PRESIDENT OBAMA SIGNS JOBS ACT

Landmark Legislation Changes the Landscape of Raising Capital

On April 5, 2012 President Obama signed the Jumpstart Our Business Startups Act (JOBS Act) into law. Passed by a 73-to-26 vote in the U.S. Senate and a 380-to-41 vote in the U.S. House of Representatives, the JOBS Act is a bipartisan collection of legislative measures that have been introduced over the past year and change dramatically the regulatory scheme for raising capital in the U.S.

Expansion of Regulation A

The JOBS Act requires the SEC to increase the amount of securities that can be issued in a 12-month period under Regulation A, an exemption from registration under the Securities Act that has been around in concept since the 1930s, from $5 million to $50 million, or to create a new exemption from registration similar to Regulation A permitting such increased amounts. Preliminary discussions between Kaplan, Voekler, Cunningham & Frank, PLC (KVCF) attorneys and the SEC have indicated that an expansion of Regulation A is more likely than a new exemption, but SEC is still in the very early stages of their process.

Regulation A securities are <u>not</u> restricted securities like those sold under Regulation D, meaning they are freely tradeable. Additionally, a Regulation A offering may be marketed publicly, and there are no investor net worth (such as accredited investor requirements) or investment limitations, in contrast to the Rule 506 and "crowd funding" exemptions, respectively, discussed below.

Regulation A offerings and securities will remain subject to state securities laws unless they are sold on a national securities exchange or to qualified purchasers (to be defined by SEC) only. The JOBS Act requires the Comptroller General to conduct a study of the impact of state securities laws on Regulation A offerings within three months of the JOBS Act's passage, so there remains future potential for limitation or simplification of the application of state securities laws to Regulation A offerings.

In addition to the expansion to $50 million, the JOBS Act also makes the following important changes to Regulation A:

- Required Annual Financial Statements and Reporting: Issuers will be required to file annual audited financial statements with the SEC. Additionally, the JOBS Act invites SEC to create reporting requirements for Regulation A companies.

- Electronic Filing: Currently Regulation A filings are one of the few remaining filings made in paper format. The JOBS Act invites the SEC to make rules requiring the filing of Regulation A documents electronically.

- Securities Act Liability: Under the JOBS Act persons offering and selling Regulation A securities will be subject to liability under Section 12(a)(2) of the Securities Act.

[1]The text of the Jumpstart Our Business Startups Act is available at http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

General Solicitation under Rule 506 and 144A

Currently an issuer relying on Rule 506 of Regulation D may not engage in any public solicitation in connection with its offering in order to maintain its exemption from registration. The JOBS Act changes this for certain offerings. Within 90 days of enactment, the SEC must revise its rules to permit companies to conduct general solicitation and advertising in private offerings under Rule 506 of Regulation D, provided that the actual purchasers are all accredited investors. Accordingly, a key aspect of the SEC's rulemaking will be the whether and how the SEC defines the "reasonable steps" an issuer must take to verify accreditation for purchasers, and what impact this would have on enforcement of state securities laws if non-accredited investors are erroneously accepted.

Similarly, general advertising and solicitation will be permitted under Rule 144A, provided that sales are made only to Qualified Institutional Buyers (QIBs).

The JOBS Act also amends the Securities Act to provide that certain trading platforms involved with the sale of securities in a valid Rule 506 private placement are not subject to registration as a broker or dealer as long as enumerated conditions are met. These conditions include that persons receive no compensation in connection with the purchase or sale of securities and that the platform does not have possession of customer funds or securities in connection with the purchase or sale of securities.

Raised Threshold for Registration and Public Company Reporting

The JOBS Act amends the Exchange Act to raise the shareholder threshold at which private companies are required to register a class of securities under the Exchange Act and become subject to public company reporting obligations. Currently, Section 12(g) of the Exchange Act requires such registration if a company's assets exceed $10 million and its shares are held of record by 500 persons or more as of the end of its fiscal year. While the asset threshold will not change, the new shareholder thresholds will increase to 2,000 shareholders, with no more than 500 shareholders who are not accredited investors. Shareholders who received securities pursuant to an employee compensation plan or in connection with the crowd funding exemption discussed below will be excluded from the shareholder threshold count.

