JOBS ACT AWAITING PRESIDENT’S SIGNATURE

Act Will Have Dramatic Effect on Private and Public Capital-Raising for Start-Ups

The U.S. Senate (by a 73-to-26 vote) and the U.S. House of Representatives (by a 380-to-41 vote) each have passed the Jumpstart Our Business Startups Act (JOBS Act). The JOBS Act now is heading to President Obama, who previously has voiced support for the bill and is expected to sign it shortly.

The JOBS Act is a collection of legislative measures that have been introduced over the past year and focus on the ability of emerging growth companies to raise capital (both publicly and privately) and to determine the timing of becoming a public company. It codifies many of the reforms to the initial public offering (IPO) and capital-raising processes presented to the U.S. Department of the Treasury by the IPO Task Force—a working group of venture capitalists, CEOs, public investors, academics, investment bankers, and securities lawyers, including Wilson Sonsini Goodrich & Rosati partner Steve Bochner.

IPO On-Ramp for Emerging Growth Companies

The JOBS Act will create a much simpler “on-ramp” 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.

IPO Process and Disclosure Reforms

The JOBS Act will make it easier for emerging growth companies to go public by amending the Securities Act and Exchange Act as outlined below.

Facilitating IPOs

- Reduced Financial Information Required: Emerging growth companies will be required to provide only two years of audited financial information 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. The current requirements provide for 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 Qualified Institutional Buyers (QIBs) and Institutions That Are Accredited Investors: Emerging growth companies and persons authorized to act on their behalf will be able to engage in oral or written communications with potential...
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...investors who are QIBs or accredited investors to determine 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.

- **Analyst Research Reports:** 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 lock-up periods.

- **Securities Analyst Communications:** Further, 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).

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.

Access to Private Capital

The JOBS Act also will make it easier for private companies to raise capital by amending the Securities Act and Exchange Act and requiring the SEC to amend its rules and regulations in the following manner:

- **General Solicitations to Accredited Investors and Qualified Institutional Buyers:** Within 90 days of enactment, the SEC must revise its rules to permit companies in private capital-raisings to conduct general solicitation and advertising for the private sale of securities under Rule 506 of Regulation D, provided that the actual purchasers are all accredited investors. Similarly, general advertising and solicitation will be permitted under Rule 144A, provided that sales are made only to QIBs. It is likely that this provision will permit a company going through an IPO to conduct a concurrent private placement without having to worry about publicity restrictions, as is currently the case.

- **No Broker-Dealer Registration:** The JOBS Act also amends the Securities Act to provide that certain trading platforms involved with the sale of securities in a

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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.

- Increased Offering Size under 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 from $5 million to $50 million, or to create a new exemption from registration similar to Regulation A permitting such increased amounts. Offerings under Regulation A still will be subject to state securities laws, unless the securities are sold on a national exchange or sold to qualified purchasers.

- Raised Threshold for Registration and Public Company Reporting: In addition, 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 crowdfunding exemption discussed below will be excluded from the shareholder threshold count.

Unlike the IPO on-ramp provisions of the JOBS Act, the access-to-private-capital provisions of the act clearly require the SEC to engage in rulemaking. While the amendments to Rule 506 are specified to occur within 90 days, the other provisions do not require the SEC to adopt the implementing rules within any specified time period. Accordingly, it is unclear how soon companies will be able to take advantage of the changes to private capital-raising that are made in 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.” The Senate version of the JOBS Act related to crowdfunding, which is the version that is going to the President for signature, contains a series of stronger restrictions on a crowdfunding transaction than were contained in the House version.

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 an issuer can sell to an individual investor in any 12-month period is limited to the maximum of:

- $100,000 or Less: Income tax returns for the last fiscal year and unaudited financial statements reviewed by an independent public accountant
- $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—are generally by rule 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 an angel or venture-capital-led transaction with accredited investors.

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Statements by Commissioners

SEC Chairman Mary Schapiro and Commissioner Luis Aguilar each have released public statements, speaking as individuals and not on behalf of the SEC, voicing a number of concerns about the JOBS Act. In particular, Chairman Schapiro stated that the proposed rulemaking deadlines in the JOBS Act do not provide sufficient time for the SEC to consider and adopt rules under the act. Given these statements, it is not clear when companies actually will be able to take advantage of all of the provisions of the JOBS Act.

Wilson Sonsini Goodrich & Rosati 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 WSGR attorney or a member of the firm’s corporate and securities practice.

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3The statement of SEC Chairman Mary Schapiro is available at http://www.thecorporatecounsel.net/nonMember/docs/jobs-SchapirotoJohnson.pdf.