

## **The Jumpstart Our Business Startups Act (the “JOBS Act”)**

On March 27, 2012, the United States Congress approved the Jumpstart Our Business Startups Act (the “JOBS Act” or the “Act”).<sup>1</sup> President Obama has expressed support for this legislation and is widely expected to sign the JOBS Act into law in the coming days.

The JOBS Act received bipartisan support and is intended to promote job creation and economic growth by facilitating capital formation for small and startup businesses, improving access to U.S. financial markets and scaling back the requirements necessary for small businesses to go public. Many provisions of the JOBS Act reflect recommendations by the IPO Task Force, a group of industry experts assembled by the U.S. Department of Treasury during the summer of 2011 to address the decline of public offerings in the U.S.<sup>2</sup>

Changes to existing U.S. securities laws proposed by the JOBS Act are intended to make the initial public offering (“IPO”) process more attractive to both domestic and foreign companies. The JOBS Act will also amend Rule 506 of Regulation D and Rule 144A under the Securities Act of 1933 (the “Securities Act”) to eliminate the current prohibition on general solicitation and general advertising in certain private offerings, allowing companies to raise capital with greater ease and to stay private longer.

### **I. Title I – Reopening American Capital Markets to Emerging Growth Companies**

Presently, every issuer contemplating an IPO must comply with a wide range of regulatory requirements prior and subsequent to completing the IPO process. Title I of the JOBS Act will reduce and, in some cases, eliminate certain requirements for “Emerging Growth Companies” (“EGCs”), streamlining the IPO process to make it less burdensome and less costly.

EGCs are a new class of small-scale businesses established by the JOBS Act. The Act defines EGCs as newly public companies (those with an IPO registration statement effective after December 8, 2011)<sup>3</sup> with less than \$1 billion in annual gross revenue during their most recently completed fiscal year.<sup>4</sup> An EGC retains its status until the earliest of:

- The first fiscal year during which its annual revenues exceed \$1 billion;
- The date on which it has, during the previous three-year period, issued more than \$1 billion in nonconvertible debt;
- The first fiscal year in which it achieves “large accelerated filer” status (having at least 12 months of reporting history and \$700 million in unaffiliated public float); or
- The first fiscal year following the fifth anniversary of its IPO.<sup>5</sup>

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<sup>1</sup> Jumpstart Our Business Startup Act, H.R. 3606, 112th Cong. (2012), available at <http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf>.

<sup>2</sup> See, e.g., *Rebuilding the IPO On-Ramp* (October 20, 2011), available at [www.sec.gov/info/smallbus/acsec/ipotaskforceslides.pdf](http://www.sec.gov/info/smallbus/acsec/ipotaskforceslides.pdf).

<sup>3</sup> Section 101(d). Citations are to Sections of the Act unless otherwise noted.

<sup>4</sup> Sections 101(a) and (b), adding new Securities Act Section 2(a)(19) and new Securities Exchange Act of 1934 (the “Exchange Act”) Section 3(a)(80).

<sup>5</sup> Section 101(a), amending Securities Act Section 2(a).

Title I directs the Securities and Exchange Commission (the “SEC”) to conduct an analysis of Regulation S-K and issue a report, within 180 days from the date of the Act’s enactment. The report shall include the specific recommendations of the SEC on how to streamline the registration process in order to make it more efficient and less burdensome for the SEC and for prospective issuers who are EGCs.<sup>6</sup> In addition, EGCs will be exempted from a number of other regulatory requirements for the entire period during which they retain their EGC status, up to a maximum of five years.

During this time period (referred to as the “on-ramp” period), EGCs will benefit from:

### **Fewer Requirements under Sarbanes-Oxley**

EGCs will be exempt from the Section 404(b) auditor’s attestation requirements of Sarbanes-Oxley for the entire period during which an EGC retains its status.<sup>7</sup> This is expected to substantially reduce recurring compliance costs incurred as the result of an IPO, by freeing EGCs from the burden of obtaining an auditor’s report on the company’s internal control over financial reporting. EGCs will, however, remain subject to the management report requirements of Section 404(a).

### **Exemption from All New Accounting Pronouncements and PCAOB Rules**

EGCs will also be exempt from any new or revised U.S. GAAP accounting pronouncements that are applicable to public companies, until such pronouncements are extended to private companies. In addition, EGCs will be exempt from any future Public Company Accounting Oversight Board (“PCAOB”) rules, including those pertaining to auditor rotation requirements.<sup>8</sup>

### **Limited Financial Disclosure Obligations in Registration Statements and Periodic Reports**

EGCs need only provide two years of audited financial statements in an IPO registration statement, as opposed to the three years of statements presently required. Selected financial data and management’s discussion and analysis in subsequent filings with the SEC will only be required to be disclosed as of the earliest period presented in the IPO registration statement.<sup>9</sup>

In addition, pursuant to an addition to Exchange Act Section 13(a), an EGC need not include selected financial data for any period prior to the earliest audited period presented in connection with its first registration statement that became effective under the Act or the Securities Act.<sup>10</sup>

### **Confidential Advance Submission of Draft IPO Registration Statements**

Both domestic and foreign EGCs will now be permitted to submit a draft IPO registration statement to the SEC for a non-public, confidential review (a course of action previously reserved for foreign issuers). This will permit the SEC Staff to comment on potentially sensitive issues in

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<sup>6</sup> Section 108.

