Jumpstart Our Business Startups Act Makes Significant Changes to Capital Formation, Disclosure and Registration Requirements

The Jumpstart Our Business Startups Act, or JOBS Act, was signed by President Obama on April 5, 2012.[1] The JOBS Act makes significant changes to the capital formation, disclosure and registration requirements applicable to many public companies. In particular, the JOBS Act:

- Creates a new class of public company, called an "emerging growth company", which is any company that has total annual gross revenues of less than $1 billion, and exempts these companies from certain of the disclosure, audit, proxy and other requirements applicable to other public companies;
- Increases the holders of record thresholds that trigger registration and public company reporting requirements with the Securities and Exchange Commission under the Securities Exchange Act of 1934; and
- Facilitates private placements of securities by:
  - amending Section 4 of the Securities Act of 1933 to add a new type of transaction exemption from SEC registration requirements for securities sold by "crowdfunding";
  - amending Section 3 of the Securities Act to add a new class of security exempt from most provisions of the Securities Act, including registration with the SEC, provided that, among other things, the aggregate offering amount of all securities offered and sold within a 12-month period in reliance on the new exemption does not exceed $50 million; and
  - permitting general advertising and general solicitation in connection with offerings conducted in accordance with Rule 506 under Regulation D or Rule 144A promulgated under the Securities Act, provided that the only purchasers in such offerings are accredited investors in Regulation D offerings or qualified institutional buyers, known as QIBs, in Rule 144A offerings.

The JOBS Act became effective on April 5, 2012 when it was signed by President Obama, although certain provisions, particularly those dealing with crowdfunding and registration under the Exchange Act, require the SEC to write implementing rules, generally in a very short time frame.

EMERGING GROWTH COMPANIES

DEFINITION

The JOBS Act amends Section 2(a) of the Securities Act and Section 3(a) of the Exchange Act to define an "emerging growth company" as an issuer that had total annual gross revenues of less than $1 billion during its most recently completed fiscal year. The $1 billion threshold is to be indexed for inflation every five years by the SEC to reflect the change in the consumer price index.

An issuer remains an emerging growth company until the earliest of:

- The last day of the fiscal year during which it had total annual gross revenues of $1 billion or more;
- The last day of the fiscal year following the fifth anniversary of its initial public offering date;
- The date on which it has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or
- The date on which it is deemed to be a "large accelerated filer".[2]

For this purpose, the "initial public offering date" is defined as the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act.

An issuer is not an emerging growth company if the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act occurred on or before December 8, 2011. The effect of this is to create two classes of public companies among those that have less than $1 billion in total annual gross revenues based on when they first publicly sold common equity securities. Those that did so on or prior to December 8, 2011 are required to comply with all existing SEC requirements, while those that did so after December 8, 2011 are able to choose to instead comply with the reduced requirements for emerging growth companies described below.

EXEMPTIONS FROM EXISTING REQUIREMENTS

The JOBS Act exempts emerging growth companies from numerous requirements under the federal securities laws including:

Say-On-Pay. Section 14A(e) of the Exchange Act has been amended to exempt emerging growth companies from the "say-on-pay", "say-on-pay-frequency" and "say-on-golden parachute" requirements that were enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act. After cessation of emerging growth company status, if an issuer was an emerging growth company for less than two years after its initial public offering date, it must hold a say-on-pay vote no later than the end of the three-year period beginning on the date it is no longer an emerging growth company. Any other company that has ceased to be an emerging growth company must hold a say-on-pay vote no later than the end of the one-year period beginning on the date it is no longer an emerging growth company. In addition, following cessation of emerging growth company status, a company will become subject to the say-on-pay-frequency and say-on-golden parachute provisions of Rule 14a-21 promulgated under the Exchange Act.

Pay-versus-Performance. Section 14(i) of the Exchange Act has been amended to exempt emerging growth companies from the pay-versus-performance requirements that were enacted as part of the Dodd-Frank Act. The SEC has not yet finalized the regulations implementing the pay-versus-performance requirements of the Dodd-Frank Act.

CEO Pay Ratio Disclosure. Section 953(b)(1) of the Dodd-Frank Act has been amended to exempt emerging growth companies from the requirement to compare CEO compensation to the median of the annual total compensation of all employees of the issuer other than the CEO. The SEC has not yet finalized the regulations implementing the pay ratio disclosure requirements of the Dodd-Frank Act.

Compensation Disclosures. Emerging growth companies may comply with the less burdensome executive compensation disclosure requirements applicable to any issuer with a market value of less than $75 million of outstanding voting and nonvoting common equity held by nonaffiliates. Currently these provisions are set forth in Item 402(l) through (r) of Regulation S-K as applicable to smaller reporting companies.

