GIBSON DUNN

JOBS ACT CHANGES THE PUBLIC & PRIVATE CAPITAL MARKETS LANDSCAPE

BY: ANDREW L. FABENS, GLENN R. POLLNER, BLAISE F. BRENNAN, NICOLAS H.R. DUMONT AND KULBIR S. WALHA*

On April 5, President Barack Obama signed the Jumpstart Our Business Startups Act (JOBS Act) into law.

We believe the JOBS Act is the most significant modernization of the federal securities laws since the Securities and Exchange Commission's (SEC's) 2005 Securities Offering Reform. The JOBS Act substantially changes a number of laws and regulations in a way that is expected to make it easier for companies to go public and facilitate the public offering process, while also making it easier for companies to raise capital privately and stay private longer. In addition, the JOBS Act is expected to reduce the cost and burden on newly public companies during their first few years as public companies.

As of May 23, 2012, the staff of the SEC (Staff) has posted written guidance on eight separate occasions[1] about the JOBS Act, yet many questions about the interpretation and implementation of the JOBS Act remain. Accordingly, we expect that Staff interpretations and market practices will continue to develop rapidly in the upcoming weeks and months, even before the Commission issues any of the rules mandated by the JOBS Act.

Facilitating Initial Public Offerings (IPOs) & Relaxing Public Reporting Requirements for Emerging Growth Companies (EGCs)

Title I of the JOBS Act, entitled "Reopening American Capital Markets to Emerging Growth Companies," tracks many of the recommendations made by the IPO Task Force—a working group of venture capitalists, CEOs, public investors, securities lawyers, academics and independent bankers—in its presentation to the U.S. Department of the Treasury.[2] The statute creates a new category of issuer—the "emerging growth company" —generally, a company with less than $1 billion in annual gross revenues.[3] In general, EGCs benefit from less extensive financial reporting obligations and less burdensome requirements for the audit of their financial statements, more limited executive compensation disclosure obligations that build on existing scaled disclosure rules, greater latitude with respect to pre-offering communications and research analyst coverage, and other measures designed to reduce the cost and burden of going public.[4] Collectively, these provisions comprise what is commonly referred to as the "IPO on-ramp" for emerging growth companies.

---

* Andrew Fabens and Glenn Pollner are capital markets partners in the New York office of Gibson, Dunn & Crutcher LLP. Blaise Brennan is of counsel in the Washington, D.C. office of Gibson, Dunn & Crutcher LLP. Nicolas Dumont and Kulbir Walha are associates in the New York and Washington, D.C. offices, respectively, of Gibson, Dunn & Crutcher LLP. Contact: afabens@gibsondunn.com, gpollner@gibsondunn.com or bbrennan@gibsondunn.com. This article is based on a Client Alert that was published on March 28, 2012, available at http://www.gibsondunn.com/publications/pages/JOBSActChangesPublic-PrivateCapitalMarketsLandscape.aspx.

EGC Status

An emerging growth company is defined as an issuer (which may be either a domestic or a foreign private issuer) that had less than $1 billion in gross revenues in its most recently completed fiscal year.[5] Issuers that have sold common equity securities pursuant to an effective registration statement under the Securities Act of 1933 (the Securities Act) on or before December 8, 2011, however, are explicitly excluded from the definition of EGC.

Once an issuer is an EGC, it will retain that status until the earliest of:

- the last day of its first fiscal year during which it had annual gross revenues of at least $1 billion;
- the last day of the fiscal year following the fifth anniversary of the first sale of common equity securities[6] pursuant to an effective registration statement under the Securities Act;
- the date on which it has, during the previous 3-year period, issued more than $1 billion in non-convertible debt;[7] or
- the date on which the issuer is deemed to be a large accelerated filer.[8]

Benefits of Being an EGC

Financial Reporting & Auditing Standards

An EGC may present only two years of audited financial statements and two years of selected financial data under Item 301 of Regulation S-K[9] in a registration statement with respect to an IPO, instead of the customary three years for audited financial statements and five years for selected financial data. In addition, the Staff has indicated that, in any other registration statement under the Securities Act or the Exchange Act, the Staff will not object if an EGC does not present audited financial statements for any period prior to the earliest audited period presented in connection with its IPO.[10] Similarly, in any other Securities Act registration statement, Exchange Act registration statement or periodic report under the Exchange Act, an EGC need not present selected financial data for any period prior to the earliest audited period presented in its effective registration statement filed in connection with its IPO.[11] It is not yet clear, however, whether underwriters and issuers will be comfortable providing only two years of audited financial statements and selected financial data in all circumstances, whether for marketing or liability reasons.

In addition, EGCs are permitted to comply with any new or revised financial accounting standard on the schedule that applies to private companies, if such standard applies to private companies.

Moreover, an emerging growth company (including any foreign private issuer qualifying as an EGC) is exempt from the requirement that its auditor attest to, and report on, management's assessment of the effectiveness of the company's internal control structure and procedures for financial reporting under Section 404(b) of the Sarbanes-Oxley Act.[12]

Finally, the JOBS Act provides that, if the Public Company Accounting Oversight Board (PCAOB) adopts[13] rules mandating audit firm rotation or the presentation of an "auditor discussion and analysis,"[14] these rules will not apply to an audit of an EGC unless "the Commission determines that the application of such additional requirements is necessary or

appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition and capital formation."

Although the JOBS Act does not explicitly reference the disclosure requirements for foreign private issuers, the Staff has indicated that the reduced disclosure requirements for EGCs will also be available for foreign private issuers qualifying as EGCs.[15]

Executive Compensation Disclosure & Corporate Governance Requirements

In general, an EGC may choose to comply with the scaled executive compensation disclosure requirements under Item 402(m)-(r) of Regulation S-K that apply to smaller reporting companies, rather than the more exhaustive requirements under Item 402(a)-(k) and (s), whether or not the EGC otherwise qualifies as a smaller reporting company under Item 10(f) of Regulation S-K.[16] Under this treatment, an EGC may provide executive compensation information for three (instead of five) named executive officers, may present two (rather than three) years of compensation data in the Summary Compensation Table and, perhaps most notably, need not present a compensation discussion and analysis section.[17] EGCs also are exempt from certain new disclosure requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), including the "pay-versus-performance" disclosure under Section 14(i) of the Exchange Act and the "pay-ratio" disclosure required under Section 953(b)(1)(C) of Dodd-Frank. Neither of these Dodd-Frank disclosure requirements is currently required of issuers, as the SEC has yet to propose and adopt implementing rules. When the SEC does adopt implementing rules, however, the statute should operate immediately to exempt EGCs from those disclosure obligations.