IPO On-Ramp for Emerging Growth Companies

Eligibility

The JOBS Act will create a much simpler "onramp" to access the public capital markets for "emerging growth companies" by reducing some of the burdens of going public and phasing in certain public company disclosure
requirements over time. The JOBS Act will amend the Securities Act of 1933 (Securities Act) and the Securities
Exchange Act of 1934 (Exchange Act) to define an "emerging growth company" as a company with less than $1 billion in annual gross revenue during its most recent fiscal year. A company will continue to be designated as an emerging growth company until the earlier of the following:

- The last day of the first fiscal year after its annual gross revenues exceeded $1 billion
- The last day of the first fiscal year following the fifth anniversary of its IPO

- The date on which it will have issued more than $1 billion in non-convertible debt in the last three-year period

- The date it becomes a "large accelerated filer," meaning the last day of the fiscal year in which (i) it has a public equity float held by non-affiliates of $700 million or more (measured as of the last business day of its second fiscal quarter of such year) and (ii) it has been a reporting company under the Exchange Act for at least 12 calendar months.

A company that completed its IPO on or before December 8, 2011, does not qualify as an emerging growth company.

Facilitating IPOs

- Reduced Financial Information Required: Emerging growth companies will not be required to provide more than two years of audited financial statements in their registration statements and will need to provide selected financial data in registration statements or reports for only the periods covered by the audited financial statements. Currently SEC rules require three years of audited financial information and selected financial data for up to the previous five years.

- Confidential Review by the Securities and Exchange Commission (SEC): Emerging growth companies will be able to submit a draft registration statement to the SEC for a confidential nonpublic review, provided that the initial submission and all amendments are filed publicly with the SEC at least 21 days before the issuer begins its road show.

- Pre- and Post-Filing Communications with QIBs and Institutions That Are Accredited Investors: Emerging growth companies and persons authorized to act on their behalf will be permitted to engage in oral or written communications with institutions who are QIBs or accredited investors to determine whether such institutions might have an interest in a contemplated securities offering, either prior to or following the date of filing of a registration statement.

- Analyst Research Reports and Appearances: Brokers or dealers will be permitted to publish or distribute a research report covering an emerging growth company that is the subject of an IPO or potential IPO, even if the broker or dealer is participating or will participate in the offering, without such research being considered an offer of securities (including research reports published prior to an IPO). In addition, neither the SEC nor any national securities association will be permitted to 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 during post-IPO quiet and lockup periods.

- Securities Analyst Communications: The JOBS Act will relax restrictions on communications between securities analysts and potential investors, and on securities analyst participation in communications with the management of emerging growth companies alongside investment banking personnel and other associates of a broker or dealer.

Relaxing Public Reporting Requirements

- Auditor Attestation: Emerging growth companies will not have to provide an auditor's attestation report on their internal controls in their annual reports on Form 10-K as currently required by Section 404(b) of the Sarbanes-Oxley Act.

- Audit Rules: Emerging growth companies will not have to comply with proposed PCAOB rules requiring auditor rotation or auditor reports, including auditor discussion and analysis, if adopted, or with any future PCAOB audit rules. This will be true unless the SEC determines that the application of such rules is necessary or appropriate in the public interest after consideration of investor protection and the promotion of efficiency, competition, and capital formation.

- Public Company Accounting Pronouncements: Emerging growth companies will not have to comply with new U.S. GAAP accounting pronouncements otherwise applicable to public companies until the pronouncements become applicable to private companies. If they do choose to comply with public company standards, however, they must comply with all such public company standards.

- Advisory Votes on Executive Compensation: Emerging growth companies will not have to hold an advisory shareholder vote on the compensation of named executive officers, as otherwise required by the Dodd-Frank Act.

- Disclosure Relating to Executive Compensation: Emerging growth companies will be permitted to comply with the same reduced executive compensation disclosure requirements currently required of smaller reporting companies. They will not have to provide median compensation numbers or comparisons of executive pay to company performance and worker pay, as otherwise required by the Dodd-Frank Act.

The JOBS Act also requires the SEC, within 180 days of the act's adoption, to conduct a review of the disclosure rules contained in Regulation S-K, in order to update, modernize, and simplify such requirements for emerging growth companies. Emerging growth companies may "opt in" and comply with the disclosure rules otherwise required of issuers under the federal securities laws on an "a la carte" basis (except as described above relating to public company accounting pronouncements).

Trading in Emerging Growth Companies

The JOBS Act charges the SEC with conducting a study, to be submitted within 90 days, of the effect of the transition to trading securities in one penny increments (known as decimalization). This study is to focus on the impact decimalization has had on the number of IPOs, the liquidity of small and mid-cap companies, and on the sufficiency of the economic incentives to support trading in the securities of these companies following decimalization. The JOBS Act instructs the SEC to designate a greater increment for trading and quoting the securities of emerging growth companies, which must be less than $0.10, if the SEC determines a greater increment necessary.