Financial Statement Requirements. Section 7 of the Securities Act has been revised to require

that two years, rather than three years, of audited financial statements be included in any registration statement filed with the SEC by an emerging growth company. Similarly, an emerging growth company need only present its Management's Discussion and Analysis of Financial Condition and Results of Operations for each period for which financial statements are presented rather than the periods required by Item 303 of Regulation S-K. Furthermore, an emerging growth company need not present selected financial data for any period prior to the earliest audited period presented in connection with its initial public offering. In addition, an emerging growth company need not comply with any new or revised financial accounting standard until such date that a company that is not an "issuer", as defined in Section 2 of the Sarbanes-Oxley Act of 2002 (generally, a nonpublic company), is required to comply with such new or revised accounting standard. Similar changes were also made to Section 13(a) of the Exchange Act.

Internal Control over Financial Reporting. Section 404(b) of Sarbanes-Oxley has been amended to exempt emerging growth companies from the requirement to obtain an attestation report on internal control over financial reporting from the issuer's registered public accounting firm. Currently, this requirement is only applicable to "accelerated filers" and "large accelerated filers" as defined in Rule 12b-2 promulgated under the Exchange Act.

PCAOB Rules. The Public Company Accounting Oversight Board must exclude emerging growth companies from any rules it might adopt addressing mandatory audit firm rotation or requiring a supplement to the auditor's report in which the auditor would provide additional information about the audit and the financial statements of the issuer (a so-called auditor discussion and analysis). No PCAOB rules adopted after the date of enactment of the JOBS Act will apply to an emerging growth company unless the SEC determines that the application of such rules is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition and capital formation.

OTHER AMENDMENTS TO SECURITIES ACT

Section 2(a)(3) and Research Reports. The definitions of "sale," "sell," "offer to sell," "offer for sale" and "offer" in Section 2(a)(3) have been amended to exclude the publication or distribution by a broker or dealer of a research report about an emerging growth company that is the subject of a proposed public offering of its common equity pursuant to a registration statement that the issuer proposes to file or has filed or that is effective, even if the broker or dealer is participating or will participate in the registered offering. For this purpose, a "research report" is defined as a written, electronic or oral communication that includes information, opinions or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision.

Section 5 and Testing the Waters. Section 5 of the Securities Act has been amended to provide that an emerging growth company or any person authorized to act on behalf of an emerging growth company may engage in oral or written communications with potential investors that are qualified institutional buyers, as defined in Rule 144A, or institutions that are accredited investors, as defined in Rule 501 promulgated under the Securities Act, to "test the waters" by determining whether such investors might have an interest in a contemplated securities offering, either prior to or following the date of filing of a registration statement with respect to such securities with the SEC.

Section 6 and Confidential Filing of Registration Statements. Section 6 of the Securities Act has been amended to provide that any emerging growth company, prior to its initial public offering date, may confidentially submit to

the SEC a draft registration statement for confidential nonpublic review by the SEC staff prior to public filing, provided that the initial confidential submission and all amendments thereto are publicly filed not later than 21 days before the date on which the issuer conducts a road show. For this purpose, a "road show" is used as defined in Rule 433(h)(4) promulgated under the Securities Act and means an offer (other than a statutory prospectus, or portion thereof, filed as part of a registration statement) that contains a presentation regarding an offering by one or more members of the issuer's management and includes discussion of one or more of the issuer, such management and the securities being offered.

OTHER AMENDMENTS TO EXCHANGE ACT

Section 15D and Securities Analyst Communications. Section 15D of the Exchange Act has been amended to provide that neither the SEC nor any registered national securities association may adopt or maintain any rule or regulation in connection with an initial public offering of the common equity of an emerging growth company that:

- Restricts, based on functional role, which associated persons of a broker, dealer or member of a national securities exchange may arrange for communications between a securities analyst and a potential investor; or
- Restricts a securities analyst from participating in any communications with the management of an emerging growth company that is also attended by any other associated person of a broker, dealer or member of a national securities association whose functional role is other than as a securities analyst.

Section 11(A)(c) and SEC Study on Decimalization of Trading Prices for Emerging Growth Companies. Section 11A(c) of the Exchange Act has been amended to require the SEC to conduct a study examining the transition to trading and quoting securities in one-cent increments, known as decimalization, including the impact decimalization has had on the number of initial public offerings since its implementation relative to the period prior to its implementation and the impact on liquidity for small and middle capitalization company securities. The SEC is to also examine whether there is sufficient economic incentive to support trading operations in these securities in one-cent increments. The study must be submitted to Congress by early July 2012. If the SEC determines that securities of emerging growth companies should be quoted and traded using a minimum increment of greater than one cent, the SEC may, by rule no later than early October 2012, designate a minimum increment for the securities of emerging growth companies that is greater than one cent, but less than ten cents, for use in all quoting and trading of securities on any exchange or other execution venue.

