Sweeping Changes to Securities Laws Affecting Small Company Capital Formation Adopted

The Jumpstart Our Business Startups (JOBS) Act, enacted April 5, 2012, relieves startup businesses of significant restraints and costs of raising capital imposed by securities laws.

General Solicitations

Current Securities and Exchange Commission rules prohibit companies from using any general solicitation (for example, through advertisements) to sell unregistered securities. The JOBS Act requires the SEC, within 90 days of the law's enactment, to amend Rules 506 and 144A to permit unregistered sales to accredited investors and qualified institutional buyers, through general solicitation or general advertising. Securities sold pursuant to the amended rules will continue to constitute restricted securities.

A person maintaining a "platform" for the offer, sale, or negotiation of a sale of securities under amended Rule 506 would not be required to register as a broker-dealer, if that person:

- Receives no compensation in connection with the sale or
- Does not have possession or custody of customer funds or securities in connection with the sale.

That person would not be required to register as a broker-dealer, notwithstanding that the person provides "ancillary services" - due diligence or standardized transaction documents - as long as the person does not provide investment advice for separate compensation and does not negotiate the sale.

Emerging Growth Companies

The JOBS Act limits compliance obligations for a new category of issuer - the "emerging growth company." The Act defines an emerging growth company as a company with less than $1 billion in revenue, until the earliest of five years from the time that it goes public in a common equity IPO, has a public float exceeding $700 million, or issues $1 billion in non-convertible debt. Companies with an IPO date before Dec. 8, 2011, are excluded from the definition.

The JOBS Act relaxes securities law compliance and disclosure obligations for emerging growth companies. The Act:

- Allows an emerging growth company (and its agents) to communicate with qualified institutional buyers and institutional accredited investors to determine whether they would have an interest in a securities offering by the emerging growth company;
- Limits emerging growth company IPO registration statements to two years of audited financial statements and makes related changes to reporting requirements;
- Allows an emerging growth company to file its IPO registration statement confidentially;
- Loosens restrictions on analysts' reports in connection with emerging growth company IPOs;
- Eliminates financial controls attestation for emerging growth companies;
- In certain cases, relieves an emerging growth company of requirements to comply with new accounting standards;

- Allows emerging growth companies to comply with executive compensation rules applicable to smaller reporting companies;
- Exempts emerging growth companies from Dodd-Frank say-on-pay rules and pay-versus-performance rules;
- Eliminates the Sarbanes-Oxley auditor-rotation rule with respect to emerging growth companies.

Offerings less than $50 million

The JOBS Act requires the SEC to create an exemption for securities sales of up to $50 million in a 12-month period. The Act imposes no deadline for the adoption of the new rules, and the SEC has wide latitude to fashion disclosure requirements relating to these offerings. The Act expressly requires the SEC to adopt specific rules:

- Securities may be sold publicly under the exemption and do not constitute restricted securities, however sold;
- Before filing an offering statement, an issuer may solicit interest in the offering, on terms the SEC prescribes;
- The SEC must require the issuer to file audited financial statements;
- The SEC is authorized to adopt rules requiring an issuer to file and distribute to investors an offering statement and may require periodic reporting by an issuer;
- State securities laws are pre-empted, if the securities are sold on a national securities exchange or to qualified purchasers.

"Crowdfunding" Offering Exemption

As originally passed by the U.S. House of Representatives, the "crowdfunding" provision of the Act would have permitted public securities sales of up to $1 million annually ($2 million if the issuer provided audited financial statements), subject to prescribed investor-protector requirements that were sensible in relation to the small dollar amounts involved and rules that the SEC would adopt applying a cost-benefit analysis. The Senate reworked the provision to include a much longer list of requirements of which the following are only a few:

- Limited sales to $1 million annually;
- Audited financial statements for sales of securities exceeding $500,000;
- Investor suitability requirements to be adopted by the SEC;
- Offering disclosure requirements to be adopted by the SEC;
- Offering materials to be filed with SEC;
- Any sales intermediary must be either a registered broker-dealer or a registered "funding portal;"
- Issuer annual reporting requirements pursuant to SEC rules to be adopted.

Given that greater sums can be raised more easily under current law, much use of the crowdfunding exemption seems unlikely.

Exchange Act Registration

The JOBS Act increases the stockholder count that triggers the requirement for a private company to register under the Exchange Act and thereafter to comply with periodic reporting and proxy solicitation requirements, among others. Prior to adoption of the JOBS Act, a company with more than 500 record holders (and at least $10 million in assets) was required to register. The Act changes the number to either 2,000 stockholders or 500 non-accredited investors. Employees receiving shares pursuant to Securities Act-exempt employee compensation plans, and shares acquired pursuant to the crowdfunding provision, are excluded from the count.

For more information about the content of this alert, please contact David Fischer or Giovanni Caruso.

Loeb & Loeb LLP's Corporate Practice Group
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