In addition to reduced disclosure requirements, EGCs are exempt from the new say-on-pay, say-on-frequency and say-on-golden parachute votes required under Section 14A of the Exchange Act implemented under Dodd-Frank. After a company ceases to be an EGC, the first say-on-pay vote will be required not later than (*i*) the end of the one-year period beginning on the date it ceases to be an EGC; or (*ii*) in the case of an issuer that was an EGC for less than two years following the first registered sale of equity securities, the end of the three-year period beginning on the date it ceases to be an EGC.

IPO Procedural Changes

Pre- & Post-Filing Communications Permitting EGCs to "Test the Waters"—In general, Section 5 of the Securities Act prohibits offers, sales and deliveries of securities prior to filing a registration statement with respect to such securities and generally limits post-filing written offers to statutorily compliant prospectuses. In a significant shift, the JOBS Act amends Section 5, with immediate effect, to explicitly permit EGCs or persons acting on their behalf (which can include an underwriter authorized to act on an EGC's behalf) to communicate orally or in writing with qualified institutional buyers (QIBs), as defined under Rule 144A under the Securities Act, or institutions that are accredited investors, as defined under Rule 501 under the Securities Act, prior to or following the filing of a registration statement.[18] These oral or written communications may be undertaken "to determine whether such investors might have an interest in the contemplated securities offering."[19] In the absence of this amendment, such communications would constitute impermissible offers to sell or solicitations of offers to buy securities under Section 5(c). This is a very significant change that should greatly facilitate the ability of EGCs and their underwriters to "test the waters" to gauge potential investor interest in advance of a public offering. In keeping with current law, deliveries of securities after sale must

be accompanied or preceded by a final prospectus. "Test the waters" communications will be subject to antifraud liability under the federal securities laws. As a result, parties engaging in "test the waters" communications should be cognizant of liability considerations in structuring these communications and the content and types of materials used in connection with these communications.

Publication & Distribution of Research Reports by Participating Underwriters—In another very significant change, the JOBS Act immediately amends Section 2(a)(3) of the Securities Act to provide explicitly that the publication or distribution by a broker or dealer of a research report about an EGC that proposes to conduct a public offering of its common equity securities pursuant to a Securities Act registration statement, either through an IPO or a follow-on equity offering, does not constitute an offer to sell a security, and therefore will not constitute an illegal prospectus or an impermissible pre-filing offer, even if the broker or dealer is participating or will participate in the registered offering of the securities of the issuer.[20] While Rule 139 under the Securities Act has allowed underwriters to continue to publish research with respect to seasoned issuers during a public offering provided that the conditions of Rule 139 are satisfied, the ability of a broker or dealer to publish research in connection with an IPO that it is underwriting for an EGC represents a dramatic departure from what has previously been permitted.

It is noteworthy that the JOBS Act effectively carves out permitted research reports from the definition of "prospectus" under Section 2(a)(10) of the Securities Act. This carve-out has the effect of excluding written research reports from "prospectus" liability under Section 12(a)(2) of the Securities Act. Research reports will nonetheless remain subject to other antifraud liability provisions, including Section 10(b) and Rule 10b-5 under the Exchange Act and Section 17 of the Securities Act.

It remains to be seen whether and how investment banks will change existing pre-IPO research practices in light of possible concerns related to existing FINRA and 2003 "Global Settlement" restrictions (which, among other things, require research reports to be independent from, and not be influenced by, investment banking personnel) and liability concerns. While pre-IPO research is not uncommon outside the United States, and some have pointed to such practices as a potential model for pre-IPO research in the United States, the unique class action securities litigation climate in the United States is one of several factors that will influence whether investment banks conduct pre-IPO research. In addition, issuers should be even more cognizant of entanglement issues, to the extent they interact with a research analyst in connection with the preparation of pre-IPO research, than they are in connection with post-IPO research reports.

Securities Analyst Conflicts Rules—Enacted in 2002, Section 15D of the Exchange Act required the SEC, and, upon authorization and direction of the SEC, all registered securities associations—currently only the Financial Industry Regulatory Authority (FINRA)—and national securities exchanges to adopt rules designed to address conflicts of interest that can arise when securities analysts recommend equity securities. The conflict of interest rules regulate, among other things, publication clearance and approval of reports by employees of brokers and dealers who are engaged in investment banking or other activities, supervision and compensation of securities analysts, protection of whistleblowers, structural and institutional separation between investment bankers and research analysts within the same firm, periods during which

brokers and dealers who participate in offerings may not publish reports, and mandatory disclosure of conflicts of interest.

Effective immediately, the JOBS Act amends Section 15D (adopted as part of the Sarbanes-Oxley Act) to prohibit the SEC and any national securities association from adopting or maintaining rules that, in connection with an IPO of common equity of an EGC, restrict an employee of a broker, dealer or FINRA member from arranging a communication between a securities analyst and a potential investor based on such person's "functional role" (*i.e.*, investment banker). The JOBS Act also amends Section 15D to prohibit the adoption or maintenance of rules that, in connection with an IPO of common equity of an EGC, restrict a securities analyst's participation in any communications with management of an EGC that also are attended by an investment banker or other employee of a FINRA member who is not a securities analyst.