POST-OFFERING COMMUNICATIONS BY BROKERS AND DEALERS

A provision in the JOBS Act provides that neither the SEC nor any registered national securities association may adopt or maintain any rule or regulation prohibiting any broker, dealer or member of a national securities association from publishing or distributing any research report or making a public appearance, with respect to the securities of an emerging growth company. This applies within any prescribed time period following the initial public offering date of the emerging growth company and within any prescribed period of time prior to the expiration date of any agreement between the broker, dealer or member of a national securities association and the emerging growth company or its shareholders that restricts or prohibits the sale of securities held by the emerging growth company or its shareholders after the initial public offering date.

OPT-IN COMPLIANCE

An emerging growth company may choose to forgo compliance with any or all of the provisions

applicable to emerging growth companies made by the JOBS Act and instead comply with the requirements that apply to an issuer that is not an emerging growth company. With respect to the extension of time for complying with new or revised financial accounting standards discussed above, if an emerging growth company chooses to comply with such standards to the same extent that a nonemerging growth company is required to comply with such standards, the emerging growth company:

- Must make such choice at the time the company is first required to file a registration statement, periodic report or other report with the SEC under Section 13 of the Exchange Act and 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 nonemerging growth company is required to comply with such standards; and
- Must continue to comply with such standards to the same extent that a nonemerging growth company is required to comply with such standards for as long as the company remains an emerging growth company.

SEC RULEMAKING

The emerging growth company provisions of the JOBS Act are effective immediately and do not require any SEC rulemaking prior to implementation. However several provisions do conflict with existing SEC rules, so we expect that the SEC will revise its rules to bring them in line with the changes made with respect to emerging growth companies.

REVIEW OF REGULATION S-K

The SEC is required to conduct a review of Regulation S-K to comprehensively analyze the current registration requirements of this regulation and determine how these requirements can be updated to modernize and simplify the registration process and reduce the costs and other burdens associated with these requirements for issuers that are emerging growth companies. The SEC must report its findings to Congress by early October 2012, and must 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 that are emerging growth companies.

REGISTRATION AND DEREGISTRATION UNDER THE SECURITIES EXCHANGE ACT OF 1934

INCREASE IN HOLDERS OF RECORD THRESHOLDS FOR REGISTRATION AND DEREGISTRATION

The JOBS Act has increased the threshold for the registration requirements of Section 12(g) of the Exchange Act. The Exchange Act registration requirements contained in Section 12(g)(1)(A) of the Exchange Act have been revised to require a company to register with the SEC within 120 days after the last day of its first fiscal year on which the issuer has total assets exceeding $10 million and has a class of equity security (other than an exempted security) held of record by either 2,000 persons in total or 500 persons who are not accredited investors (as such term is defined by the SEC).

In addition, Section 12(g)(1)(B) of the Exchange Act has been revised to require registration under the Exchange Act by an issuer that is a bank or bank holding company, not later than 120 days after the last day of its first fiscal year ending after April 5, 2012, on which the issuer has total assets exceeding $10 million and a class of equity security (other than an exempted security) held of record by 2,000 or more persons. With respect to bank and bank holding companies, Section 12(g)(4) and Section 15(d) of the Exchange Act have been amended to permit termination of registration when the issuer has fewer than 1,200 holders of record. The SEC is to issue final regulations no later than early April 2013 to implement these changes.

Holders of Record

Section 12(g)(5) of the Exchange Act has been amended to provide that to determine whether an issuer must register a security under the Exchange Act, the definition of "held of record" will 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. The SEC is directed to revise the definition of "held of record" in Rule 12g5-1 promulgated under the Exchange Act to implement this amendment. The SEC must also adopt safe harbor provisions that issuers can follow when determining whether holders received the securities pursuant to an employee compensation plan in transactions that were exempt from the registration requirements of Section 5 of the Securities Act.

In addition, the SEC is to examine its authority to enforce Rule 12g5-1 to determine if new enforcement tools are needed to enforce the anti-evasion provision contained in subsection (b)(3) of the rule and is to, no later than early August 2012, transmit its recommendations to Congress.

Finally, as noted below, the JOBS Act adds new Section 12(g)(6) to the Exchange Act to require the SEC by rule to exempt, conditionally or unconditionally, securities acquired pursuant to an offering made under new Section 4(6) of the Securities Act from the provisions of Section 12(g) of the Exchange Act.

