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JOBS Act -- Will It Make Capital More Accessible for My Business?

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After being approved by Congress with wide bipartisan support, on April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the "***JOBS Act***"). The JOBS Act is an amalgamation of various bills the combined impact of which is intended to provide entrepreneurs, start-ups and small businesses increased access to the capital markets while at the same time provide average investors increased investment opportunities. The JOBS Act considerably alters the regulations surrounding public and private security offerings and, for certain issuers with revenues of less than $1 billion, reduces the burden of certain periodic reporting obligations.

The JOBS Act impacts capital raising and public company registration and reporting in a multitude of ways, including facilitating initial public offerings ("***IPOs***") for a new category of so-called emerging growth companies (companies with less than $1 billion in total gross revenues), expanding private offering exemptions and capital-raising options, increasing the amount of information available about emerging growth companies, and significantly increasing shareholder record thresholds that trigger public company registration under the Securities Exchange Act of 1934 (the "***Exchange Act***"). The JOBS Act accomplishes this through six titles as follows:

- Title I—eases the IPO process and ongoing public disclosure of new public companies.
- Title II—allows general solicitation and advertising in offerings under Rule 506 of Regulation D.
- Title III—creates a new registration exemption for "crowdfunding."
- Title IV—creates a new exemption for public offerings of $50 million or less.
- Titles V & VI—increases the shareholder threshold for reporting under the Exchange Act.

Some of the provisions of the JOBS Act are effective immediately and others require SEC rulemaking before becoming effective. Set forth below are some of the highlights of the JOBS Act.

Reopening American Capital Markets to Emerging Growth Companies

Title I of the JOBS Act, referred to as the "IPO On-Ramp" provisions, creates a new category of issuers known as "emerging growth companies" and exempts these companies from certain federal securities regulations relating to the IPO process and periodic reporting obligations including certain executive compensation matters instituted under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Emerging growth companies are issuers that had total annual gross revenues of less than $1 billion during their most recently completed fiscal year, and whose IPO was completed after December 8, 2011. If an issuer qualifies as an emerging growth company on the first day of its fiscal year, it maintains that status until the earliest of the following: (i) the last day of the fiscal year of the issuer during which it has total annual gross revenues of $1 billion or more; (ii) the last day of the fiscal year of the issuer following the fifth anniversary of the issuer's initial public offering; (iii) the date on which the issuer has, during the previous 3-year period, issued more than $1 billion in non-convertible debt; or (iv) the date on which the issuer is deemed to be a "large accelerated filer" (as defined in Rule 12b-2 of the Exchange Act).

The IPO On-Ramp provisions ease federal securities laws applicable to emerging growth companies related to the IPO process and ongoing public company reporting obligations in several key ways:

Confidential IPO Process – Emerging growth companies are permitted to file their IPO registration statement with the SEC on a confidential, nonpublic basis. Additionally, all SEC comment letters and company response letters will constitute confidential information and will not be made public via EDGAR. The original submission and all amendments must be publicly filed at least 21 days before the road show. This new confidential IPO process will permit an emerging growth company to consider an IPO without disclosing sensitive information to the market or enduring the negative consequences of a delay or withdrawal of the offering.

Availability of Information – Currently, investment banks participating in an IPO are subject to rules related to publishing research in advance of an IPO and ensuring that research is independent of investment banking. The IPO On-Ramp provisions amend certain of those rules to permit the following with respect to the role of investment banks and analysts for emerging growth companies: (i) the publication of research reports prior to a proposed IPO, as well as communications between a securities analyst and potential investors, and participation by a securities analyst in meetings with management regarding securities offerings; (ii) oral and written communications both before and after the filing of a registration statement, so long as the potential investors are qualified institutional buyers or accredited investors; and (iii) broker or dealer public appearances following an IPO and after the expiration of any lock-up period related to the IPO.

