April 18, 2012

THE "JOBS ACT" LEGISLATION DESIGNED TO EASE ACCESS TO PRIVATE AND PUBLIC CAPITAL BECOMES LAW

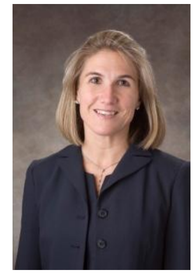
On April 5, 2012, the "Jumpstart Our Business Startups Act" (JOBS Act) became law. The JOBS Act aims to reduce certain capital raising restrictions currently faced by many companies, both by loosening regulations governing private securities offerings and by easing the road to public securities offerings for so-called "emerging growth companies." The JOBS Act implements sweeping changes to various aspects of the Securities Act of 1933, as amended (Securities Act), the Securities Exchange Act of 1934, as amended (Exchange Act), and other laws and regulations.

Although much of the JOBS Act became effective immediately, significant rulemaking and guidance from the Securities and Exchange Commission (SEC) and other regulatory agencies will be necessary to fully implement the JOBS Act. The true effect of the JOBS Act will depend in large part on the choices the SEC makes in designing these rules and regulations. As we highlight in more detail below, the staff of the SEC has already begun addressing questions raised by the JOBS Act to provide initial guidance on how companies can take advantage of those provisions of the JOBS Act that are immediately effective within the context of existing SEC rules and practice. These interim measures will ultimately be replaced by new and updated rules that are required to be adopted under the JOBS Act.

As the first in a series dedicated specifically to the JOBS Act and its impact on the capital raising process, this Client Alert provides an initial overview of the most significant aspects of the JOBS Act and highlights what they mean for smaller and emerging companies. We will monitor SEC guidance and rule making and other developments relating to this monumental legislation and provide additional updates aimed to help you take advantage of its intended benefits.

FLEXIBILITY FOR PRIVATE COMPANIES – NEW AND EXPANDED REGISTRATION EXEMPTIONS

The JOBS Act aims to provide more flexibility for private companies raising capital by (1) lifting the cap on Regulation A offerings from $5 million to $50 million; (2) creating an exemption for so-called "crowdfunding"; (3) 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 (QIBs); and (4) significantly increasing the threshold of holders of record that triggers registration under the Exchange Act. We have set forth below important details about each of these provisions.



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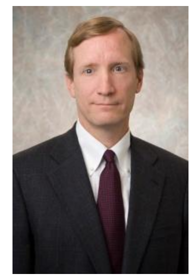

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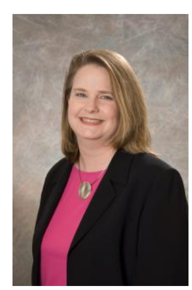

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Offering Threshold for Regulation A Offerings Raised from $5 Million to $50 Million

- *Historical Overview.* Before enactment of the JOBS Act, Regulation A (often called the "mini-public offering" exemption) allowed companies to "test the waters" for interest in a proposed offering of up to $5 million without limiting solicitations to a particular types of investor and while avoiding certain of the more onerous disclosure requirements typically associated with a traditional IPO. However, no corresponding exemption from state "blue sky" registration requirements was available for these Regulation A offerings. As a result, due to the cost of state "blue sky" registration and SEC review and the low offering threshold of $5 million, companies rarely used the Regulation A exemption.

- *New Broadened Regulation A Exemption.* Title IV of the JOBS Act establishes a new and expanded exemption similar to Regulation A that aims to address these problems by:
  - raising the offering threshold from $5 million to $50 million for offerings made in any 12-month period, and
  - exempting these offerings from state "blue sky" registration (but not anti-fraud regulation) if they are made on a national securities exchange or to "qualified purchasers," as to be defined by the SEC.

- *Freely Tradable.* Consistent with their historical treatment under Regulation A, the securities offered and sold in the expanded Regulation A offering will not be deemed "restricted securities" for Rule 144 resale purposes and will not be subject to corresponding transfer restrictions or holding period requirements.