CROWDFUNDING

DEFINITION

Although the JOBS Act created a new exemption from the registration requirements of the Securities Act designed to ease SEC or statutory requirements as they apply to crowdfunding, the JOBS Act does not contain a definition of crowdfunding. A common definition is that it is a method of raising capital in small amounts from a large group of people using the internet and social media.[3] By not defining crowdfunding and not limiting how funds can be raised, the new exemption can apply to a broader range of capital raising than just through the internet or social media.

NEW SECTION 4(6) OF THE SECURITIES ACT

The JOBS Act amends Section 4 of the Securities Act by adding new paragraph (6) to exempt from the registration requirements of Section 5 transactions involving the offer or sale of securities by an issuer (including all entities controlled by or under common control with the issuer) provided that:

- The aggregate amount of securities sold by the issuer to all investors during the 12-month period, including any amount sold in reliance on the new exemption, preceding the date of the transaction is not more than $1 million;
- The aggregate amount of securities sold to any investor by an issuer, including any amount sold in reliance on the new exemption, during the 12-month period preceding the date of such transaction does not exceed the greater of $2,000 and 5 percent of such investor's annual income or net worth, if either the annual income or net worth is less than $100,000, or 10 percent of such investor's annual income or net worth, 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;
- The transaction is conducted through a broker or funding portal, defined below, that complies with the requirements of new Section 4A(a); and
- The issuer complies with the requirements of new Section 4A(b).

Dollar amounts in new Section 4(6) discussed above and new Section 4A(b) discussed below are to be indexed for inflation no less frequently than every five years to reflect the change in the consumer price index. The income and net worth tests in new Section 4(6) are to be calculated in accordance with any rules of the SEC adopted for this purpose.

NEW SECTION 4A(a) OF THE SECURITIES ACT AND REQUIREMENTS APPLICABLE TO INTERMEDIARIES

Under new Section 4A(a), a person acting as an intermediary in a transaction exempt under new Section 4(6) must:

- Register with the SEC as a broker or a funding portal;
- Register with any applicable self-regulatory organization;
- Provide such disclosures, including disclosures relating to risks and other investor education materials, as the SEC by rule determines appropriate;
- Ensure that each investor:
  - reviews investor education information in accordance with standards established by the SEC by rule;
  - positively affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor could bear such a loss; and
  - answers questions demonstrating an understanding of the level of risk generally applicable to investments in startups, emerging businesses and small issuers, the risk of illiquidity, and such other matters as the SEC by rule determines appropriate;
- Take measures to reduce the risk of fraud with respect to these transactions, as established by the SEC by rule, including obtaining a background check and securities enforcement regulatory history check on each officer, director and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person;
- Make available to the SEC and to potential investors, not later than 21 days prior to the first day on which securities are sold to any investor (or such other period as the SEC may establish), any information provided by the issuer pursuant to new Section 4A(b), as described below;
- Ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, and allow all investors to cancel their commitments to invest, as the SEC by rule determines appropriate;
- Make such efforts as the SEC by rule determines appropriate to ensure that no investor in a 12-month period has purchased securities offered pursuant to new Section 4(6) that, in the aggregate, from all issuers, exceed the investment limits in that section;
- Take such steps to protect the privacy of information collected from investors as the SEC by rule determines appropriate;
- Not compensate promoters, finders or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor;
- Prohibit its directors, officers or partners from having any financial interest in an issuer using its services; and
- Meet such other requirements as the SEC by rule may prescribe for the protection of investors and in the public interest.

The SEC is to make, or cause to be made, available to the state securities commissioners, by the relevant broker or funding portal, the information described above, and such other information as the SEC by rule determines appropriate.

NEW SECTION 4A(b) OF THE SECURITIES ACT AND REQUIREMENTS APPLICABLE TO ISSUERS

Under new Section 4A(b), an issuer that offers or sells securities in a transaction exempt under new Section 4(6) must:

- File with the SEC and provide to investors and the relevant broker or funding portal and make available to potential investors:
  - the name, legal status, physical address and website address of the issuer;

- the names of the directors and officers and each person holding more than 20 percent of the shares of the issuer;
- a description of the business of the issuer and the anticipated business plan of the issuer;
- a description of the financial condition of the issuer, including, for offerings that have, together with all other offerings of the issuer under new Section 4(6) within the preceding 12-month period, aggregate target offering amounts of (i) $100,000 or less, the income tax returns filed by the issuer for the most recently completed fiscal year and financial statements of the issuer, which are to be certified by the principal executive officer of the issuer to be true and complete in all material respects, (ii) more than $100,000, but not more than $500,000, financial statements reviewed by a public accountant who is independent of the issuer, using professional standards and procedures for such review or standards and procedures established by the SEC by rule for such purpose; and (iii) more than $500,000 (or such other amount as the SEC by rule may establish), audited financial statements;
- a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;
- the target offering amount, the deadline to reach the target offering amount and regular updates regarding the progress of the issuer in meeting the target offering amount;
- the price to the public of the securities or the method for determining the price, provided that, prior to sale, each investor is provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities;
- a description of the ownership and capital structure of the issuer, including (i) the terms of the securities being offered and each other class of equity security of the issuer, including how such terms may be modified, and a summary of the differences between such securities, including how the rights of the securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer, (ii) how the exercise of the rights held by the principal shareholders of the issuer could negatively impact the purchasers of the securities being offered, (iii) the name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer, (iv) how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate transactions and (v) the risks to purchasers of the securities related to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related persons; and
- such other information as the SEC by rule may prescribe for the protection of investors and in the public interest;