These provisions of the JOBS Act prohibit the maintenance of rules that have previously been adopted. Accordingly, various rulemaking amendments will be required to conform existing rules to these provisions. Further, the interrelationship among the new provisions and existing and any forthcoming FINRA and stock exchange rules, as well as the 2003 "Global Settlement" reached between certain investment banks and various regulators regarding research analyst conflicts may take some time to ascertain. As a result, there may be some risk in immediately allowing investment bankers to facilitate communications between securities analysts and the investing public in connection with an EGC IPO or to permit management of EGCs to meet with associated investment bankers and securities analysts simultaneously. Guidance is needed from the SEC and FINRA on these issues.

These changes, mandated by the JOBS Act, potentially will permit a significant shift in practice compared to practices that have prevailed in the aftermath of the bursting of the "dot-com" bubble, the adoption of the Sarbanes-Oxley Act and the Global Settlement about 10 years ago. Nevertheless, the JOBS Act does not otherwise amend Section 15D, leaves intact other existing FINRA conflict of interest rules and does not modify the Global Settlement. In addition, the JOBS Act does not expressly address rulemaking by national securities exchanges (such as NYSE Rule 472), which leaves open whether the exchanges are still permitted to maintain independent conflict of interest rules regarding conduct addressed by the JOBS Act.[21]

Timing of Publication of Research Reports & Public Appearances by Brokers and Dealers—The JOBS Act prohibits the SEC and registered national securities associations (effectively, FINRA) from adopting or maintaining any rule that prohibits any FINRA member from publishing or distributing research reports or making a public appearance for a prescribed period of time following the IPO of an EGC or prior to the expiration of a lock-up agreement entered into in connection with the IPO of an EGC. Currently, under NASD Rule 2711, a FINRA member may not distribute research material with respect to an issuer until after 40 calendar days following such issuer's IPO if the FINRA member acted as a manager or co-manager in connection with the offering, or within 25 calendar days if the member acted as underwriter or dealer (other than as manager or co-manager). Similarly, FINRA members are prohibited from issuing research 15 days prior to the expiration of a lock-up agreement entered into in connection with a securities offering if the FINRA member acted as manager or co-manager in such offering.[22] As with the prohibition on adopting or maintaining certain conflict of interest rules discussed above, we believe that the legal and practical effect of lifting the prohibition on IPO-related research reports is that, to the extent existing rules contravene the new provisions of the

JOBS Act, the portions of the existing rules which contravene the new law are invalid as to conduct occurring after the date of enactment of the JOBS Act. Further rulemaking will be required to conform existing rules to these prohibitions. As with respect to the conflict of interest rules discussed above, investment banks may want to await further guidance from the SEC and FINRA before acting in reliance solely on these statutory provisions.

Confidential Submissions of Draft EGC Registration Statements—An EGC, prior to its IPO, will be permitted to submit a draft registration statement with the SEC for confidential nonpublic review by the Staff of the SEC.[23]

The initial confidential submission and all amendments thereto must, however, be publicly filed not later than 21 days before the issuer conducts a road show.[24] Although the definition of "road show" may be broad enough to encompass "test the waters" communications, the Staff indicated that it will not object if an EGC does not publicly file its registration statement prior to engaging in "test the waters" communications. Instead, the Staff has clarified that the 21-day requirement will be measured from the commencement of a "traditional" roadshow.[25]

The confidential submission procedures will allow an EGC to begin the review process without disclosing information that may be sensitive or confidential until it has greater confidence in the likely success of the offering.[26]

The Staff has also clarified that the confidential submission of a draft registration statement does not constitute a filing for purposes of the prohibition in Section 5(c) against making offers of a security in advance of filing a registration statement.[27] As a consequence, no filing fee is due at the time of a confidential submission and certain provisions of the Sarbanes-Oxley Act, such as the prohibition on loans to executive officers, will not apply at such time.[28] However, because the confidential submission does not constitute a filing for purposes of Section 5(c), EGCs must remain sensitive to possible "gun-jumping" issues during the confidential submission period (for example, any communication that could be deemed a pre-filing "offer" and not permitted under the test the waters provisions of the JOBS Act). In addition, EGCs may not issue press releases or other written communications in reliance on Rule 134 during this period (although they may issue a more limited press release complying with Rule 135). Confidential submissions are subject to filing by the underwriters with FINRA under FINRA Rule 5110.[29] The Staff has said that it will release its comment letters and issuer responses to Staff comment letters on confidential draft submissions after the registration statement is effective, on the same time frame as for the public release of Staff comment letters and issuer responses with respect to filings that are not submitted confidentially.[30]

Foreign private issuers qualifying as EGCs may use the JOBS Act confidential submission process, or, to the extent they qualify, they may alternatively use the confidential submission process available to certain foreign private issuers and in place prior to the JOBS Act.[31]

Required SEC Studies

The JOBS Act also requires the SEC, by July 4, 2012, to conduct and submit to Congress a study examining the impact of decimalization – that is, the trading and quoting of securities in one penny increments – on U.S. IPOs and on liquidity for small- and middle-capitalization

company securities. It also authorizes the SEC to adopt rules designating a minimum trading increment between $0.01 and $0.10.

In addition, the JOBS Act requires the SEC to conduct a review of Regulation S-K to determine how such requirements can be updated to modernize and simplify the registration process and reduce costs and burdens encountered by EGCs, and to transmit to Congress, by October 2, 2012, a report and the SEC's specific recommendations for streamlining the registration process.

Elimination of Prohibitions on General Solicitation & General Advertising in Connection with Rule 506 & Rule 144A Offerings

Title II of the JOBS Act will permit general solicitations and advertising in offerings under Rule 506 of Regulation D and under Rule 144A under the Securities Act. These relaxed restrictions are not limited to offerings by EGCs.

Under the exemptions provided by Regulation D and Rule 144A, securities may be sold in private offerings without registration under the Securities Act. Issuers of securities in such offerings historically have been prohibited from using general solicitation or advertising to market the securities, which may have had the effect of limiting the pool of potential investors. By eliminating the ban on solicitations and advertisements by issuers and broker-dealers, the JOBS Act would permit, for example, offline and online forums that bring together investors with companies seeking to raise capital.