Disclosure and Periodic Reporting Obligations – Certain rules related to the disclosure of information in a registration statement as well as rules related to on-going reporting obligations have been significantly relaxed for emerging growth companies, including:

- Financial Statements and Financial Disclosure – Emerging growth companies are required to present only two years (rather than three years) of audited financial statements in their IPO registration statement. Additionally, no selected financial data is required to be included in the IPO registration statement and, in other registered offerings and Exchange Act reports, there is no obligation to file selected financial information for periods prior to the earliest audited period presented in connection with the IPO. Emerging growth companies will only be required to provide MD&A disclosure with respect to their two most recent fiscal years instead of three years.

- Audit and Accounting – An emerging growth company is exempt from the requirement under Section 404(b) of Sarbanes-Oxley Act of 2002 that an independent external auditor attest to a company's internal control over financial reporting. An emerging growth company is also not subject to any rules requiring mandatory audit firm rotation or a supplement to an auditor's report. Additionally, an emerging growth company is not required to comply with new or revised GAAP accounting standards until the date that a private company would be required to comply with that standard.

- Executive Compensation – Emerging growth companies can take advantage of the scaled disclosure of smaller reporting companies for executive compensation disclosure. Further, an emerging growth company is not required to hold shareholder advisory votes on executive compensation (i.e., "say-on-pay", "say-on-frequency" and "say-on-golden-parachutes"), or disclose certain executive compensation required for non-smaller reporting companies, such as a comparison of executive pay to performance and median compensation.

The IPO On-Ramp provisions are effective immediately and require no SEC rulemaking. However, we do expect SEC interpretive guidance and SEC rulemaking to make conforming changes.

Regulation D—Access to Capital for Job Creators

Title II of the JOBS Act will allow general solicitation and advertising (by all issuers, not just emerging growth companies) in connection with private offerings pursuant to Rule 506 of Regulation D and Rule 144A, provided that all purchasers in Rule 506 offerings are accredited investors and all purchasers in Rule 144A offerings are qualified institutional buyers. The JOBS Act does not alter state preemption of offerings under Rule 506.

Additionally, the JOBS Act clarifies that certain persons acting to bring issuers and potential purchasers together for a Rule 506 offering will not be required to register with the SEC as a broker or dealer if that person complies with certain requirements, including that it may not receive compensation or have possession of customer funds in connection with the purchase or sale of the securities.

The Title II provisions of the JOBS Act become effective upon SEC rulemaking which is required within 90 days of enactment of the JOBS Act.

Crowdfunding

Title III of the JOBS Act adopts a new registration exemption under Section 4 of the Securities Act of 1933 (the "***Securities Act***") for "crowdfunding," a concept which refers to the sale of equity securities to individuals who have pooled their money through small individual contributions.

The new crowdfunding exemption allows, subject to the following conditions, non-reporting, domestic issuers to sell unregistered securities to the public through a broker or funding portal that complies with the requirements of the exemption:

- The total amount sold to all investors by the issuer, including amounts sold in reliance on the crowdfunding exemption during the prior 12-month period, may not exceed $1 million; and

- The total amount sold to any single investor by the issuer, including any amount sold in reliance on the crowdfunding exemption during the prior 12-month period, may not exceed: (i) the greater of $2,000 or 5% of the investor's annual income or net worth if either the annual income or the net worth of the investor is less than $100,000, and (ii) 10% of the investor's annual income or net worth so long as the maximum aggregate amount invested by that investor is less than $100,000, if either the annual income or the net worth of the investor is $100,000 or more.

An issuer relying on the exemption would be required to file with the SEC and provide to investors and intermediaries certain required information, including, among other things, financial statements (which would be reviewed or audited depending on the size of the offering), information related to officers, directors, and greater than 20% shareholders, risks relating to the issuer and the offering, the use of proceeds and target amount of the offering, the deadline to reach the target offering amount, and regular updates regarding progress in reaching the target. An issuer relying on the exemption also would be prohibited from advertising the terms of the offering (other than to provide notices directing investors to the funding portal or broker), and would be required to disclose any amounts paid to compensate solicitors promoting the offering through the funding portal or the broker and file with the SEC and provide to investors (at least annually) reports of the issuer's results of operations and financial statements.

Other important provisions of the crowdfunding section of the JOBS Act include:

- Restrictions on Resales. An investor cannot transfer securities acquired in a crowdfunding offering for one year from the date of purchase, except in limited circumstances.