- Not advertise the terms of the offering, except for notices that direct investors to the funding portal or the broker;
- Not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal without taking such steps as the SEC by rule requires to ensure that such person clearly discloses the past or prospective receipt of such compensation, upon each instance of such promotional communication;
- File with the SEC not less frequently than annually, and provide to investors, reports of the results of operations and financial statements of the issuer, as the SEC by rule determines appropriate, subject to such

exceptions and termination dates as the SEC by rule may establish; and

- Comply with such other requirements as the SEC by rule may prescribe for the protection of investors and in the public interest.

The SEC is to make, or cause to be made, available to the state securities commissioners, by the relevant broker or funding portal, the information described above and such other information as the SEC by rule determines appropriate.

LIABILITY FOR MISSTATEMENTS AND OMISSIONS

Under new Section 4A(c), a person who purchases a security in an offering pursuant to the exemption provided by new Section 4(6) may bring an action against an issuer to recover the consideration paid for such security, with interest thereon, less the amount of any income received, if the issuer makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading. Similar to the liability provisions in Section 12(a)(2) of the Securities Act, a purchaser may only recover if the purchaser did not know of such untruth or omission and the issuer is not able to show that it did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.

For purposes of the new liability provision, an issuer includes any person who is a director or partner of the issuer and the principal executive officer, principal financial officer, and controller or principal accounting officer of an issuer and any person who offers or sells the security in a transaction exempted by new Section 4(6).

RESTRICTIONS ON RESALE

If securities are issued in a transaction described in new Section 4(6), a purchaser may not transfer such securities during the one-year period beginning on the date of purchase, except to:

- The issuer;
- An accredited investor;
- As part of an offering registered with the SEC; or
- A member of the family of the purchaser, or in connection with the death or divorce of the purchaser or similar circumstances, as determined by the SEC.

The SEC by rule may also establish other limitations on resales of securities purchased in transactions subject to new Section 4(6).

LIMITS ON AVAILABILITY OF NEW EXEMPTION

New Section 4(6) is not available for transactions involving the offer or sale of securities by any issuer that:

- Is not organized under and subject to the laws of a state or territory of the United States or the District of Columbia;
- Is required to file reports with the SEC pursuant to Section 13 or Section 15(d) of the Exchange Act;
- Is an investment company; or
- The SEC by rule or regulation excludes.

FUNDING PORTAL REGULATION

Section 3 of the Exchange Act has been revised to add subsection (h) requiring the SEC to adopt rules exempting, conditionally or unconditionally, a registered funding portal from the requirement to register as a broker or dealer, provided that such funding portal:

- Remains subject to the examination, enforcement and other rulemaking authority of the SEC;
- Is a member of a registered national securities association; and
- Is subject to such other requirements as the SEC determines appropriate.

New Section 3(h) defines "funding portal" to mean any person acting as an intermediary in a transaction involving the offer and sale of securities for the account of others solely

pursuant to new Section 4(6) of the Securities Act that does not:

- Offer investment advice or recommendations;
- Solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal;
- Compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;
- Hold, manage, possess or otherwise handle investor funds or securities; or
- Engage in such other activities as the SEC by rule determines.

In addition, the revisions allow a national securities association to examine a registered funding portal and enforce against a registered funding portal rules of the national securities association written specifically for registered funding portals.

No later than the end of 2012, the SEC is to issue rules to carry out funding portal regulation.

NON-EXCLUSIVE EXEMPTION

The exemption from registration provided by new Section 4(6) is not exclusive and does not prevent an issuer from relying on another exemption from registration in connection with the sales of other securities.

SEC RULEMAKING

No later than the end of 2012 the SEC is to issue such rules as may be necessary or appropriate for the protection of investors to carry out new Section 4(6) and new Section 4A of the Securities Act.