The JOBS Act directs the SEC to revise Rule 506 under Regulation D and Rule 144A by July 4, 2012 (within 90 days after the date of enactment of the JOBS Act), to remove the prohibition against general solicitation or general advertising in offers and sales of securities made pursuant to these exemptions so long as all purchasers of the securities are accredited investors[32] (in the case of an offering pursuant to Rule 506) or sold only to persons reasonably believed to be qualified institutional buyers (QIBs) (in the case of an offering under Rule 144A). Until the SEC revises Rule 506 and Rule 144A, market participants relying on such non-exclusive safe harbors should generally continue to implement customary procedures for these offerings, including limiting the information contained in any notice of such offerings to that permitted by the safe harbor provided by Rule 135c under the Securities Act.

The JOBS Act also provides that an offering under Rule 506 made by means of general advertising or solicitation, which otherwise complies with the requirements of Rule 506, shall not be deemed a public offering.

In addition, persons who maintain an exchange platform with respect to securities offered and sold pursuant to Regulation D, co-invest in such securities or provide certain "ancillary services" will not be required to register as broker-dealers under the Exchange Act, subject to certain conditions.[33] These conditions include a requirement that such persons receive no compensation with respect to purchases or sales of the securities, not be subject to any statutory disqualification from being a broker-dealer, and not have possession of customer funds or securities in connection with the purchase or sale of the securities. The legislation leaves in place what has become the key determinant of broker-dealer status, particularly the receipt of transaction-based compensation. It leaves open, however, whether negotiating the terms of a transaction or solicitation of purchasers will still be viewed as broker-dealer activities.

Crowdfunding

The JOBS Act amends Section 4 of the Securities Act to add new Section 4(6) and also adds a new Section 4A to the Securities Act. Section 4(6) will allow U.S. private companies (excluding investment companies) to raise up to $1 million over a 12-month period from pools of small investors in crowdfunding transactions without registration under the Securities Act. The JOBS Act directs the SEC to issue final rules to implement the new exemption by December 31, 2012 (within 270 days after the date of enactment of the JOBS Act). The Staff has reminded issuers that, until such rules are adopted and effective, "any offers or sales of securities purporting to rely on the crowdfunding exemption would be unlawful under the federal securities laws."[34]

Use of the Section 4(6) exemption is not available to every company. Foreign companies, issuers already reporting pursuant to Section 13 or Section 15(d) of the Securities Act, investment companies and other companies that the SEC determines appropriate are ineligible to use this exemption.

The $1 million limitation applies to the aggregate amount of all securities sold by the issuer, whether of the same class or a different class, over the preceding 12 months (including the securities sold in the offering under the crowdfunding exemption).[35] There is no separate restriction, however, on the issuance of securities after completion of the crowdfunding offering, and the crowdfunding provisions of the JOBS Act specifically provide that the exemption for crowdfunding shall not be construed as preventing an issuer from raising capital pursuant to other exemptions or registered offerings. For the purposes of this exemption, the term "issuer" includes all entities controlled by or under common control with the issuer.

The amount sold to each investor is limited based on the investor's annual income and net worth. For an investor with an annual income or net worth of less than $100,000, the investor's maximum aggregate annual investment in securities issued under the crowdfunding exemption over a 12-month period is capped at the greater of $2,000 or 5% of such investors' annual income or net worth. For investors with an annual income or net worth of greater than $100,000, such investments are capped at the lesser of $100,000 or 10% of such investors' annual income or net worth.[36]

Securities purchased under this registration exemption will be subject to a one-year transfer restriction, during which time such securities may only be transferred (a) to the issuer; (b) pursuant to a registered offering; (c) to an accredited investor; or (d) to certain family members or in connection with the death or divorce of the purchaser or similar circumstances at the discretion of the SEC. These transfers will also be subject to other limitations as the Commission may establish.

A private company raising capital under this exemption will be required to use an intermediary—either a registered broker or a person registered with the SEC as a "funding portal"—that will act as a platform for investors to review the company information and handle investments. A funding portal is a newly-defined entity that, among other things, does not "solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal" or "offer investment advice or recommendations." Registered brokers that act as intermediaries, however, will not be subject to these same restrictions. In addition to registration with the SEC, funding portals will be subject to rulemaking by the Commission. The JOBS Act

directs the SEC, however, to issue rules that either conditionally or unconditionally exempt funding portals from the requirement to register as broker-dealers under the Exchange Act.

The funding portals and the brokers acting as intermediaries in crowdfunding transactions will be required to:

- register with the SEC as a broker or as a "funding portal";
- register with any applicable self-regulatory agency;
- provide such disclosures, including investor education materials, as the SEC determines appropriate;
- ensure that each investor (a) reviews such investor education information; (b) affirms that such investor understands that there is a risk that the entire investment could be lost; and (c) answers questions demonstrating their understanding of (*i*) the level of risk associated with investing in emerging businesses, startups and small issuers, (*ii*) the risk of illiquidity and (*iii*) such other matters as the Commission determines appropriate;
- take measures to reduce the risk of fraud as specified by the SEC, including obtaining a background and a securities enforcement check on each officer, director and 20% or greater holder of the issuer;
- make the disclosures required by the issuers available to potential investors at least 21 days prior to the offering;
- ensure that the offering proceeds are provided to the issuer only after the target offering amount has been met or exceeded, while allowing investors to cancel their commitment to invest;
- ensure that no investor has exceeded the aggregate investment level permitted under the exemption;
- take steps to protect the privacy of the information collected from investors;
- not compensate lead generators or promoters for providing the intermediary with personal identifying information of any potential investor;
- prohibit their officers, directors or partners from having any financial stake in the issuer using their services; and
- meet any other requirements set forth by Commission rulemaking.