- *Disclosure and Antifraud Requirements.* Companies making offerings under this expanded Regulation A structure will be required to file audited financial statements and make other periodic disclosures with the SEC, as determined by rules yet to be adopted by the SEC. Companies issuing securities under Regulation A will be subject to civil liability for false or misleading statements or omissions in communications involved in the offering.

Effectiveness: The SEC must issue rules to implement the new and expanded Regulation A exemption. No deadline for the issuance of these rules is imposed by the JOBS Act.

Impact of Expanded Regulation A:

- The expanded Regulation A offering exemption may be appealing to late-stage companies as it enables them to broaden the universe of potential investors and avoid some of the offering restrictions imposed by Rule 506, while potentially limiting the time and costs associated with a full-blown public offering. Securities issued under Regulation A, unlike those sold in Rule 506 offerings, are freely tradable, which may be more appealing to investors in late-stage companies. This, in turn, could ultimately lead to a more robust trading market in private company securities.

- Federal preemption of state "blue sky" registration applies only to those Regulation A offerings made on a national securities exchange or to "qualified purchasers." The SEC has yet to define the category of "qualified purchasers," a term which has been used under federal securities laws since 1996. Until it does, only those companies that actually have shares listed and traded on a national securities exchange will benefit from federal preemption. All other Regulation A offerings would remain subject to state "blue sky" registration requirements, which involve "merit" review in some states. As a result, until the SEC defines "qualified purchaser," state "blue sky" compliance may significantly increase the time and cost associated with Regulation A offerings for many companies.

New Crowdfunding Exemption

- *Overview.* Title III of the JOBS Act creates a "crowdfunding" exemption that allows U.S. private companies to raise small amounts of capital from an unlimited number of individuals, including unsophisticated investors, without having to comply with the Securities Act registration requirements.

- *Limitations.* The JOBS Act imposes the following limitations on crowdfunding programs:
    - the aggregate amount of securities sold to all investors within any 12-month period, including all amounts sold over the internet, may not exceed $1 million,
    - the aggregate amount of securities sold to an individual investor within any 12-month period, including all amounts sold over the internet, may not exceed:
        - the greater of $2,000 or 5% of the annual income or net worth of such investor—if either the annual income or the net worth of such investor is less than $100,000, and
        - 10% of the annual income or net worth of such investor—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.
    - Sales must be conducted through a registered broker-dealer or a special funding portal. Intermediaries must provide disclosures to investors (and the SEC) and comply with other regulations to be adopted by the SEC.
    - Companies must file with the SEC, and provide to investors and intermediaries, certain information about the company (including financial statements), its officers, directors and significant shareholders, risks related to the offering and certain other information determined by rules adopted by the SEC, each in varying levels of depth depending on the target amount of capital to be raised.

- *Resale Restrictions.* Securities acquired through crowdfunding offerings will be subject to resale restrictions for a one-year period unless sold to accredited investors or resold to the company.

- *Preemption.* The JOBS Act preempts (effectively eliminating) state "blue sky" regulation of offerings that meet these requirements.

Effectiveness: The crowdfunding exemption was immediately effective upon enactment of the JOBS Act. However, various provisions require implementing rules to be issued by the SEC, which must occur within 270 days of the JOBS Act's enactment (or by early-January 2013).

Impact of Crowdfunding Exemption:

- The new crowdfunding exemption has been, and will likely continue to be, hotly debated. Supporters believe crowdfunding could revolutionize startup investing. Skeptics argue that crowdfunding will have unintended consequences, from fraud to a bubble of epic proportions. What is certain is that funding portals and companies seeking to take advantage of this new process will be required to comply with a number of new rules and regulations, most of which are not yet known. The JOBS Act gives the SEC nine months to adopt rules governing crowdfunding and registration requirements for "funding portal" intermediaries. Companies and intermediaries using crowdfunding to raise investment capital before the new rules are adopted will need to register the offering or find an applicable exemption from registration requirements under existing rules and regulations.