DISQUALIFICATION

No later than the end of 2012, the SEC by rule is to establish disqualification provisions under which an issuer is not eligible to offer securities pursuant to new Section 4(6) and a broker or funding portal is not eligible to effect or participate in transactions pursuant to new Section 4(6). These disqualification provisions are to be substantially similar to the disqualification provisions of Rule 262 of Regulation A promulgated under the Securities Act. They should disqualify any offer or sale of securities by a person who:

- Is subject to a final order of a state securities commission, a state authority that supervises or examines banks, savings associations or credit unions, a state insurance commission, an appropriate federal banking agency or the National Credit Union Administration that (i) bars the person from association with an entity regulated by such commission, authority or agency, engaging in the business of securities, insurance or banking, or engaging in savings association or credit union activities; or (ii) that constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative or deceptive conduct within the 10-year period ending on the date of the filing of the offer or sale; or
- Has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security involving the making of any false filing with the SEC.

EXEMPTION FROM SECTION 12(G) OF THE EXCHANGE ACT

The JOBS Act adds new Section 12(g)(6) to the Exchange Act, which requires the SEC to exempt by rule, either conditionally or unconditionally from the registration requirements of Section 12(g) of the Exchange Act discussed above, securities acquired pursuant to an offering made under new Section 4(6) of the Securities Act.

PREEMPTION OF STATE LAW

Section 18(b)(4) of the Securities Act has been revised to include securities issued in new Section 4(6) offerings as covered securities. This prohibits states from requiring their registration or qualification.

Section 18(c)(1) of the Securities Act has been revised to clarify state jurisdiction over unlawful conduct of funding portals and issuers as it relates to fraud or deceit or unlawful conduct by a broker, dealer, funding portal or issuer in connection with a transaction under new Section 4(6).

Section 18(c)(2) has been revised to prohibit any filing or fee being required with respect to any security that is a covered security pursuant to Section 18(b)(4)(B), or that will be a covered security upon completion of the transaction, except for the requirements of the securities commission of the state of the principal place of business of the issuer, or any state in which purchasers of 50 percent or more of the aggregate amount of the issue reside.

Section 15(i) of the Exchange Act has been amended to prohibit any state or political subdivision thereof from enforcing any law, rule, regulation or other administrative action against a registered funding portal with respect to its business as a registered funding portal. This provision does not apply to the examination or enforcement of any law, rule, regulation or administrative action of a state or political subdivision thereof in which the principal place of business of a registered funding portal is located, provided that such law, rule, regulation or administrative action is not in addition to or different from the requirements for registered funding portals established by the SEC.

SMALL COMPANY CAPITAL FORMATION

NEW SMALL OFFERING EXEMPTION

Section 3(b) of the Securities Act has been amended by adding Section 3(b)(2) requiring the SEC to adopt rules and regulations adding to the securities exempted by Section 3 from the application of the Securities Act securities issued in accordance with the following terms and conditions:

- The aggregate offering amount of all securities offered and sold within the prior 12-month period in reliance on the new exemption is not to exceed $50 million;
- The securities may be offered and sold publicly;
- The securities will not be restricted securities;
- The civil liability provision in Section 12(a)(2) of the Securities Act will apply to any person offering or selling such securities;
- The issuer may solicit interest in the offering prior to filing any offering statement, on such terms and conditions as the SEC may prescribe in the public interest or for the protection of investors;
- The SEC is to require the issuer to file audited financial statements with the SEC annually; and
- Such other terms, conditions or requirements as the SEC may determine necessary in the public interest and for the protection of investors, which may include:
  - a requirement that the issuer prepare and electronically file with the SEC and distribute to prospective investors an offering statement, and any related documents, in such form and with such content as prescribed by the SEC, including audited financial statements, a description of the issuer's business operations, its financial condition, its corporate governance principles, its use of investor funds and other appropriate matters; and
  - disqualification provisions under which the exemption will not be available to the issuer or its predecessors, affiliates, officers, directors, underwriters or other related persons, which are to be substantially similar to the disqualification provisions discussed above under "Crowdfunding".

SECURITIES TO BE ISSUED IN RELIANCE ON NEW EXEMPTION

The only securities that may be exempted under Section 3(b)(2) are equity securities, debt securities and debt securities convertible into or

exchangeable for equity interests, including any guarantees of such securities.

FILING PERIODIC DISCLOSURES WITH THE SEC

Upon any terms and conditions as the SEC determines necessary in the public interest and for the protection of investors, the SEC by rule or regulation may require an issuer of a class of securities exempted under new Section 3(b)(2) to make available to investors and file with the SEC periodic disclosures regarding the issuer, its business operations, its financial condition, its corporate governance principles, its use of investor funds and other appropriate matters and also may provide for the suspension and termination of such a requirement with respect to that issuer.

SEC REVIEW OF DOLLAR LIMITATION

Every two years the SEC is to review the offering amount limitation (initially $50 million) and increase such amount as the SEC determines appropriate. If the SEC determines not to increase the dollar amount, it must report to Congress on its reasons for not increasing the amount.