Issuers relying on the crowdfunding exemption will be subject to a number of informational and other requirements set forth in the JOBS Act, including an obligation to provide to investors and file with the SEC, and provide to the funding portal or broker, as applicable, to make available to potential investors, the following disclosures:

- basic corporate information, including name and address;
- names of the officers and directors of the issuer;
- names of any holder of more than 20% of the shares of the issuer;
- description of the business plan of the issuer;
- financial information or financial statements that are (a) certified true and complete by the issuer's principal executive officer, in the case of offerings no greater than $100,000; (b) reviewed by an independent public accountant, in the case of offerings of more than $100,000 and no greater than $500,000; or (c) audited, in the case of offerings of more than $500,000;
- description of the intended use of the proceeds of the offering;

- the target offering amount, the deadline to reach such target amount and regular funding progress reports relating to the issuer's progress in meeting the target offering amount;
- written disclosure prior to the sale of the final price and all required disclosures, and providing investors with a reasonable opportunity to rescind the commitment to purchase;
- a description of the ownership and capital structure of the issuer; and
- such other information as the SEC may prescribe.

The issuer also will be required to file with the Commission annual reports setting forth the results of operations and financial statements of the issuer, as the SEC shall determine appropriate.

Issuers are prohibited from advertising the terms of the crowdfunding offering, except for notices that direct investors to a broker or funding portal. Any solicitor or promoter using the communication channels provided by a broker or funding portal to promote the crowdfunding offering will have to disclose the receipt of compensation in each instance of promotional communication.

Issuers will be subject to liability to purchasers of the securities comparable to that under Section 12(a)(2) of the Securities Act for material misstatements or omissions contained in these documents.

The JOBS Act also directs the SEC to establish "bad actor" disqualification provisions for issuers, brokers and funding portals similar to those to be adopted pursuant to Regulation D.

Importantly, the JOBS Act amends Section 12(g) of the Exchange Act to direct the SEC to promulgate rules to exclude securities issued in crowdfunding transactions from the new shareholder limits for private companies.

Securities issued under the crowdfunding exemption will be "covered securities" under Section 18 of the Securities Act, and thus benefit from federal preemption of certain state securities laws and regulations relating to registration, documentation and offering requirements. States will retain enforcement authority. The statute clarifies, however, that states will continue to have jurisdiction over certain fraudulent, deceitful or unlawful conduct in connection with crowdfunding transactions by brokers, dealers, funding portals and issuers. The JOBS Act also restricts the states that may charge notice filing fees to the issuer's home state and a state where at least 50% of the investors reside. State regulation of funding portals also will be preempted, with the states retaining examination and enforcement authority.

Although the exemption is created by the JOBS Act, various provisions needed to implement crowdfunding require implementing rules to be issued by the SEC. The JOBS Act sets a 270-day deadline for such rules but, in light of the opposition expressed by some members of the Commission to the JOBS Act generally and to the crowdfunding provisions in particular, as well as the overhang of rules yet to be adopted pursuant to Dodd-Frank, it is uncertain whether these implementing rules will be adopted by the deadline.

New Exemption from Registration Under Section 3(b)(2) for Public Offerings up to $50 Million

Section 401 of the JOBS Act adds Section 3(b)(2) under the Securities Act, which requires that the SEC add a new exemption for securities offerings of up to $50 million. The JOBS Act leaves in place the existing authority for the Commission to exempt issuances of securities of up to $5 million, pursuant to which the SEC previously adopted the existing exemptions from registration provided by Regulation A and by Rules 504 and 505 under Regulation D under the Securities Act.

The JOBS Act sets forth a number of specific parameters that must govern the new exemption, which are comparable to, but somewhat more expansive than, the requirements for an offering under current Regulation A.

The SEC is also permitted to add such other terms, conditions or requirements as it determines necessary in the public interest and for the protection of investors, and the JOBS Act does not set a deadline for rulemaking to enact this exemption.

Securities issued under the new exemption will be "covered securities" under Section 18 of the Securities Act, and thus benefit from federal preemption of certain state securities laws and regulations, only if the securities are offered or sold on a national securities exchange or are offered and sold only to qualified purchasers.

Biennially, the SEC must review the offering amount limitation created under the new exemption and increase it as the Commission deems appropriate. Should the SEC determine not to increase the offering amount limitation, it will be required to report to the House Committee on Financial Services and the Senate Committee on Banking, Housing, and Urban Affairs on its reasons for not doing so.

Again, in light of the opposition expressed by some members of the Commission to the JOBS Act, as well as the overhang of rules yet to be adopted pursuant to Dodd-Frank, it may take some time for the Commission to adopt rules to implement this new exemption.

Increased Shareholder Thresholds under Section 12(g) for Public Company Reporting

Section 501 of the JOBS Act increases the holders-of-record threshold, at or above which an issuer is required to register such securities under Section 12(g) of the Exchange Act, from 500 persons to either (a) 2,000 persons or (b) 500 persons who are not accredited investors.[37] The JOBS Act also increases the total-assets threshold under Section 12(g) from $1 million to $10 million, but because the SEC has previously exempted the equity securities of issuers having less than $10 million in total assets from registration,[38] as a practical matter the asset threshold remains unchanged.

Section 601 of the JOBS Act increases the holders-of-record threshold for banks and bank holding companies to 2,000 or more persons. This section also raises the holders-of-record threshold below which a bank or bank holding company may suspend its duty to file reports and terminate the registration of its securities, from 300 persons to 1,200 persons.[39]

In addition, Section 502 of the JOBS Act amends Section 12(g)(5) of the Exchange Act to provide that the definition of securities "held of record" will exclude securities held by persons who received the securities pursuant to an employee compensation plan in transactions exempted

from the registration requirements of the Securities Act.[40] Section 503 of the JOBS Act requires the SEC to adopt safe harbor provisions that issuers can follow to provide such issuers with certainty in making the determinations with respect to securities received pursuant to employee compensation plans.

The Staff has indicated that, although persons that have purchased securities in exempt crowdfunding offerings and employees that receive shares under compensation plans in transactions exempt from SEC registration will not count as holders of record, any transferees of such shares would count as holders of record.[41]

Finally, the JOBS Act requires the SEC to examine its authority to enforce Rule 12g5-1(b)(3), an anti-avoidance rule relating to the counting of shareholders, to determine "whether new enforcement tools are needed to enforce" this provision, and to transmit its recommendations to Congress by August 3, 2012.