- A company that chooses to use crowdfunding to raise capital will be required to use an intermediary as a "funding portal" to conduct the transaction, which will add costs to the transaction. We anticipate that there will be numerous ventures that will try to take advantage of the new "funding portal" line of business. Initially, we may see significant variations in price, operational effectiveness and compliance among these new intermediaries. It will be important for companies to take the time to fully investigate their options, particularly as rules are announced and market practice develops, and to select the most reputable, cost-effective intermediary possible.

Impact of Crowdfunding and Expanded Regulation A:

- All companies should consider various important issues before seeking to raise capital through crowdfunding or the expanded Regulation A exemption.

    - Companies utilizing these provisions will be required to disclose a significant amount of information to investors. This type of information (much of which would not be required in connection with an offering to accredited investors under Rule 506) is costly to prepare and will be made available for public scrutiny (by the media, competitors and others) through required SEC filings. While the JOBS Act sets forth certain minimum standards to be met, SEC rulemaking is needed before the full extent of disclosure obligations is known as it applies to each new exemption. In most cases, the disclosure will involve (at a minimum) providing financial statements as well as detailed information about the company and its operations.

    - Use of crowdfunding or the expanded Regulation A exemption could add a large number of unsophisticated investors to the company's shareholder base. This could cause significant challenges for management and make it harder for a company to secure subsequent venture-backed financings or to engage in significant corporate transactions in the future. Items such as shareholder actions or approvals may be more challenging to manage and may require more detailed communications or extended time to complete. Investors with less experience and lower risk thresholds may also be more likely to raise conflicts with management or instigate litigation against the company should the expected return of their investment go unrealized. For these and other reasons, venture capital firms or other institutional investors may avoid private companies with a significant base of unsophisticated shareholders. In addition, it may be more difficult to implement a restructuring, merger or acquisition event that requires the company to utilize an exemption from securities laws when the company has a large number of unaccredited investors.

Removal of Ban on General Solicitation in Rule 506 Offerings

- *General Solicitation for Rule 506 Offerings.* Private companies have historically relied on the Rule 506 "private placement" safe harbor in order to sell securities without registration with the SEC. Rule 506 of Regulation D permits sales of securities to sophisticated investors, subject to certain limitations, including the requirement that the company and its agents refrain from engaging in "general solicitation" (activities that would broadly solicit investors with whom they had no previous relationship) or advertising of the offering. Title II of the JOBS Act expands Rule 506 to permit general solicitation and advertising for private offerings under Rule 506 if all purchasers qualify as "accredited investors," as defined under established SEC rules and regulations.

- *Expansion of Rule 144A.* Title II of the JOBS Act also directs the SEC to adopt rules to permit general solicitation and advertising in connection with the resale of such securities under Rule 144A, provided that such sales are made to QIBs.

- *Verification.* Sellers must take reasonable steps to verify that purchasers are accredited investors or QIBs using as-yet undetermined procedures.

Effectiveness: The SEC must issue implementing rules within 90 days of the JOBS Act's enactment (or by early-July 2012).

Impact of Removal of Ban on General Solicitation in Rule 506 Offerings:

- Federal and state antifraud regulations continue to apply to Rule 506 offerings (as well as crowdfunding and expanded Regulation A offerings). These regulations, combined with the continued ban on the use of general solicitation and advertising in private placements under Section 4(2) of the Securities Act (the most commonly used "fall-back" exemption for Rule 506 offerings) and state regulation that may continue to apply to such offerings (at least to the degree not pre-empted by the JOBS Act), could have a restraining effect on the unfettered use of publicity to offer and sell securities (even if limited to accredited investors and QIBs).