PREEMPTION OF STATE LAW

Section 18(b)(4) of the Securities Act has also been revised to include securities issued in new Section 3(b)(2) offerings as covered securities and therefore prohibits states from requiring their registration or qualification, provided that the security is offered or sold on a national securities exchange or is offered or sold to qualified purchasers.

COMPTROLLER GENERAL STUDY

The Comptroller General is to conduct a study on the impact of state laws regulating securities offerings on offerings made under Regulation A. The study is to be presented to Congress no later than early July 2012.

PRIVATE OFFERING EXEMPTIONS

REVISIONS TO REGULATION D TO PERMIT GENERAL SOLICITATION

No later than early July 2012, the SEC must revise Rule 506 of Regulation D promulgated under the Securities Act to provide that the prohibition against general solicitation or general advertising will not apply to offers and sales of securities made pursuant to Rule 506 if all purchasers of the securities are accredited investors. The SEC must also revise Rule 506 to require the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors, using methods to be determined by the SEC.

REVISIONS TO RULE 144A TO PERMIT GENERAL SOLICITATION

No later than early July 2012, the SEC must revise Rule 144A(d)(1) to provide that securities sold under Rule 144A may be offered to persons other than QIBs, including by means of general solicitation or general advertising if the securities are sold only to persons that the seller and any person acting on behalf of the seller reasonably believe are QIBs.

AMENDMENT TO SECTION 4

Section 4 of the Securities Act has been revised to provide that offers and sales exempt under Rule 506 are not to be deemed public offerings under the federal securities laws as a result of general advertising or general solicitation.

Section 4 has been further revised to provide that, with respect to securities sold in compliance with Rule 506 of Regulation D, no person must register as a broker or dealer solely because:

- That person maintains a platform or mechanism that permits the offer, sale purchase or negotiation of or with respect to securities, or permits general solicitations, general advertisements or similar or related activities by issuers of such securities, whether online, in person or through any other means;

- That person or any person associated with that person co-invests in such securities; or
- That person or any person associated with that person provides ancillary services with respect to such securities.

The exemption from registration as a broker or dealer only applies if the person and each person associated with the person:

- Does not receive any compensation in connection with the purchase or sale of such security;
- Does not have possession of customer funds or securities in connection with the purchase or sale of such security; and
- Is not subject to a statutory disqualification described in the Securities Act.

For purposes of this provision, ancillary services means:

- The provision of due diligence services in connection with the offer, sale, purchase or negotiation of such security, so long as such services do not include, for separate compensation, investment advice or recommendations to issuers or investors; or
- The provision of standardized documents to the issuer and investors, so long as such person or entity does not negotiate the terms of the issuance for and on behalf of third parties and issuers are not required to use the standardized documents as a condition of using the service.

SEC OUTREACH

The SEC must provide online information and conduct outreach to inform small- and medium-size businesses, women-owned businesses, veteran-owned businesses and minority-owned businesses of the changes made by the JOBS Act.

PRACTICAL CONSIDERATIONS

EMERGING GROWTH COMPANIES

Emerging growth companies are permitted to both "test the waters" to determine whether certain investors might have an interest in a contemplated securities offering and to submit registration statements confidentially to the SEC for nonpublic review. However, confidential registration statements must be filed publicly at least 21 days before the date on which the issuer conducts a road show that constitutes an offering of securities. Because "testing the waters" is inconsistent with the new public filing deadlines for confidential submissions, issuers will not be able to do both at the same time. In practice, issuers will need to choose when and whether they want to test the waters and whether they want to submit a registration statement for confidential review by the SEC staff. It does not appear that persons who are not affiliated with the issuer but who are acting on behalf of the issuer are subject to the same limitations. As a result, investment bankers, for example, may be able to test the waters without issuer participation at the same time that an issuer has submitted a registration statement confidentially. However, before testing the water, issuers and persons acting on their behalf should make sure that their activities will be in compliance with then-current SEC guidance.

Rather than complying with the exemptions available to an emerging growth company, such a company can instead choose to comply with any or all of the requirements, other than financial accounting standards, applicable to nonemerging growth companies. With regard to financial accounting standards only, an emerging growth company must elect whether it wants to comply with the provisions applicable to nonemerging growth companies at the time it files its first report or registration statement with the SEC and notify the SEC of the election. It then cannot change its election for so long as it remains an emerging growth company. With regard to all

other provisions, it would appear that an emerging growth company can elect at any time whether to comply with some or all of the exemptions available to emerging growth companies and can change its election as many times as it desires. Emerging growth companies should discuss the available exemptions matter with all of its advisors to determine whether there are any adverse consequences, such as negative perception in the market place, to be considered.

