

# House Passes JOBS Act—Legislation Would Facilitate Public and Private Capital Formation by Emerging Growth Companies

**March 14, 2012**

The U.S. House of Representatives has passed legislation that, if approved by the Senate and enacted into law, would allow companies to raise capital more easily in both the private and public markets. On March 8, 2012, the House approved, with bi-partisan support, the Jumpstart Our Business Startups Act, or "JOBS" Act. Given election-year politics, and apparent White House support, we believe that there is a reasonable likelihood that the Senate will pass legislation along the same lines before year-end. It is difficult to predict, however, if and when a bill that can be reconciled with the House bill would be passed.

The purpose of the JOBS Act is to increase job creation and economic growth by improving access to private and public capital. The legislation would make it easier for (i) private companies to raise capital through private offerings and (ii) "emerging growth companies" to go public, and once public, to raise additional funds in the capital markets. We expect that, if adopted by the Senate, the legislation will encourage more companies to pursue initial public offerings, subject to market conditions, and to increase activity in the private markets.

## **Private Capital Formation**

The JOBS Act would facilitate the private offering process by (1) eliminating the prohibition on general solicitation or advertising for offerings under Rule 506 of Regulation D to accredited investors and for secondary sales under Rule 144A to qualified institutional buyers; (2) lifting the cap on Regulation A offerings from \$5 million to \$50 million; and (3) creating an exemption for so-called "crowdfunding." Crowdfunding describes a method of raising capital, usually through the Internet, among people who network and pool money, typically in very small individual contributions. The JOBS Act would permit crowdfunding up to \$2 million per year in the aggregate, with individual investors limited to the lesser of \$10,000 and 10% of an investor's annual income. The legislation also would ease requirements for broker-dealer registration requirements for intermediaries that facilitate offerings under Rule 506 of Regulation D and the crowdfunding exemption.

Another provision of the JOBS Act would make it easier for private companies to raise capital from investors without triggering the registration requirements under Section 12(g) of the Securities Exchange Act of 1934. Under current law, an issuer is required to register a class of securities under the Exchange Act once such class is held of record by 500 or more shareholders and the issuer has in excess of \$10 million in assets. Many private companies restrict offering activity for fear that a growing shareholder base will trigger public registration requirements. The legislation would significantly increase the threshold to 2,000 shareholders of record, or 500 persons who are not "accredited investors" as defined in Regulation D. The new rule would exclude from the calculation (i) employees who obtained equity under employee compensation plans in reliance on exemptions from registration and (ii) investors who purchased securities pursuant to the crowdfunding exemption.

## **Public Capital Formation**

The JOBS Act would amend the Securities Act of 1933 and the Exchange Act to create a new category of issuer referred to as an "emerging growth company." The legislation would facilitate the ability of emerging growth companies to raise funds in the public capital markets. By easing regulatory burdens, the legislation is designed to encourage private emerging growth companies to pursue initial public offerings, and to facilitate raising additional funds in the capital markets once public. The legislation would create a transitional process, or "on ramp," by which emerging growth companies would transition to the full rigors of SEC compliance through a combination of scaled disclosure requirements and transitional compliance burdens. It also includes provisions that would enable eligible companies to communicate more freely with institutional investors to determine their interest in a potential IPO.

The provisions of the JOBS Act are designed to lead to broader analyst coverage of emerging growth companies by allowing analysts to publish research prior to, during and after an offering, as well as by allowing analysts to meet more freely with issuers and institutional investors. Companies would also be entitled to file a registration statement with the SEC on a confidential basis, and maintain a confidential registration process, until up to 21 days prior to the commencement of a road show. The freer communication rules are intended to assist a private company to assess the viability of an IPO, while preserving the confidentiality of sensitive financial and competitive information until such time as it is prepared to commence marketing through a road show process.

"Emerging growth companies" that would benefit from the new regime would include any issuer that, during its most recently completed fiscal year at the time of registration with the SEC, had less than \$1 billion in annual gross revenues. Full compliance with the SEC's reporting requirements would be required after the earliest of (i) such time that the company generates \$1 billion or more in annual revenues, becomes a "large accelerated filer" (at least 12 months of reporting history and \$700 million in public float), or raises more than \$1 billion in non-convertible debt in the prior three years, and (ii) five years following the company's IPO. The legislation generally only provides benefits to companies that have not yet effected an IPO or have done so very recently. An issuer is ineligible to be considered an emerging growth company if it has already completed its initial public offering such that the date of first sale of public equity occurred on or before December 8, 2011.

The scaled disclosure requirements and streamlined communication rules under the legislation would include:

- Two rather than three years of audited financial statements in a registration statement for an IPO, and corresponding relief from requirements to provide selected financial data and management's discussion and analysis;
- Exemption from Sarbanes-Oxley Section 404(b) auditor attestation of internal controls and procedures, and from certain other accounting and auditing standards (including auditor rotation requirements if such requirements are imposed);
- Exemption from say-on-pay votes, say-on-golden-parachute votes, disclosure of pay-versus-performance and the ratio of CEO-to-worker pay compensation under the Dodd-Frank Act;
- Reduced disclosure requirements regarding executive compensation and management's discussion and analysis for the annual report on Form 10-K and proxy statement;
- Brokers and dealers, including underwriters participating in an emerging growth company's IPO, would be allowed more latitude to publish or distribute research reports regarding the company prior to, during and immediately following its IPO; and
- Both pre- and post-filing oral and written communications would be permitted with qualified institutional buyers and institutional accredited investors.

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A copy of the JOBS Act is available at the following link:

<http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606eh/pdf/BILLS-112hr3606eh.pdf>. We will continue to monitor this legislation, and provide updates as appropriate. Please feel free to contact us with questions or comments.

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- **Frank Zarb**  
Partner