- We believe changes imposed by Title II of the JOBS Act ultimately may significantly alter the manner in which companies offer securities to accredited investors. By lifting the ban on general solicitation, private companies and their agents should be able to use a number of new tools to reach qualified investors, such as blogs, e-mail newsletters and investing communities. These changes should enable private companies to reach a much broader pool of investors, provided that sellers verify that those investors qualify as accredited investors. We recommend that companies consult legal counsel before using general solicitation or advertising to promote investment opportunities to confirm how best to structure the offering in light of expected SEC rules and various risks that continue to apply under federal and state regulation.

- The changes to Rule 506 and Rule 144A required by the JOBS Act will not become effective until the SEC amends those rules (within 90 days of enactment). In the interim, companies should continue to implement customary offering procedures applicable to Rule 506 and Rule 144A. We will monitor and continue to provide updates on any new guidance or rules applicable to Rule 506 and Rule 144A announced by the SEC or its staff.

Relaxed Thresholds for Exchange Act Registration and Reporting

- *Historical Overview.* Previously, the Exchange Act generally required companies with total assets exceeding $10 million to register with the SEC if a class of securities was held of record by 500 or more persons, making such companies subject to the burdensome reporting obligations applicable to public companies.

- *Expanded Threshold to Trigger Reporting.* Title V and Title VI of the JOBS Act amend Section 12(g) and Section 15(d) of the Exchange Act to raise the threshold for triggering mandatory Exchange Act registration for all companies other than banks and bank holding companies from 500 to 2,000 holders of record, so long as there are no more than 499 holders of record who are not "accredited investors." Holders of record who received their securities in exempt offerings under employee benefit plans or (subject to SEC rule making) in exempt crowdfunding offerings are excluded from these thresholds.

- *New Thresholds for Banks and Bank Holding Companies.* The JOBS Act also raises the threshold for triggering mandatory Exchange Act registration for banks and bank holding companies to 2,000 record holders (with no limit on non-accredited investors). In addition, the JOB Act raises the threshold that allows termination of registration and suspension of reporting obligations for banks and bank holding companies to 1,200 holders of record. (The deregistration threshold for companies other than banks and bank holding companies remains unchanged, at fewer than 300 holders of record in most circumstances.)

Effectiveness: The increased thresholds triggering Exchange Act reporting were effective immediately upon the JOBS Act's enactment. The SEC must issue rules to implement these provisions no later than one year after enactment of the JOBS Act (in early-April 2013). The SEC also must adopt rules to revise the definition of "held of record," although the JOBS Act does not provide a deadline for such adoption.

Impact of Relaxed Exchange Act Reporting Thresholds:

- On April 11, 2012, the SEC staff issued a set of frequently asked questions (FAQs) designed to address preliminary questions under Title V and Title VI. (The FAQs are available at the following link: http://sec.gov/divisions/corpfin/cfjobsact.shtml). Most of these FAQs address how reporting companies may use current rules to terminate Exchange Act registration, but they also clarify that those companies that triggered the Exchange Act reporting requirements as of a fiscal year-end before enactment of the JOBS Act would not need to register (to the extent they have not already done so).

- The new thresholds should enable private companies with large shareholder bases to stay private longer, thus enabling them to defer the cost, public scrutiny and increased liability associated with being public reporting companies. Eliminating securities issued in crowdfunding offerings (subject to SEC rulemaking) and in exempt offerings under employee benefit plans lends additional flexibility for growth and expansion without triggering onerous registration and reporting under the Exchange Act. Private companies should implement tracking systems to monitor the new thresholds imposed by the JOBS Act. Systems should be designed to track (and keep current) whether securities were issued to accredited investors, under employee benefit plans or through crowdfunding.

- As companies grow and stay private longer and as the amount of freely tradable private company securities increases (whether issued under Regulation A or otherwise), it is possible that, with additional SEC guidance regarding applicable broker-dealer regulation, we will see the development of trading platforms or a more robust market for secondary sales of securities issued by private companies. Appropriately regulated secondary sales platforms could offer a solution to the problem raised by critics that unsophisticated investors will be stuck with illiquid crowdfunded securities. Alternatively, some private companies and their investors may see value in establishing restrictive trading policies to maintain control over the company's shareholder base. Companies may therefore want to review their current organizational documents and related investment agreements and consider whether they should be revised in light of the developments under the JOBS Act.