An emerging growth company can elect to comply with the financial accounting standards applicable to all other public companies or the financial accounting standards in effect at the time it becomes a public company. Consequently, investors must carefully review the financial statements of an emerging growth company to determine what financial standards the company has elected to use and will have to determine on their own whether the financial statements have been prepared on a comparable basis with those of any other public company. In addition, it is unclear whether it will be obvious to investors which accounting standards are being used.

For an emerging growth company that went public after December 8, 2011, or that has already filed a registration statement with the SEC, the deadline may have passed for electing which set of financial accounting standards it will comply with as an emerging growth company. If the emerging growth company would like to change its standards, it should immediately begin a dialogue with the SEC staff to determine if this is possible and, if so, the method to make such election.

CROWDFUNDING

The new liability provisions and related defenses that can be raised by participants in crowdfunding offerings are similar to those contained in Section 12(a)(2) for registered offerings. Accordingly, participants in crowdfunding offerings should consider performing similar types of due diligence as they would do if participating in an offering registered with the SEC in order to best avail themselves of the defenses provided by new Section 4A(c) of the Securities Act.

Based on the restrictions placed on crowdfunding by new Section 4A of the Securities Act, the new exemption may not be as appealing to potential issuers as initially hoped. However, depending on the rules ultimately adopted by the SEC in connection with the new small offering exemption, that new exemption may result in a much more appealing option to potential issuers as the maximum amount that can be raised is $50 million and the securities are freely tradeable when purchased.

Securities purchased pursuant to the new crowdfunding exemption contained in new Section 4(6) of the Securities Act are not to be counted in determined whether the shareholder of record threshold is tripped for purposes of registration under Section 12(g) of the Exchange Act. However, it is unclear whether this result changes when a crowdfunding purchaser transfers those shares. It will be important for issuers engaging in crowdfunding offerings to monitor SEC rulemaking and interpretations in this regard to determine whether records must be maintained to track securities sold in crowdfunding offerings separately from securities sold in other offerings and securities initially sold in crowdfunding offerings that have been subsequently transferred. Similar tracking concerns and monitoring of SEC rulemaking are present in connection with securities sold in employee compensation plans exempted from the registration requirements of the Securities Act.

SMALL OFFERING EXEMPTION

All companies, including public companies, should monitor the SEC rulemaking process regarding the new small offering exemption as it may be a very efficient and cost effective way to raise up to $50 million in the aggregate in any

12-month period through the sale of unrestricted debt or equity securities.

GENERAL SOLICITATION

Issuers engaging in private offerings in reliance on Rule 506 of Regulation D or Rule 144A will be able to engage in general solicitations and general advertising in connection with their offerings provided that the purchasers are either accredited investors or QIBs, as applicable. This could result in a significant change in practice for many issuers. However, until the SEC actually changes its rules, general solicitations and general advertising are still prohibited in connection with offerings made in reliance on Rule 506 of Regulation D or Rule 144A.

The SEC is directed to identify methods that issuers can use to verify the status of purchasers in offerings made pursuant to Rule 506 of Regulation D. All issuers should monitor this rulemaking process to determine whether changes will need to be made to existing verification procedures to comply with SEC rules. It is extremely important to implement SEC-compliant procedures to verify that all purchasers are qualified, as even one nonqualified purchaser will call the exemption into question.

EXCHANGE ACT REGISTRATION

As described in more detail above, the new requirement to register under the Exchange Act set forth in Section 12(g)(1)(A) is triggered when an issuer with $10 million in assets has a class of equity security held of record by either 2,000 persons in total or 500 persons who are not accredited investors. Under these revised thresholds, an issuer will need to maintain records that specify whether or not its holders of record are accredited investors. At a minimum, it should obtain representations from investors at the time of initial investment, such as through a subscription agreement or shareholders agreement, and a commitment from the investor to update the issuer if its status changes or upon request of the issuer. In addition, any transfer of securities could be conditioned upon the transferee making the same commitments.

If you have any questions regarding the JOBS Act, including anything not addressed in this Legal Update, please contact the authors, Michael L. Hermsen at +1 312 701-7960 or Jennifer J. Carlson at +1 312 701 8591, any of the lawyers listed below or any other member of our Corporate and Securities group.

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Endnotes

[1] Available at http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

[2] Rule 12b-2 promulgated under the Exchange Act defines a "large accelerated filer" as a company that has: (i) an aggregate worldwide market value of the voting and nonvoting common equity by its nonaffiliates of $700 million or more, (ii) been subject to the reporting requirements of the Exchange Act for at least 12 months, and (iii) filed at least one annual report pursuant to the requirements of the Exchange Act.

[3] See, e.g., www.techopedia.com.

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