JOBS Act Creates Significant U.S. Capital-Raising Opportunities for U.S. and Non-U.S. Companies and Funds

The Jumpstart Our Business Startups Act (the JOBS Act) has raced through Congress, sped along by its bipartisan popularity as a jobs growth bill, and has stranded at least 11 Senate and House bills (most passed in 2011) which deal with securities law reforms. The Act accomplishes private offering rules reforms (which have been on the table since 2007), implements many of the recommendations of the IPO Task Force and endeavors to create a healthy equity market food chain.

After racing through Congress[1], the Jumpstart Our Business Startups Act (the JOBS Act) has stranded in the Senate Committee on Banking, Housing and Urban Affairs ("Senate Banking Committee") at least 11 Senate and House bills (most passed in 2011) which deal with securities law reforms. H.R. 3606 sped through the legislative process due to its bipartisan popularity as a jobs growth bill, owing in significant part to a finding by the IPO Task Force that 90% of job creation occurs after a company's IPO. At the time of this alert, it is expected that the JOBS bill will be delivered to President Obama for his signature in the next few days.

The Act accomplishes private offering rules reforms (which have been on the table since 2007), implements many of the recommendations of the IPO Task Force and endeavors to create a healthy equity market food chain. While it seems likely that the United States will again be a jurisdiction of choice for both domestic and non-U.S. companies contemplating an IPO, it also seems that much of the oxygen was removed from the lower end of the food chain by Senator Merkeley's amendments to the crowdfunding provisions of Title III of the JOBS Act, which were motivated by concerns of potentials for fraud on small investors.

At the upper end of the equity market food chain, an important aspect of H.R. 3606 is the creation of a new category of issuer (including hedge funds, private equity funds and special purpose entities)—an "emerging growth company" ("EGC")—which benefits from various significant IPO inducements and related concessions (as noted below). Essentially, an EGC is any domestic or non-U.S. company (or other entity including funds) with total annual gross revenues (presumably on a U.S. GAAP basis) of less than US$1 billion (as adjusted for inflation by the SEC every 5 years) during its most recently completed fiscal year.

Another important aspect of H.R. 3606 is the lifting of the prohibition on general advertising and general solicitation that has since 1962 been essential to characterize an offering as private and not subject to registration under the U.S. Securities Act of 1933, as amended (the "1933 Act"). As long as a Rule 506

[1] H.R. 3606 was passed by the House on March 8, placed on the Senate Legislative Calendar on March 12, passed by the Senate on March 22 and then approved by the House (after amendments in the Senate) on March 27.

offering is made only to "accredited investors" and "qualified institutional buyers" (within the meaning of Regulation D and Rule 144A, respectively), general advertising will be permitted for all issuers (including hedge funds, private equity funds and special purpose entities), after a 90-day period during which the SEC is to issue implementing rules.

The confluence allowing general advertising with raising the number of record holders of an issuer's shares to 2,000 (or 500 record holders which are not accredited investors) before the registration (and ongoing periodic reporting) requirements under Section 12(g) of the U.S. Securities Exchange Act of 1934, as amended (the "1934 Act") are triggered should result in a substantial increase in pre-IPO financings in the United States by both domestic and non-U.S. companies from the approximately US$609 billion raised during 2009 in the United States.

The prognosis for the lower end of the equity market food chain looks less promising. Crowdfunding has been an increasingly popular method of capital formation where "groups of people pool money typically comprised of very small individual contributions to support an effort by others to accomplish a specific goal" (SEC Chairman Mary Schapiro). Yet concerns about possible frauds expressed during Senate Banking Committee hearings on earlier alternative measures to H.R. 3606 apparently motivated various constraining amendments to this initiative as noted below.

Highlights of the JOBS Act:

- EGC benefits include: pre-filing solicitations of interest (can apparently circulate Executive Summary portion of Prospectus) to accredited investors and qualified institutional buyers, confidential (or "quiet") filings until 21 days before first roadshow, continuous research reports even by syndicate members, only two years of audited financial statements required, no 404(b) auditor internal controls certification under Sarbanes Oxley, no need to disclose executive compensation under 953(b)(1) of the Investor Protection and Securities Reform Act of 2010, post-IPO research reports and public appearances permitted, no mandatory auditor rotation, no need for shareholder approval of executive compensation under Section 14A of the 1934 Act and proxy rules relief under Section 14(i) of the 1934 Act.
- Foreign private issuers ("FPI") are likely best advised to utilize the IPO and post-IPO disclosure concessions given to EGCs and then when such concessions expire (the earlier of the last day of the fiscal year in which the 5th anniversary of the IPO occurs, the US$1 billion total annual gross revenues threshold is met, or when non-convertible debt issued during any three-year period exceeds US$1 billion), to utilize reporting concessions based on FPI status.
- The SEC is required to report on how to streamline the Regulation S-K and the IPO registration processes within 180 days of enactment.
- The new Section 12(g) registration trigger of 2,000 record holders (or 500 non-accredited holders) excludes all purchasers who acquired shares via crowdfunding or an employee compensation plan; fewer FPIs will need to utilize 12g3-2(b) going forward.
- Due to the new alternative registration trigger under Section 12(g) of 500 holders which are not accredited investors, companies will need to canvass their shareholders as of the last day of each fiscal year (presumably using the methodology for determining accredited investor status that the SEC is charged with providing within 90 days of enactment for purposes of allowing general advertising under Rule 506).

- The SEC is charged with promulgating a new Regulation A-like offering with an annual ceiling of US$50 million of securities rather than US$5 million currently imposed on Regulation A offerings; SEC to study impact of state regulation of Regulation A offerings.
- All capital raises via crowdfunding (new Section 4(6) of the 1933 Act) have to be conducted through a registered broker-dealer or funding portal (under earlier alternative legislation, issuers could use crowdfunding directly) which may have such an onerous set of obligations and potential liabilities as to likely chill interest in this tier of capital raise (more cold water—all offerings of more than US$500,000 are required to have audited financial statements, and all Section 4(6) offerings will be subject to both state and federal regulation).
- Funds exempt from registration under the Investment Company Act of 1940 by reason of Section 3(c), including hedge funds and private equity funds, cannot take advantage of the crowdfunding provisions, as would have been possible under earlier alternative legislative initiatives.
- Non-U.S. companies cannot take advantage of the crowdfunding provisions (contrast earlier alternative legislative initiatives).
- Non-U.S. dealers or funding portals cannot participate in crowdfunding (contrast earlier alternative legislative initiatives).

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