PUBLIC OFFERINGS--IPO "ON-RAMP" FOR "EMERGING GROWTH COMPANIES"

Title I of the JOBS Act creates a new category of public companies called "emerging growth companies" (EGCs). The legislation aims to make it easier for EGCs to raise funds in the public markets by creating a transitional process, or "on-ramp," by which EGCs will transition to the full rigors of SEC compliance over time. It also includes provisions intended to enable EGCs to communicate more freely with qualified investors to determine their interest in a potential public offering and to broaden analyst coverage of EGCs. Title I is designed, primarily, to help private companies go public; however, in some limited circumstances, existing public and reporting companies that qualify as EGCs may also be able to benefit from the provisions of Title I. Please contact us if you have specific questions about how these provisions may apply to your company.

- *Annual Gross Revenues of Less than $1 Billion.* An EGC is defined as any company that had less than $1 billion in total annual gross revenues during its last completed fiscal year. Generally, EGC status is not available to any company that conducted a federally registered sale of common equity securities (most commonly through an initial public offering of equity securities (IPO)) before December 8, 2011. Prior private placements do not disqualify a company from EGC status.

- *Reduced Disclosures.* The JOBS Act reduces financial reporting and other disclosure requirements in connection with IPOs by EGCs. These scaled-back requirements include (among other things):
  - a reduced period (two years rather than three years) for which to include audited financial statements in the IPO registration statement;
  - longer phase-in periods for new or revised financial accounting standards;
  - an exemption from the requirement to have an independent auditor attest to the company's internal financial controls (commonly referred to as "404 attestation");
  - reduced executive compensation and management discussion and analysis disclosures;
  - an exemption from "say-on-pay" and "say-on-pay frequency" shareholder votes; and
  - an exemption from golden parachute disclosure and the accompanying shareholder vote.

- *Latitude to "Opt In" to More Stringent Disclosure.* When filing its first registration statement or Exchange Act report, an EGC must elect whether it will decide to adhere to all new or revised financial accounting standards to which non-EGCs are subject. Otherwise, with respect to all other relaxed disclosures, an EGC may decide to comply with any of the stricter disclosure standards applicable to non-EGCs at any time.

- *Status as an EGC.* EGC status is lost and full compliance with SEC reporting requirements is required after the earliest of:
  - such time that the company generates more than $1 billion in annual gross revenues;
  - such time that the company becomes a "large accelerated filer" (at least 12 months of reporting history and $700 million in public float);
  - such time that the company raises more than $1 billion in non-convertible debt in a three-year period; or
  - five years following the company's first sale of common equity securities pursuant to an effective registration statement (most commonly by IPO).

- *Confidential Filings.* The JOBS Act provides for confidential SEC staff review of draft IPO registration statements. The initial confidential submission and all amendments thereto must be publicly filed no later than 21 days before the date on which the EGC conducts a road show.

- *Relaxed Regulation of Communications and Analyst Coverage.* Historically, oral and written offers designed to solicit interest (or to "test the waters") in a proposed public offering were prohibited while a company was contemplating an IPO or other public offering of securities. The JOBS Act eliminates these long-standing restrictions on communications (commonly referred to as "gun jumping") by allowing for direct oral or written communication with accredited investors and QIBs to ascertain their interest in an EGC public offering, even before a registration statement with respect to the proposed offering is filed. In an effort to increase analyst coverage of EGCs, the JOBS Act also lifts historical restrictions on, and permits broader research analyst coverage of and participation in, EGC IPOs and public offerings.

Effectiveness: While these provisions have immediate effect, the SEC, its staff and other regulatory agencies (such as the Financial Industry Regulatory Authority (FINRA)) will need time to adopt formal rules and procedures before a number of the changes required and benefits intended by the JOBS Act can be fully realized.