- Exemption from Blue Sky Laws. Securities sold under the crowdfunding provisions of the JOBS Act are exempt from state registration requirements, but are subject to state enforcement authority.

- Exclusion from Shareholder Cap. Securities acquired in a crowdfunding offering are not considered to be held of record for purposes of determining whether the issuer has exceeded the trigger for Exchange Act reporting.

The Title III provisions of the JOBS Act become effective upon SEC rulemaking which is required within 270 days of enactment of the JOBS Act.

Regulation A—Small Company Capital Formation

Title IV of the JOBS Act adds Section 3(b)(2) of the Securities Act to create a new exemption for public offerings of $50 million or less in any 12-month period, in which the securities may be offered and sold publicly. Issuers relying on this exemption will be able to solicit interest in the offering before filing any offering statement with the SEC and would only be required to file audited financial statements with the SEC annually. Title IV provides that the SEC may require issuers relying on this exemption to file an offering statement and periodic disclosures with the SEC about its business operations, financial condition, corporate governance principles, use of proceeds and other matters. Securities sold pursuant to this exemption will not be "restricted securities" and will be exempt from state registration and review if the securities are offered or sold on a national securities exchange or to a qualified purchaser.

The Title IV provisions of the JOBS Act become effective upon SEC rulemaking but no date for such rulemaking is specified.

Shareholder Limits--Private Company Flexibility and Growth and Capital Expansion

Title V of the JOBS Act increases the number of shareholders non-bank and non-bank holding company issuers can have before triggering the registration provisions of Section 12(g) of the Exchange Act. Prior to enactment of the JOBS Act, Section 12(g) of the Exchange Act required registration of a class of an issuer's securities if, as of the first day of the issuer's fiscal year, (a) the issuer had more than $10 million in assets, and (b) the class of equity securities was held of record by 500 or more persons. The JOBS Act retains the $10 million threshold, but increases the 500 holders of record threshold to 2,000 holders of record or 500 or more persons who are not accredited investors. As a result, private companies will need to keep track of the number of their non-accredited investors. The definition of "held of record" is amended to exclude "securities held by persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act." Securities held of record will also exclude securities received in exempt crowdfunding transactions. Interestingly, Title V did not increase the 500 and 300 holders of record thresholds for deregistration under the Exchange Act.

Similarly, Title VI of the JOBS Act amends Section 12(g) of the Exchange Act to modify the registration threshold for banks and bank holding companies as follows: (i) the Section 12(g) threshold for required registration of a class of equity securities by a bank or bank holding company is increased from 500 holders of record to 2,000 holders of record; (ii) the Section 12(g) deregistration threshold for bank and bank holding companies is increased from 300 holders of record to 1,200 holders of record; and the Section 15(d) standard for ceasing reporting for banks and bank holding companies is increased from 300 holders of record to 1,200 holders of record.

Title V is effective on the date of its enactment, however, certain SEC conforming rules are required. There is no date by which the SEC must adopt those rules. Title VI is effective on the date of its enactment, however, certain SEC conforming rules are required within one year of enactment of the JOBS Act.

Conclusion

The JOBS Act significantly reduces the regulatory requirements for public and private securities offerings in the United States for emerging growth companies, and is an unprecedented legislative loosening of federal securities laws. All companies should benefit from the JOBS Act in that access to capital has been increased through more flexible private placement rules and average investors have been given greater access to investment opportunities in companies that have not become public. Further, companies will be able to stay private for a much longer period of time before being required to report under the Exchange Act, the IPO process has been eased for emerging growth companies that make the important decision to go to the public capital markets and the reporting burdens facing emerging growth companies once they are public have been significantly relaxed. The reduced regulatory burdens on private and public capital raising transactions should facilitate faster and more efficient capital raising by smaller companies. Jackson Walker has spent substantial time familiarizing itself with these new opportunities, and our experienced team is available to assist you in evaluating whether one of these options fits your company's needs.

If you have any questions about the JOBS Act, please contact your Jackson Walker attorney or any one of the following Jackson Walker attorneys:

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