The IPO on-ramp provisions of the JOBS Act discussed above each are structured as amendments to the Securities Act and the Exchange Act, which make such changes immediately effective upon signing by the President. There are, however, a number of existing rules and regulations previously adopted by the SEC, the Financial Industry

Regulatory Authority (FINRA), and other bodies that will need to be amended or clarified in light of the changes made by the JOBS Act. The SEC and FINRA have not yet commented on plans to make conforming changes to existing rules, which may lead to uncertainty about the implementation of various aspects of the JOBS Act.

Crowdfunding

The JOBS Act also amends Section 4 of the Securities Act, and it requires the SEC to promulgate related rules to create an exemption from registration that permits a private company to sell securities in small amounts to large numbers of investors that are not accredited over a 12-month period. Such capital-raising is known as "crowdfunding." Importantly, crowdfunding securities will be "federally covered securities" and therefore their offer and sale will be exempt from state registration. States will be permitted to require notice filings, but not to charge fees, except in the principal place of business of the issuer or in states in which purchasers of more than 50% of the securities reside. Furthermore, purchasers of crowdfunding securities will be excluded from the shareholder calculations of Section 12(g) of the Exchange Act, so crowdfunding, on its own, will not result in public reporting requirements.

As adopted, the JOBS Act limits the aggregate dollar amount of securities that an issuer can sell in a crowdfunding transaction to $1 million over a 12-month period. In addition, the amount of crowdfunding securities an individual investor may purchase from all issuers in any 12-month period is limited to the maximum of:

• the greater of $2,000 or 5 percent of the annual income or net worth of an investor, if either the investor's net worth or annual income is less than $100,000; and

- 10 percent, not to exceed $100,000, of annual income or net worth of an investor, if either the investor's annual income or net worth is equal to or greater than $100,000.

The issuer must sell the securities through a broker or funding portal, which would be required to register with the SEC and other applicable self-regulatory organizations as a broker or funding portal as defined under the Exchange Act. These intermediaries would need to meet a series of specific and restrictive requirements to be set by the SEC, including disclosures of risk and information about the issuers, and policing investment to ensure that an investor's aggregate investments in crowdfunding securities do not exceed the maximums set forth above. Issuers utilizing the crowdfunding exemption must make financial and other information available to both the SEC and investors, both in connection with the offering and on an annual basis, under a tiered disclosure regime based on the size of the offering, including the following:

- $100,000 or Less: Income tax returns for the last fiscal year and unaudited financial statements certified as accurate by the principal executive officer

- $100,000 to $500,000: Financial statements reviewed by an independent public accountant

- More than $500,000: Audited financial statements.

In addition, the JOBS Act specifically authorizes an investor in a crowdfunding transaction to bring a civil action against an issuer for material misstatements or omissions in disclosures provided to investors. Such an action is subject to the provisions of Section 12(b) and Section 13 of the Securities Act.

While the JOBS Act specifically states that the crowdfunding amendments to the Securities Act are not to be interpreted as preventing an issuer from raising capital through other methods, it is unclear in practice how this will work. Private placements conducted through Regulation D—the most common type of private securities transaction—by rule may be integrated with other offerings conducted within six months. This means that unless the SEC clarifies otherwise, it may not be possible to conduct a crowdfunding transaction at the same time as another private funding.

Timing of Rule Changes

SEC Chairman Mary Schapiro[2] has released a public statement speaking as an individual and not on behalf of the SEC, voicing a number of concerns about the JOBS Act, including, in particular, the proposed rulemaking deadlines. Although the final JOBS Act did grant the SEC additional time with respect to crowdfunding than the House bill to which Chairman Schapiro commented, generally Chairman Schapiro's requests for additional time for rulemaking fell on deaf ears. With these statements in mind, it is not yet clear when companies actually will be able to take advantage of all of the provisions of the JOBS Act. KVCF attorneys will continue to monitor developments related to the JOBS Act, including related SEC and FINRA rulemaking. For more information regarding the JOBS Act or any related matter, please contact your regular KVCF attorney or a member of the firm's corporate and securities practice.

[2] SEC Chairman Mary Schapiro's statement is available at http://www.thecorporatecounsel.net/nonMember/docs/jobs-chapirotoJohnson.pdf.

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