Commission Outreach

Under Section 701, the SEC must provide online information and conduct outreach to inform small- and medium-sized businesses, women-owned businesses, veteran-owned businesses, and minority-owned businesses of the changes made by the JOBS Act.

---

[1] *See Division announcement regarding confidential submission of draft registration statements under the Jumpstart Our Business Startups Act* (available at http://www.sec.gov/divisions/corpfin/cfannouncements/draftregstatements.htm) (April 5, 2012); *Jumpstart Our Business Startups Act Frequently Asked Questions* (available at http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm) (April 10, 2012) ("April 10 FAQs"); *Frequently Asked Questions on Changes to the Requirements for Exchange Act Registration and Deregistration* (available at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-12g.htm) (April 11, 2012); *Jumpstart Our Business Startups Act*

Frequently Asked Questions Generally Applicable Questions on Title I of the JOBS Act (available at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm (April 16, 2012, updated on May 3, 2012) ("Title I FAQs"); *Information Regarding the Use of the Crowdfunding Exemption in the JOBS Act* (available at http://www.sec.gov/spotlight/jobsact/crowdfundingexemption.htm) (April 23, 2012) ("Crowdfunding Statement"); *Division update regarding submission of draft registration statements for confidential review under the JOBS Act and non-public review under the Division's policy for certain foreign private issuers* (available at http://www.sec.gov/divisions/corpfin/cfannouncements/secureemail.htm) (May 11, 2012) ("Confidential Submission Update"); and *Instructions for Submitting Draft Registration Statements for Confidential/Non-public Review* (available at http://www.sec.gov/divisions/corpfin/cfannouncements/cfsecureemailinstructions.pdf) (May 11, 2012).

[2] *Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth*, IPO Task Force (October 20, 2011) (available at https://www.documentcloud.org/documents/327129-ipo-task-force-report.html). *See also Webcast -- The JOBS Act: A Dialogue with Senior Staff from the SEC Division of Corporation Finance and Private Practitioners, available at* http://www.pli.edu/Content/Seminar/The_JOBS_Act_A_Dialogue_with_Senior_Staff/_/N-4kZ1z12ta1?Ns=sort_date|0&ID=155026 (April 21, 2012) ("PLI Webcast"); *JOBS Act & More: How Private Placements and Reg. D are Changing* (available at http://www.thecorporatecounsel.net/member/Webcast/2012/04_24/ (April 24, 2012) ("April 24 Corporate Counsel Webcast"); *The New World of IPOs: Dissecting the JOBS Act* (available at http://www.thecorporatecounsel.net/Webcast/2012/05_02/) (May 2, 2012) ("May 2 Corporate Counsel Webcast").

[3] The Staff has indicated that "the phrase 'total annual gross revenues' means total revenues as presented on the income statement presentation under U.S. GAAP (or IFRS as issued by the IASB, if used as the basis of reporting by a foreign private issuer)." Title I FAQs, Question 1; *see also* PLI Webcast (in which the Staff indicated it views

gross revenues as the "top line" revenues under applicable accounting standards – for U.S. issuers, U.S Generally Accepted Accounting Principles (U.S. GAAP)). For financial institutions, the Staff has noted that it would be appropriate to use the same approach that is used in calculating revenues to determine smaller reporting company status, set forth in Section 5110.2(c) of the Division of Corporation Finance's Financial Reporting Manual (available at http://www.sec.gov/divisions/corpfin/cffinancialreportingmanual.shtml), in determining "total annual gross revenues" for purposes of determining EGC status. The JOBS Act provides for the revenue threshold to be indexed for inflation every five years, to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics. For EGCs that report in a currency other than U.S. dollars, "total annual gross revenues" for the purposes of the EGC qualification test should be determined using the exchange rate for such reporting currency as of the last day of the EGC's most recently completed fiscal year. April 16 FAQs, Question 1.

[4] In general, an EGC may choose to forgo any exemption available to EGCs. Notably, if an EGC chooses to forgo the exemptions relating to the extension of time to comply with new or revised financial accounting standards, it must notify the Commission of this choice, and this choice will be irrevocable. The Staff has indicated that the EGC should notify the review staff of this choice in its initial confidential submission, "as that choice will inform the [S]taff's review of the financial statements in the draft registration statement." An EGC that is not utilizing the confidential submission procedures should notify the Commission of this choice when it initially files its registration statement. An EGC that is currently in registration or is already filing periodic reports with the SEC should make, and disclose, this choice in the next amendment to its registration statement or in its next periodic report. The EGC must thereafter comply with new or revised accounting standards on the same schedule as a non-EGC. Title I FAQs, Question 13. If, however, an EGC initially takes advantage of the extended transition period for complying with new or revised financial accounting standards, the Staff has advised that it will not object if the EGC later "opts in," and complies with financial accounting standards on the same schedule as non-EGCs. In this case, "this decision should be prominently disclosed in the first periodic report or registration statement following the [EGC's] decision and is irrevocable." Title I FAQs, Question 37.

[5] The Staff has indicated that EGC status will be determined at the time the issuer conducts an activity permitted for EGCs. For example, if an issuer engages in "testing the waters" activity but later loses its EGC status, the communications will not be deemed to violate Section 5 of the Securities Act if the issuer qualified as an EGC at the time the "testing the waters" occurred. *See* Title I FAQs, Question 3; *see also* PLI Webcast. Similarly, if a company publicly files its registration statement while it is an EGC but ceases to be an EGC while it is in registration, pursuant to Rule 401(a) under the Securities Act, the disclosure provisions for EGCs will apply through effectiveness of the registration statement. Conversely, if a company confidentially submits its registration statement while it is an EGC, and subsequently ceases to be an EGC, it must publicly file its registration statement in order to continue the review process, and the company will not be able to take advantage of the disclosure provisions that apply to non-EGCs. *Id.*

[6] The Staff has noted that "The phrase 'first sale of common equity securities' in the JOBS Act is not limited to a company's initial primary offering of common equity securities for cash. It could also include offering common equity pursuant to an employee benefit plan on a Form S-8 as well as a selling shareholder's secondary offering on a resale registration statement." Title I FAQs, Question 2.

