their processes can be revamped to comply with the new regulations, in particular given the extensive information that intermediaries will need to provide to investors for crowdfunding offerings and the critical role that intermediaries will play in terms of self-regulating these offerings.

### REGULATION A+

Regulation A under Section 3(b) of the Securities Act, allows issuers to raise up to \$5 million through sales of their securities in interstate offerings without complying with the registration requirements of the Securities Act. Regulation A as it currently exists is considered an unappealing capital-raising alternative because of the need to comply with state securities laws and its low dollar annual cap.

Title IV of the JOBS Act amends Section 3(b) of the Securities Act, increasing the threshold to \$50 million for a Regulation A-style offering (Section 3(b)(2)) and requires the SEC to amend Regulation A or adopt a new, similar regulation. Practitioners informally refer to this provision as Regulation A+.

### Practical Considerations

Understanding the advantages of Regulation A+ compared to an EGC public offering or revised Rule 506 offering will become a bit more nuanced after factoring in the availability of scaled disclosures, relaxed communications rules and the availability of general solicitation.

An exempt offering, including a Regulation D offering, remains subject to several limitations that may not be appealing and a registered offering may still be too time consuming and costly. Regulation A+ may provide an offering format that is similar to, but possibly more efficient than, a registered offering. It might be especially appealing for an issuer to consider this type of offering as a precursor to an IPO.

While there are many similarities between an offering circular and a prospectus, the preparation of an offering circular is generally simpler and cheaper to prepare. The costs associated with external advisors, such as counsel and auditors, will be lower in



connection with a Regulation A+ offering. Since timing is often the most important determinant of success for an offering, Regulation A+ may offer a distinct advantage.

In contrast to Rules 505 and 506 of Regulation D and Section 4(2) of the Securities Act, Regulation A+ does not limit the number of offerees or investors that can participate in the offering. It also does not impose any requirement that offerees be accredited investors.

In addition, an issuer and underwriter may have greater flexibility in structuring a Regulation A+ offering. The securities will be freely tradeable in the secondary market (assuming that there is a secondary market) after the offering with no holding period or resale restrictions. This may be important to certain institutional investors that are subject to limitations on investments in restricted securities.

Further, in connection with a Regulation A+ offering, an issuer may test the waters to gauge investor interest. An issuer also may consider conducting a Regulation D or Regulation S offering after it has completed a Regulation A+ offering.

## HIGHER EXCHANGE ACT REGISTRATION THRESHOLDS

Titles V and VI of the JOBS Act amend Section 12(g) of the Exchange Act to increase the thresholds that trigger compliance with SEC reporting requirements for public companies.

## Practical Considerations

### Issuers

Non-reporting issuers should review their current organizational documents and related stockholders' or investors' rights agreements and consider whether they should be revised in light of the increased threshold. Overall, private companies should assess their history of securities issuances to determine and document exempt issuances made in connection with executive compensation plans.

The capital markets have evolved in ways that now offer growing private companies many more capital-raising alternatives than existed in the past. A private company may not want to pursue an IPO, or it may want to defer becoming public until later in its life. This may increase the number of private company shares traded on secondary markets. Private companies should ensure measures are in place to control the trading of their shares.

In addition, banks and bank holding companies (especially community banks) that have engaged in repurchases to avoid crossing the Exchange Act threshold may want to consider whether to suspend or defer repurchase programs.

### Intermediaries

Intermediaries that facilitate transfers of private securities may want to undertake a review of their procedures, to the extent they are responsible for monitoring ownership limitations.

## THE ROAD AHEAD

Many of the provisions of the JOBS Act require the SEC to undertake additional rulemaking and, in some cases, give the SEC broad authority to shape the utility of the JOBS Act. Market participants will need to remain focused on this additional rulemaking to assess the changes that will be required to their existing processes and documentation.

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