

Congress Has Adopted Legislation to Facilitate Public and Private Capital Formation by Emerging Growth Companies

April 4, 2012

Congress passed legislation that, if signed as expected by President Obama, will allow companies to raise capital more easily in both the private and public markets. As reported in our client alert dated March 14, 2012, the House of Representatives passed a version of the Jumpstart Our Business Startups Act, or "JOBS" Act, on March 8, 2012. On March 22, 2012, the Senate approved a substantially similar version of the legislation with an amendment related to "crowdfunding." On March 27, 2012, the House approved the Senate version of the legislation. Now that the House and Senate have reached agreement on the final version of the legislation, the JOBS Act will become law once signed by President Obama.

The purpose of the JOBS Act is to increase job creation and economic growth by improving access to private and public capital. The legislation will 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, when approved by President Obama, the legislation will encourage more companies to pursue initial public offerings, subject to market conditions, and to increase activity in the private markets.

Public Capital Formation

The JOBS Act will amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to create a new category of issuer referred to as an "emerging growth company." The legislation will 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 will create a transitional process, or "on ramp," by which emerging growth companies will transition to the full rigors of SEC compliance through a combination of scaled disclosure requirements and transitional compliance burdens. It also includes provisions that will 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 companies and institutional investors. Companies will 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 will benefit from the new regime will include any company 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 will 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. A company 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 will 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, will 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 will be permitted with qualified institutional buyers and institutional accredited investors.

Private Capital Formation

The JOBS Act will 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." The legislation will also ease broker-dealer registration requirements for intermediaries that facilitate offerings under Rule 506 of Regulation D.

In terms of easing requirements regarding general solicitations, Rule 506 of Regulation D will be amended to permit general solicitation and general advertising, as long as all purchasers are accredited investors. The prohibitions in Rule 144A offerings on general solicitation, general advertising and making offers to investors who are not qualified institutional buyers will be eliminated, as long as all purchasers are qualified institutional buyers. Reasonable steps must be taken to verify that purchasers are accredited investors or qualified institutional buyers, as applicable, using as-yet undetermined procedures.

Regulation A currently provides an exemption from registration for securities offerings by non-reporting companies, not to exceed \$5 million per year, but requires companies to file offering documents with the SEC and in states where offers are made. Regulation A allows companies to "test the waters" for interest in a proposed offering, does not limit solicitations to particular investors, and, moreover, immediately after an offering, the securities are not subject to any transfer restrictions. The exemption permits general solicitation activities within specified parameters. However, due to the costs of SEC review and the low offering threshold, the exemption has rarely been used.

By raising the offering threshold under Regulation A to \$50 million in any 12-month period, the JOBS Act should make the exemption more attractive to some issuers. However, issuers will be required to file audited financials with the SEC annually, and the SEC may impose further reporting requirements, such as filing offering statements (including audited financial statements). Offerings under Regulation A, furthermore, will remain subject to state blue sky laws in many if not most cases, with pre-emption only under narrow circumstances.

"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 will permit crowdfunding up to \$1 million per year in the aggregate. Sales to individual investors who have an annual income or net worth of less than \$100,000 will be limited to the greater of \$2,000 and 5% of an investor's annual income or net worth, as applicable. Sales to individual investors who have an annual income or net worth equal to or more than \$100,000 can reach 10% of an investor's annual income or net worth, as applicable, not to exceed a maximum annual amount of \$100,000.

An intermediary (a broker or "funding portal") must be used in the transaction and must, among other things, meet certain registration requirements, ensure that investors understand the risks of the investment and can bear the burden of losing the investment, act to reduce the risk of fraud, and monitor investment amounts and limits.

Eligible companies will have to provide certain information to investors, the intermediary and potential investors (and file it with the SEC), and will also have ongoing reporting requirements, including disclosure of a target offering amount and deadline, and regular progress updates. Certain restrictions on advertising offering terms and compensating intermediaries will also apply, as will restrictions on resale of the securities.

Another provision of the JOBS Act will make it easier for private companies to raise capital from investors without triggering the registration requirements under Section 12(g) of the Exchange Act. Under current law, a company 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 company 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 will 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 will 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.

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

<http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.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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