[7] The Staff has indicated that all non-convertible securities issued that constitute indebtedness, irrespective of whether such securities were issued publicly or privately and whether or not such indebtedness remains outstanding, will be included in this calculation. Title I FAQs, Question 17; PLI Webcast. The Staff has also stated that the calculation will be made on the basis of a rolling three-year period without respect to any fiscal year end. *Id.* Finally, the Staff has indicated that it will not object if a company does not count debt securities issued in an A/B exchange offer in this calculation. Title I FAQs, Question 18.

[8] Under Exchange Act Rule 12b-2, an issuer is deemed to be a large accelerated filer "after it first meets the following conditions as of the end of its fiscal year: (*i*) the issuer had an aggregate worldwide value of the voting and non-voting common equity held by its non-affiliates of $700 million or more as of the last business day of the issuer's most recently completed second fiscal quarter: (*ii*) the issuer has been subject to the requirements of 13(a) or 15(d) for a period of at least 12 calendar months; (*iii*) the issuer has filed at least one annual report pursuant to [S]ection 13(a) or 15(d) of the [Exchange Act]; and (*iv*) the issuer is not eligible to use the requirements for smaller reporting companies… for its annual and quarterly reports." Notably, because large accelerated filer status is based upon market capitalization rather than gross revenues, if the price of an issuer's publicly traded stock increases rapidly, it may lose EGC status more quickly than it might anticipate.

[9] Title I FAQs, Question 11.

[10] Title I FAQs, Question 12.

[11] Relatedly, an EGC need not include in the MD&A contained in its Securities Act or Exchange Act registration statements or its Exchange Act reports a discussion of periods prior to the earliest year for which audited financial statements are required to be presented.

[12] The JOBS Act does not affect the Sarbanes-Oxley Act requirements for an issuer to maintain internal control over financial reporting, nor management's obligation to report on and certify as to the company's internal control over financial reporting.

[13] The statute also provides that any such existing rules shall not apply to the audit of an EGC, but no such rules are currently in place.

[14] These provisions relate to the PCAOB's *Concept Release On Possible Revisions To PCAOB Standards Related To Reports On Audited Financial Statements*, PCAOB Release No. 2011-003 (June 21, 2011) and its *Concept Release On Auditor Independence And Audit Firm Rotation*, PCAOB Release No. 2011-006 (August 16, 2011), which discuss and request comment on the potential of these and other measures to improve the usefulness of audit reports and bolster auditor independence.

[15] April 16 FAQs, Question 8 and April 16 FAQs, Question 30.

[16] Item 10(f)(1) of Regulation S-K provides generally that "smaller reporting company" means "an issuer that is not an investment company, an asset-backed issuer… or a majority-owned subsidiary of a parent that is not a smaller reporting company and that… (*i*) Had a public float of less than $75 million as of the last business day of its most recently completed second fiscal quarter… or (*ii*) In the case of an initial registration statement under the Securities Act or Exchange Act for shares of its common equity, had a public float of less than $75 million as of a date within 30 days of the date of the filing of the registration statement… or (*iii*) in the case of an issuer whose public float as calculated under paragraph (*i*) or (*ii*) of this definition was zero, had annual revenues of less than $50 million during the most recently completed fiscal year for which audited financial statements are available."

[17] The Staff has clarified that an existing issuer at the time the JOBS Act was signed into law that is an EGC but which currently does not qualify as a smaller reporting company will be permitted to avail itself of the scaled executive compensation disclosure pursuant to the JOBS Act. Title I FAQs, Question 6.

[18] This change is not limited to IPOs or to equity offerings. As a result, "testing the waters" would also be permitted in connection with follow-on equity offerings and debt offerings by EGCs (subject to Regulation FD and similar considerations and implementation of appropriate "wall cross" procedures).

[19] Rule 15c2-8(e) under the Exchange Act generally requires that broker-dealers make available a preliminary prospectus relating to securities prior to soliciting orders for such securities. The Staff has noted that Rule 15c2-8 is historically based on, and speaks as to, communications taking place after the issuer has filed a registration statement. The Staff also stated that the understanding of "soliciting orders" is based on facts and circumstances but that, in general, soliciting indications of interest at different price ranges, without soliciting a commitment or firm bid from investors, would not be viewed as soliciting orders that would require the delivery of a preliminary prospectus under Rule 15c2-8. May 2 Corporate Counsel Webcast. Additional guidance is anticipated to be issued by the Division of Trading and Markets soon.

[20] The definition of "research report" under this provision of the JOBS Act is broad. While the definition largely tracks the definition contained in the existing safe harbors relating to research reports provided by Rules 137, 138 and 139 of the Securities Act, it also covers "oral" research reports. The definition includes any written or oral communication that features "information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision."

[21] We believe, however, that those securities exchange rules that effectively contravene the JOBS Act should be deemed invalid as to conduct occurring after the date of enactment of the JOBS Act, and anticipate that the exchanges will act quickly to amend their rules in accordance with the spirit and intent of the statute.

[22] The JOBS Act does not address current research report or public appearance restrictions under NYSE Rule 472, nor does it address such restrictions with respect to secondary offerings, such as FINRA's current 10-day blackout period following such an offering. It also does not expressly address FINRA's rules as they relate to blackouts around a waiver or termination of a lock-up agreement, or to periods following expiration, waiver or termination of

a lock-up agreement (although arguably, in the case of an EGC IPO, these might be covered by the JOBS Act proscription against the SEC or FINRA adopting or maintaining rules prohibiting the publication of research within any prescribed period following an EGC's IPO). For example, current FINRA rules restrict publication of research reports or analyst public appearances 15 days prior to and after the expiration, waiver or termination of a lock-up agreement with respect to a securities offering.