<sup>7</sup> Section 103, amending Sarbanes-Oxley Act of 2002 Section 404(b).

<sup>8</sup> Section 104.

<sup>9</sup> Section 102(b)(1), amending Securities Act Section (7)(a).

<sup>10</sup> Section 102(b)(2), adding a new provision to Exchange Act Section 13(a).

advance, thereby allowing the EGC to file a final registration statement that addresses those potential issues noted in the SEC’s initial review. However, the EGC must file the initial confidential submission and subsequent amendments on EDGAR at least 21 days before commencing its roadshow.<sup>11</sup> Therefore, those who wish to do so would be able to track changes made in the final registration statement from the initial confidential filing and similarly, the SEC will be able to point to such changes made in response to Staff comments when commenting on filings by other EGCs.

## **Exemption from Executive Compensation-Related Requirements**

EGCs will not be required to comply with certain compensation disclosure provisions required pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, including: the new advisory “say-on-pay” executive compensation shareholder vote, the advisory shareholder vote on golden parachutes, disclosures pertaining to the relationship between executive compensation and the financial performance of the issuer, and disclosures pertaining to the ratio of CEO compensation to median employee pay.<sup>12</sup>

## **Permissive “Testing-the-Waters” Communications with Certain Investors**

Additionally, EGCs will be permitted to engage in oral or written communications with potential accredited investors or qualified institutional buyers (“QIBs”), in order to “test-the-waters” of investor interest before filing a registration statement.<sup>13</sup>

## **Research Reports by Broker-Dealers Permitted**

Finally, the JOBS Act will also amend Section 2(a)(3) of the Exchange Act to permit the publication or distribution of broker-dealer research reports discussing an EGC that is the subject of a potential IPO, before or after the filing of a Registration Statement. These reports, which would otherwise violate Section 5 of the Securities Act, will be permitted even if the broker-dealer is participating in the registered offering. Likewise, Section 15(d) of the Exchange Act will be amended to prohibit the SEC and the Financial Industry Regulatory Authority (“FINRA”) from maintaining rules that restrict the ability of broker-dealers and research securities analysts to make public appearances, engage in communications or participate in meetings with an EGC, or issue research reports in the context of a registered equity offering<sup>14</sup>. Broker dealers will remain liable under Exchange Act Rule 10b-5 for false or misleading research reports.

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<sup>11</sup> Section 106, amending Securities Act Section 6. This amendment also references the Freedom of Information Act (5 U.S.C. Section 552) and appears to give the SEC discretion to not compel disclosure of information obtained by the SEC pursuant to the confidentiality provision of Section 6. It is not clear whether this means that the SEC will not require EGCs to disclose SEC comment letters and responses thereto submitted prior to finalization of an EGC registration statement.

<sup>12</sup> Section 102(a), amending Exchange Act Section 14 and Section 953(b)(1) of the Investor Protection and Securities Reform Act of 2010.

<sup>13</sup> Section 105(d). This provision covers both EGCs as well as “any person authorized to act on behalf of an emerging growth company.” It therefore may extend to potential underwriters as well, provided they are authorized to act on behalf of an EGC. Registrants may wish to seek clarification of this provision from the SEC.

<sup>14</sup> Section 105, amending Securities Act Sections 2(a)(3) and 5 and Exchange Act Section 15D.

An issuer may opt to forgo the EGC exemptions and instead comply with the requirements that apply to an issuer that is not an EGC. An issuer making such an election:

- must do so at the time the company is first required to file a registration statement, periodic report or other report with the SEC under the new provisions in Exchange Act Section 13(a);
- must notify the SEC of such choice;
- may not select some standards to comply with in such manner and not others, but must comply with all such standards to the same extent that a non-EGC is required to comply with such standards; and
- must continue to comply with such standards to the same extent that a non-EGC is required to comply with such standards for as long as the company remains an EGC.<sup>15</sup>

## II. Title II – Access to Capital for Job Creators

Title II of the JOBS Act will ease the capital formation process for private companies. Title II directs the SEC to amend Rule 144A and Rule 506 of Regulation D under the Securities Act to remove the prohibition on general solicitation and general advertising in private placements. This required amendment will permit 144A offerings of unregistered securities, including by general solicitation or offering, to persons who are not QIBs, provided that the actual purchasers of such securities are persons reasonably believed to be QIBs.<sup>16</sup>

The elimination of the general solicitation prohibition will also apply to Rule 506 offers and sales of securities that exceed \$5 million, provided that the actual purchasers of such securities are persons reasonably believed to be accredited investors.<sup>17</sup> In connection with Rule 506 offerings, issuers will be required to take reasonable steps to verify that purchasers of securities are accredited investors, “using such methods as determined by the [SEC]”.<sup>18</sup>

Under these Title II provisions, companies will be free to solicit investor interest widely and publicly, although they will still be obligated to follow reasonable policies and procedures to ascertain the identity and status of securities purchasers.

