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DAVIS MALM & D'AGOSTINE P.C.

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A Guide To The 2012 Jobs Act For Private Companies

The following is a summary of the provisions of the new Jumpstart Our Business Startups Act (the "JOBS Act") enacted on April 5, 2012. This Guide is intended to assist private companies contemplating raising capital in private placements or public offerings.

This Guide reflects SEC administrative interpretations in effect as of June 11, 2012. As discussed below, certain provisions of the JOBS Act are subject to the issuance of final SEC regulations which have not yet been proposed. A copy of this Guide will be posted on the Davis, Malm & D'Agostine, P.C. website (www.davismalm.com) and will be periodically updated.

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I. Background

The JOBS Act is intended to encourage capital formation and job creation by reducing regulatory barriers to smaller companies' efforts to raise capital. Following the recommendations of the 2011 Treasury Department IPO Task Force,[1] the JOBS Act, among other things,

- increases the number of shareholders required to trigger the periodic disclosure and proxy requirements of the Securities Exchange Act;
- eliminates the prohibition on "general solicitation" for most private placements;
- provides an "on-ramp" to an IPO by reducing regulatory disclosures for "emerging growth companies;"
- modifies the little-used Regulation A exemption by increasing the offering size to $50 million; and
- provides a $1 million annual exemption for "crowdfunding" through a broker or "funding portal" registered with the SEC.

II. Staying Private Longer

Under prior law, a private company with 500 or more shareholders of record and more than $10 million in assets was required to register with the SEC and became subject to periodic reporting and proxy disclosure requirements under the Securities Exchange Act, even though it may never have had a public offering registered under the Securities Act. The JOBS Act increases this threshold to either (a) 2,000 or more shareholders of record or (b) 500 or more shareholders of record who are not accredited investors[2]). Shares issued under an employee compensation plan in an exempt transaction (such as Rule 701) are generally excluded from this calculation. This provision is intended

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[1] *See Rebuilding the IPO On-Ramp—Putting Emerging Companies and the Job Market Back on the Road to Growth,* issued by the IPO Task Force on October 20, 2011.

[2] An "accredited investor" is defined as including certain classes of institutional investors as well as individual investors meeting relatively high minimum net worth or annual income requirements.

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Davis Malm's business attorneys represent public and privately held businesses in a wide range of industries. The breadth of experience of the attorneys on our team allows us to represent our business clients in all areas of corporate and securities law, from initial organization through the entire range of business transactions over the life of the business. We represent our business clients in ongoing legal matters such as: employment arrangements, licensing matters, stock incentive plans, securities law compliance, intellectual property, supply and distribution agreements, corporate succession planning as well as Internet commerce, franchise, and stockholder agreements. Our start-up and emerging growth attorneys serve the legal needs of businesses across all stages of their development, from inception to IPO and beyond We also represent venture capital investors and small business investment companies (SBICs) in the formation of investment funds and in early stage and mezzanine financing transactions.

to protect private companies with large numbers of shareholders (Facebook is the most common example) from compulsory public disclosure of information they desire to keep confidential. This provision of the Act takes effect immediately and applies to all private companies (other than banks and bank holding companies), not only "emerging growth companies."

III. Encouraging Private Placements

Under current law, "general solicitation and/or general advertising" of most private placements of securities are prohibited. The JOBS Act directs the SEC to adopt amendments to Rule 506 permitting such solicitation or advertisements, so long as all purchasers are accredited investors. Issuers must now take "reasonable steps" to verify that purchasers are in fact accredited investors; prior law permitted sales to persons whom the issuer "reasonably believed" to be accredited investors. This provision will not take effect until the SEC adopts implementing regulations on or before July 4, 2012. It is worth noting that Rule 506 provides an exemption only from the *registration* requirements of the federal securities laws. It does not exempt issuers from liability for false or misleading statements in connection with the sale of securities under the *antifraud* provisions of federal or state securities laws.

IV. The IPO "On-Ramp" For Emerging Growth Companies

Emerging Growth Companies.

An "emerging growth company" (or "EGC") is defined as a company with less than $1 billion[3] in revenues in its most recent fiscal year. This status continues until (a) the last day of its fiscal year in which it has $1 billion or more in annual revenues; (b) the last day of its fiscal year following the fifth anniversary of its IPO; (c) the date on which the company has more than $1 billion in nonconvertible debt issued during the previous three-year period; or (d) the date on which it is deemed a "large accredited filer."[4] Companies that made their first sale of common equity securities in a registered IPO on or before December 8, 2011 are excluded from the definition of EGCs.

Two Years of Audited Financial Statements.

An EGC will need only two years of audited financial statements for its IPO, instead of the usual three, and will need to present only two years of data in the "Selected Financial Data" and "Management's Discussion and Analysis" sections of its IPO prospectus.

Limited Compensation Disclosure.