Impact of IPO On-Ramp Developments:

- On April 10, 2012, the SEC staff issued a set of frequently asked questions (FAQs) relating to the confidential submission of registration statements and the interplay with the requirement to file those submissions 21 days prior to the first road show. The staff has stated that these FAQs are based on "our current understanding of the JOBS Act and in light of our existing rules, regulations and procedures"; however, it cautions that the FAQs "are not rules, regulations or statements of the [SEC]. Further, the [SEC] has neither approved nor disapproved these FAQs." On April 16, 2012, the staff issued a second set of FAQs addressing questions of general applicability under Title I. These FAQs provide additional guidance on interpreting the technical requirements imposed by Title I and how EGCs can utilize the various provisions of Title I under current SEC rules and regulations. (Both sets of FAQs are available at the following link: http://sec.gov/divisions/corpfin/cfjobsact.shtml.) We will monitor and continue to provide updates on the developments under these FAQs and other Title I guidance provided by the SEC and other regulators.

- The ability to rely on scaled-back disclosure obligations should reduce the costs of going public and on-going reporting requirements for companies that qualify as EGCs. It remains to be seen the degree to which investment banks will be willing to underwrite IPOs of EGCs that take full advantage of the disclosure exemptions or whether EGCs will "opt in" to stricter standards due to market pressures, lender requirements or the desire for more transparent disclosure on specific issues. The April 10th FAQs provide valuable guidance on various timing and interpretation questions, particularly in light of the new opportunities to "test the waters" (with qualified investors) prior to conducting more "traditional" road shows. Companies and their underwriters will need to work together, in consultation with the SEC staff, to determine how the new provisions may change historical timing and mechanics of filing and effectiveness.

- Historically, companies looking to conduct an IPO were required to publicly file registration statements, which subjected the company (and its sensitive financial information and other disclosure) to public scrutiny by the media, market participants and competitors. In addition, the SEC review process could lead some companies to modify the way they present key business metrics or accounting information. Sometimes this review process also led to significant delays in, or withdrawal of, the offering, which created further public scrutiny. Under the new rules, companies are able to initiate the review process with SEC examiners without releasing the full registration statement to the public, thus allowing the company to avoid placing itself and its sensitive information in the public limelight prematurely.

- The ability to market an EGC offering to accredited investors and QIBs before, during and after any filing is made, as well as the changes permitting analyst coverage of EGCs, represents monumental changes to historical limitations on "gun jumping." Since liability for omissions and misstatements continues to apply to these communications, we believe that market players may take a cautious approach towards broad use of these relaxed standards, at least until corresponding guidance and procedures can be formally adopted by the SEC and FINRA.

CONCLUDING OBSERVATIONS

- *Attracting Investment.* The JOBS Act will not affect marketability of a company as an investment target, so, in that sense, it does not address the underlying need for access to capital. To the extent a company is an attractive investment target, the JOBS Act should make it easier for the company to test the waters, and to ascertain preliminarily market interest, at lower cost and with lower legal and accounting fees.

- *Relaxed IPO Requirements.* If a company is an attractive EGC IPO candidate, the JOBS Act makes a public offering a more attractive financing alternative. After adoption of the Sarbanes-Oxley Act of 2002 and the Dodd–Frank Wall Street Reform and Consumer Protection Act, we saw a trend of fewer companies with a market cap of under $700 million accessing the public markets because of the high on-going costs of being public. The JOBS Act aims to address this concern by lowering costs for companies with market caps of less than $700 million.

- *Crowdfunding Successes and Failures.* The JOBS Act allows anyone to become an investor through the crowdfunding exemption. We expect reputable funding portals to emerge that will facilitate crowdfunding. We also expect there to be abuses and tales of money lost to fraudulent ventures.

We will keep you current on these matters as regulations are issued and market practice develops. Please feel free to contact us with questions or comments about the JOBS Act generally or how it may impact your company or your investments.

A full copy of the JOBS Act is available at the following link: http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

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