Jumpstart Our Business Startups (JOBS) Act Signed Into Law

Friday, April 20, 2012

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups, or “JOBS,” Act (H.R. 3606), which is designed to streamline or eliminate the regulatory and legal barriers many emerging companies currently face when attempting to raise capital. The JOBS Act contains multiple amendments to the federal securities laws that could have significant effects on small businesses, broker-dealers, private investment funds, banks and bank holding companies, and existing public companies. This alert explains the principal provisions of the JOBS Act and various practical ramifications for our clients.

I. IPO On-Ramp for Emerging Companies

To begin with, Title I of the JOBS Act seeks to improve access to capital for certain newly-registered public companies, known as “emerging growth companies” or “EGCs,” by easing them into SEC reporting requirements. An EGC is defined as a company that had total annual gross revenues of less than $1 billion during its most recently completed fiscal year, other than an issuer that completed its initial public offering on or before Dec. 8, 2011. As a result, most current public companies do not qualify for EGC status.

If a company meets the definition of an EGC upon going public, the company will retain its EGC status until the earliest of the following:

- The last day of the fiscal year following the 5th anniversary of its IPO;
- The end of a fiscal year in which the company has $1 billion (inflation-adjusted) in annual gross revenue;
- The date on which the company issues $1 billion in non-convertible debt (aggregated over the previous three-year period); or
- The date on which the company becomes a “large accelerated filer” for purposes of SEC reporting (i.e., the company has a worldwide market value of common equity held by non-affiliates of $700 million or more at the end of its most recently completed second fiscal quarter).

During the period of EGC eligibility, and EGC will enjoy the following relief from reporting, disclosure, and auditing requirements:

- EGCs will be able to submit draft IPO registration statements to the SEC for confidential review. However, EGCs will have to publicly file a registration statement at least 21 days before the commencement of an IPO roadshow.
- EGCs will be permitted to “test the waters” by holding meetings with accredited investors and qualified institutional buyers to evaluate interest in an upcoming IPO without being subject to the prospectus filing and delivery requirements of the Securities Act of 1933.
- Broker-dealers, including the underwriters participating in the company’s IPO, will be permitted to publish and distribute research reports on the EGC both prior to and after the filing of a registration statement without any blackout period applying.
- EGCs will not be required to conduct nonbinding “say-on-pay” or “frequency-on-pay” shareholder votes on executive compensation, including advisory votes on “golden parachutes” payments. EGCs also will be exempt from the requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act to disclose the ratio of the median annual total compensation of all employees to the total compensation of
the company’s chief executive officer, as well as any requirements to make pay-versus-performance
disclosures.

- EGCs will not be required to disclose “selected financial data” (i.e., five-year lookback on certain income
and balance sheet items) in any registration statement or any report filed under the Securities Exchange
Act of 1934 (including annual reports to shareholders and Form 10-Ks) for any period prior to the earliest
audited period presented in the EGC’s registration statement. Also, EGCs will be required to present only
two years of audited financial statements in an IPO registration statement (as opposed to three years
under the old rules).

- EGCs will be exempt from the PCAOB’s rules on mandatory auditor rotation.

- EGCs will be exempt from the auditor attestation on internal control requirements under Section 404(b) of
the Sarbanes-Oxley Act of 2002 (“SOX”).

- EGCs will be permitted to provide the “smaller reporting company” scaled executive compensation
disclosures in proxy statements and Form 10-Ks.

- EGCs will not be subject to any newly adopted or revised accounting standards unless and until these
standards are deemed to apply to companies that are not “issuers” as defined under SOX.

These new requirements are effective immediately and are retroactive for companies that went public on or after
December 8, 2011.

From a practical perspective, it is unclear how useful the IPO on-ramp provisions will be for smaller emerging
companies in the long-run. While these provisions are sure to provide cost savings to many newly-registered
public companies as a result of the scaled disclosure requirements and other exemptions, the on-ramp provisions
do not appear to provide any new impetus for companies to go public. In this regard, the IPO on-ramp provisions
do not address the traditional reasons companies go public – to obtain cash for operations, to use stock as
currency for acquisitions, and to bolster the company’s public prestige and status, to name a few – and rather
appear to provide benefits to emerging companies that have already made the decision to go public for other
reasons and are already subject to public company disclosure requirements.

II. Elimination of General Solicitation Ban

In addition to the IPO on-ramp provisions, the JOBS Act directs the SEC to eliminate certain restrictions on private
placements for all companies seeking to raise capital. In this regard, Title II of the JOBS Act requires the SEC to
adopt rules to eliminate the ban on general solicitation and general advertising when issuers are selling
securities to “accredited investors” under Rule 506 of Regulation D, so long as such issuers take “reasonable
steps” to ensure that all purchasers are accredited investors. Persons engaging in resales to “qualified
institutional buyers” under SEC Rule 144A (i.e., banks, insurance companies, broker-dealers, investment advisers,
and other institutional investors) also will be permitted to engage in general solicitation and general advertising,
so long as such persons take “reasonable steps” to ensure that all such purchasers are qualified institutional
buyers. Rule 144A offerings are commonly used to facilitate foreign private investment in U.S. companies.

In addition, Title II of the JOBS Act states that persons which maintain trading platforms to facilitate Rule 506
offerings will not be required to register as broker-dealers if certain requirements are met, including no payment
of compensation to the platform operator or its associated persons, the operator and its associated persons
cannot hold customer funds or securities, and the operator and its associated persons are not disqualified by the
statutory “bad actor” provisions of the legislation. Platform operators and their associated persons also will be
permitted to co-invest in offerings facilitated through the platform and provide ancillary services in connection
with such offerings, such as due diligence services and the provision of standardized subscription documents to
the issuers and investors. These provisions have the potential to increase the creation and use of online angel-
investment platforms and bulletin boards, which previously were forced to seek SEC no-action relief in order to
have comfort their structures were not running afoul of the SEC’s broker-dealer rules.

The SEC is required to adopt rules implementing these provisions, within 90 days after enactment of the JOBS Act,
or July 4, 2012. As a result, the ban on general solicitation and general advertising will remain in effect until these
rules are adopted by the SEC. These rules will include an explanation of the “reasonable steps” issuers and other
sellers must take to ensure that all purchasers are “accredited investors” or “qualified institutional buyers,” as
the case may be.

Prior to the JOBS Act, companies raising private capital under Regulation D (which is the most common exemption
used for private capital raises) were prohibited from engaging in general advertising or general solicitation of
investors, as such practices were more indicative of public offerings of securities to the general public.
Consequently, issuers were typically limited to soliciting family members, friends, business associates, or others
with whom the issuer had a substantial pre-existing personal or business relationship, or using a registered
broker-dealer to effect the issuer’s securities offering.
However, the passage of the JOBS Act represents a fundamental change in the law with respect to how private securities offerings are permitted to be conducted. Moreover, these provisions present significant opportunities for issuers that were previously unavailable, especially entrepreneurial seed- and venture-stage companies as well as private investment funds, to reach a large number of potential investors who are accredited investor or qualified institutional buyers. In this regard, a private operating company or investment fund is expected to be able to use the Internet, e-mail, print and broadcast media, outdoor advertisements, and websites without password protection, to name a few methods, in order to communicate with such potential investors regarding a securities offering. That being said, issuers will need to be careful in how they conduct their general advertising in order to manage reputational risk and public perception concerns. Overall, the elimination of the ban on general solicitation and general advertising may prove to have the most significant long-term effect of any provision of the JOBS Act on issuers attempting to raise capital.

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