## III. Title III – Crowdfunding

Title III of the JOBS Act also aims to ease the capital raising process by creating a new registration exemption for “crowdfunding” (an acronym referred to within the JOBS Act as standing for “Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012”). The crowdfunding exception will permit non-reporting companies to raise up to \$1 million over a 12-month period from small investments drawn from a large pool of investors. Crowdfunding transactions will require an intermediary registered broker or registered person to act as a “funding portal”.<sup>19</sup> Annual investments by individuals will be capped at:

- (a) the greater of \$2,000 or 5% of the investor’s annual income or net worth for investors with an annual income or net worth of less than \$100,000, and

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<sup>15</sup> Section 107.

<sup>16</sup> Section 201(a)(2).

<sup>17</sup> As defined in Rule 501(a) of Regulation D under the Securities Act.

<sup>18</sup> Section 201(a)(1).

<sup>19</sup> Section 302(b), as set forth in new Securities Act Section 4A(a).

(b) the lesser of \$100,000 or 10% of an investor's annual income or net worth for investors with an annual income or net worth equal to or more than \$100,000.<sup>20</sup>

Crowdfunding issuers must comply with certain other requirements that are not otherwise applicable to EGCs, including an obligation to make available to investors, and file with the SEC, certain financial disclosures with varying levels of detail according to the offering size.<sup>21</sup> Crowdfunding investors will be excluded from the calculation of shareholders of record under Section 12(g) of the Exchange Act (discussed further below).

## **IV. Title IV – Small Company Capital Formation**

Title IV of the JOBS Act will amend Regulation A under the Securities Act to broaden the “small issuer exemption”. As amended, the registration exemption will be expanded by increasing the aggregate amount of securities that can be publicly issued within a 12-month period from \$5 million to \$50 million.<sup>22</sup>

Small issuers relying on the Regulation A exemption, as amended, will be obligated to comply with several new investor protection provisions. Small issuers will be required to file audited annual financial statements with the SEC. In addition, unless the securities offered under this exception are offered or sold on a national securities exchange, the offering will still be subject to individual state blue sky laws. Finally, Title IV gives the SEC the authority to require periodic post-offering disclosures that are analogous to registered offering reporting requirements.<sup>23</sup>

## **V. Title V – Private Company Flexibility and Growth**

Title V of the JOBS Act increases the “holders of record” threshold that triggers registration and periodic reporting requirements under the Exchange Act and the SEC’s rules. The threshold at which a private company must register a class of securities and comply with the statutory and regulatory requirements applicable to public companies will increase from 500 persons to either (a) 2,000 persons, or (b) 500 persons who are not accredited investors, as currently defined by the SEC.<sup>24</sup> Additionally, securities held by employees pursuant to compensation plan transactions that are exempt from registration under Section 5 of the Securities Act, will be excluded from the “holders of record” threshold.<sup>25</sup>

For companies with shareholders that are exclusively or predominantly comprised of accredited investors or employees, Title V will alleviate the cost of complying with the SEC registration and periodic and current disclosure requirements.

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<sup>20</sup> Section 302(a), amending Securities Act Section 4.

<sup>21</sup> Section 302(b), as set forth in new Securities Act Section 4A(b)(1)(D).

<sup>22</sup> Section 401(a), amending Securities Act Section 3(b).

<sup>23</sup> Section 401(a), amending Securities Act Section 3(b).

<sup>24</sup> Section 501, amending Exchange Act Section 12(g)(1)(A).

<sup>25</sup> Section 502, amending Exchange Act Section 12(g)(5).

## VI. Title VI – Capital Expansion

Title VI of the JOBS Act addresses the ability of banks and bank holdings companies to obtain funding. Under Title VI, Section 12(g) of the Exchange Act will be amended to increase the “holders of record” threshold that triggers registration and periodic reporting requirements from 500 to 2,000 persons. In addition, the minimum number of holders of record, below which a bank may suspend periodic reporting and registration requirements, will also increase from 300 persons to 1,200 persons.<sup>26</sup>

## VII. Conclusion

If the JOBS Act is signed into law as expected, it will pave the way for an increased number of IPOs by smaller issuers. Companies which had not yet priced their IPO before the December 8, 2011 cutoff, and which meet the other requirements to be considered an EGC, will be able to benefit from the streamlined IPO process, reduced disclosure requirements, and limited reporting obligations.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Charles A. Gilman at 212.701.3403 or [cgilman@cahill.com](mailto:cgilman@cahill.com); Jon Mark at 212.701.3100 or [jmark@cahill.com](mailto:jmark@cahill.com); or John Schuster at 212.701.3323 or [jschuster@cahill.com](mailto:jschuster@cahill.com).

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<sup>26</sup> Section 601, amending Exchange Act Sections 12(g) and 15(d).