An EGC may limit the executive compensation disclosure in its SEC filings to the disclosures required by Regulation S-K for smaller reporting companies. This will allow the EGC to omit the "Compensation Disclosure and Analysis" discussion and provide compensation disclosure for only three executive officers (including the CEO), rather than the usual five.

No Dodd-Frank Executive Compensation Requirements.

An EGC will be exempt from the "say-on-pay," "say-on-frequency" and "say-on-golden parachutes" votes required by the Dodd-Frank Act. An EGC will also be exempt from providing the "pay-for-performance" graph and CEO pay ratio disclosure under that act and from providing certain other disclosure requirements.

Analyst Reports.

The publication of research reports about an EGC during an IPO will be permitted, even if by a broker-dealer participating in the offering. This provision of the JOBS Act is intended to address the limited research coverage available for EGCs under existing FINRA rules.[5] It remains to be seen how FINRA will modify its rules. This provision may conflict with the terms of the 2003 "Global Research Analyst Settlement" entered into by certain large investment banks and several regulators settling litigation commenced by then New York Attorney General Eliot Spitzer. The Global Settlement does not affect many smaller investment banking firms.

No Internal Controls Attestation.

An EGC is not subject to Section 404(a) of the Sarbanes-Oxley Act requiring auditor attestation regarding the adequacy of the company's internal control over financial reporting.

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[3] This number is to be adjusted for inflation every five years.

[4] A large accelerated filer is defined as one with a market valuation of the shares owned by non-affiliates of $700 million or more and which meets certain other requirements.

[5] These rules impose research "quiet periods" during the 40 days (or in some cases, 25 days) following an IPO as well as the 15 days preceding the expiration of a "lock-up" agreement with the underwriters. They also restrict research analysts from contacts with investors and participation in company management presentations with sales force personnel. *See* FINRA Rule 2711.

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No Auditor Rotation.
An EGC will not have to comply with any rules of PCAOB requiring auditor rotation or audit report supplements.

New or Revised *FASB Rules.*
An EGC may elect not to comply with any new or revised FASB accounting standard which is not applicable to non-public companies.

"Testing the Waters" Permitted.
An EGC may make offers of its securities to qualified institutional buyers or institutional accredited investors before or during its IPO registration period.

Confidential Submission of Draft Registration Statements.
An EGC may use the SEC's email system to submit, on a confidential basis, a draft registration statement for its IPO. No filing fees or signatures (other than auditor's certifications) are required, but the issuer must publically file such information at least 21 days prior to the first "road show" for the offering. The SEC requires the draft registration statement to include a description of the issuer's EGC status and an election regarding new or revised FASB standards.

V. "Regulation A "

Regulation A under the Securities Act provides an exemption for up to $5 million of securities sold under an "offering statement" calling for less extensive disclosure than a registered IPO. The JOBS Act increases this limit to $50 million in any twelve month period. Eligible securities include debt, equity and convertible securities. Securities sold under new Regulation A will have no restrictions on resale, and securities sold on a national securities exchange or to "qualified purchasers" (a term to be defined in future SEC regulations) will be "covered securities" exempt from state Blue Sky laws. "Testing the waters" will be permitted. This provision of the JOBS Act will become effective upon adoption of new SEC regulations by December 31, 2012. It remains to be seen what additional conditions the SEC will impose; these may include the form of the offering statement, audited financial statements and "bad boy" disqualification provisions. Regulation A issuers will not have to comply with the reporting requirements under the Securities Exchange Act until the new higher shareholder threshold is met (*see* Section II above). However, a Regulation A issuer will have to file annual audited financial statements with the SEC, and will be subject to such other periodic disclosure obligations as the SEC may determine.

VI. "Crowdfunding"

Private U.S. companies may raise up to $1 million in capital in any twelve month period by issuing securities in small amounts to a large pool of unaccredited investors under this new exemption. The aggregate amount that may be purchased by any investor in a twelve month period is limited to (a) the greater of $2,000 or 5% of the investor's annual income or net worth, if the investor has an annual income or net worth less than $100,000; or (b) 10% of the investor's annual income or net worth (to a maximum of a $100,000 investment) if the investor's annual income or net worth exceeds $100,000. The $1 million

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annual amount is reduced by the amount of securities sold under other exemptions, such as private placements.

A crowdfunding transaction must be conducted through a broker-dealer or "funding portal" registered with the SEC, acting as an intermediary. A funding portal may not (a) offer investment advice; (b) solicit purchases or sales of securities offered on its portal; (c) compensate employees or others for the solicitation or sale of such securities; or (d) possess or handle investor funds or securities. The portal must also conduct due diligence on the issuer.

Issuers using the crowdfunding exemption may not advertise the terms of the offering, and must file required disclosure documents with the SEC, including tax returns or audited or reviewed financial statements. Transfers of securities issued under the exemption are restricted, with a few exceptions. The crowdfunding exemption will take effect upon the adoption by the SEC of final regulations prior to December 31, 2012. Until then, the SEC will regard any sales of securities under a "crowdfunding" plan as unlawful under the federal securities laws. DMD

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