[23] The SEC has provided procedures for the confidential submission of draft registration statements via a secure email system. All draft registration statement submissions must be in text searchable PDF format and should include a transmittal letter identifying the issuer and the type of submission. EGCs should confirm their status as an EGC in their transmittal letters. Confidential Submission Update.

[24] Securities Act Rule 433(h)(4) defines a "road show" as "an offer (other than a statutory prospectus or a portion of a statutory prospectus filed as part of a registration statement) that contains a presentation regarding an offering by one or more members of the issuer's management… and includes discussion of one or more of the issuer, such management, and the securities being offered…"

[25] That is, "when the emerging growth company and underwriters begin actively marketing the offering". April 10 FAQs, Question 8. If an EGC does not conduct a traditional road show, the Staff has advised that it must publicly file its registration statement and confidential submissions no later than 21 days before the anticipated date of effectiveness of the registration statement. *Id.*

[26] Note that, because these confidential submissions eventually must be filed prior to completing the offering, the confidential submission process only delays the public disclosure of this information—it does not prevent its public disclosure if the offering is completed. The issuer still must request confidential treatment of information that otherwise is required to be disclosed in or filed as an exhibit to its registration statement pursuant to the procedures contained in Rule 406 under the Securities Act. If the offer is not completed, however, the JOBS Act provides for such submission to remain confidential. In addition, EGCs should take appropriate steps to ensure confidential treatment, where appropriate, of information contained in an EGCs responses to Staff comment letters. *See* n.31. The Staff has clarified that, until the Edgar system is updated to provide for the filing of draft registration statements previously confidentially submitted to the Staff, these confidential filings, together with all exhibits thereto, should be filed as Item 99 exhibits to the first publicly filed registration statement relating to the offering. PLI Webcast.

[27] April 10 FAQs, Question 6.

[28] *Id.*, Question 5.

[29] FINRA Regulatory Notice 12-22 (April 2012) ("Notice 12-22"); FINRA Regulatory Notice 04-13 (February 2004). Note that all filings with FINRA pursuant to the FINRA Rule 5110 are nonpublic. *See* Notice 12-22 at 5.

[30] Title I FAQs, Question 25. Accordingly, as with issuer responses to Staff comment letters with respect to filings that are not submitted confidentially, an EGC must take appropriate steps to seek confidential treatment, where appropriate, of information contained in their response letters. The Staff has noted that, in an EGC's response letters submitted to the Staff during the confidential review of its draft registration statement, "an EGC should appropriately identify the information for which it intends to seek confidential treatment upon public filing to ensure that the [S]taff does not include that information in its comment letters," and that "[w]hen the company resubmits its responses to [S]taff comments on the confidential draft registration statement on EDGAR, it should follow the Rule 83 procedures. Alternatively, the company could follow the Rule 83 procedures at the time it submits its response letters to the [S]taff." Title I FAQs, Question 26.

[31] April 16 FAQs, Question 9. Under the confidential submission policy applicable to private issuers prior to the JOBS Act, certain foreign private issuers (foreign governments registering debt securities, foreign private issuers already listed or is concurrently listing its securities on a non-U.S. securities exchange, foreign private issuers being privatized by a foreign government, or foreign private issuers that could demonstrate that the public filing of an initial registration statement would conflict with the law of an applicable foreign jurisdiction, subject to certain exceptions) are able to submit complete initial draft registration statements for non-public review. Prior to December 8, 2011, the Staff had even more broadly allowed foreign private issuers, including those whose only stock exchange listing would be in the United States, and foreign governments the ability to submit to the Staff draft registration statements and amendments on a non-public basis in connection with their first-time registration with the Commission; the Staff narrowed this policy in December 2011. See *Division announcement regarding Non-Public Submissions from Foreign Private Issuers* (December 8, 2011) (available at http://www.sec.gov/divisions/corpfin/internatl/nonpublicsubmissions.htm).

[32] The JOBS Act also mandates that the revised SEC rules require that the issuer take reasonable steps to verify that purchasers of securities under the Rule 506 exemption are accredited investors. Although the Commission has not yet proposed rules to define what will be required to satisfy this "reasonable steps" standard, the Staff has indicated that it believes that self-certification, which is currently a common market practice for Rule 506 offerings, will not satisfy the "reasonable steps" standard. April 24 Corporate Counsel Webcast.

[33] Permitted "ancillary services" include due diligence services not involving compensated investment advice or recommendations to issuers or investors. Ancillary services also include the provision of standardized documents to issuers and investors, so long as the person does not negotiate the terms of the issuance for third parties, and issuers are not required to use the standardized documents as a condition for using the ancillary services.

[34] Crowdfunding Statement.

[35] Seemingly, a company seeking to issue securities in reliance on the "crowdfunding" exemption will need to count all shares of restricted stock granted to employees, as well as all other stock issuances, in the prior 12 months against the $1 million limitation.

[36] The income and net worth of a person is required to be calculated in accordance with the SEC's rules for calculating income and net worth of an "accredited investor." Thus, the value of a person's primary residence, and the outstanding balance of the associated mortgage on the person's primary residence, would generally not be included in measuring his or her net worth.

[37] Note that the separate thresholds under Rule 12g3-2(a), which provides an exemption from Section 12(g) for securities of any class, issued by a foreign private issuer, with fewer than 300 holders resident in the United States (as calculated under Rule 12g3-2(a)(1) and (2)), remains unchanged.

[38] Rule 12g-1 under the Exchange Act.

[39] Section 602 directs the Commission to issue regulations to implement the changes in Section 601, but because these changes amend the Exchange Act directly, they should have immediate legal effect without SEC action.

[40] Section 503 directs the Commission to "revise the definition of 'held of record' pursuant to [S]ection 12(g)(5)… to implement the amendment made by Section 502," but because the JOBS Act amends the Exchange Act directly to specifically exclude these securities from the meaning of "held of record," these changes should have immediate legal effect without SEC action.

[41] PLI Webcast.

© 2012 Gibson, Dunn & Crutcher LLP

Attorney Advertising: The enclosed materials have been prepared for general informational purposes only and are not intended as legal advice