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SEC Continues to Provide Guidance on JOBS Act

The Jumpstart Our Business Startups Act (the "JOBS Act") became law on April 5, 2012, implementing sweeping changes to the rules governing IPOs and private capital formation in the United States by domestic and foreign issuers. The JOBS Act substantially reduces the regulatory burdens on "emerging growth companies" (companies with less than $1 billion in annual revenue) during and following an IPO, and also substantially relaxes restrictions on communications with potential investors in the context of both public and private offerings.

Many provisions of the JOBS Act, including the new relaxed standards for emerging growth companies, were immediately effective and did not require further SEC rulemaking. Certain other provisions, including the elimination of restrictions on publicity in connection with certain private offerings, will not become effective until the SEC adopts implementing rules.

Since mid-April, the SEC has issued guidance on various provisions of the JOBS Act. We have updated our earlier alert to reflect the guidance issued to date.

Facilitating Access to the Capital Markets and Easing Reporting Requirements

Title I of the JOBS Act facilitates the IPO process and eases reporting requirements for emerging growth companies ("EGCs") through amendments to the Securities Act of 1933 (the "Securities Act"). These provisions are immediately effective and do not require further SEC rulemaking.

Emerging growth companies. An "emerging growth company" is a company that has had total revenue of less than $1 billion during its most recent fiscal year.[1] This threshold will be indexed for inflation every five years. An emerging growth company will retain its status as such until the earliest of:

- the first fiscal year after its total revenue as presented on its income statement exceeds $1 billion;
- the last day of the fiscal year during which the fifth anniversary of its IPO occurs;
- the date when the company has issued more than $1 billion in non-convertible debt securities, whether or not issued in a registered offering, over the previous rolling three-year period; and

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1 If a private company exceeded the threshold in past fiscal years, it may still be able to qualify as an EGC since only the revenue for its most recent fiscal year is considered. The revenue is the total revenue as presented on the income statement under U.S. GAAP or IFRS as issued by the IASB. If the financial statements are presented in currencies other than the U.S. dollars, the revenue is calculated in U.S. dollars using the exchange rate as of the last day of the most recently completed fiscal year. A predecessor's revenue should be used for the calculation of revenue if the financial statements are those of the predecessor. Financial institutions should use the specific approach developed for the determination of smaller reporting company status and explained in Section 5110.2 of the SEC's Financial Reporting Manual to determine their EGC status.

- the first fiscal year in which the company becomes a large accelerated filer (meaning the company has been reporting for at least one year, has filed at least one annual report and the value of its common equity held by non-affiliates is at least $700 million).

An EGC that loses its status as such will not be able to regain it.

EGC status will need to be tested at various points during an IPO process. Specifically, a company must test its status each time it makes a confidential submission to the SEC of its IPO registration statement and amendments thereto; at the time of the first public filing of its IPO registration statement with the SEC; at the time of each test-the-waters communication (described below); and whenever a research report is issued. If, for example, during the IPO process, an EGC starts a new fiscal year and during the preceding fiscal year the EGC's revenue increased to above $1 billion, it would no longer be able to rely on the accommodations for EGCs. However, once an EGC files the registration statement publicly, it will retain its status as an EGC while it is in registration for the purpose of determining the contents of that registration statement.

A company (or its predecessor) that sold common equity securities under an effective registration statement on or before December 8, 2011 cannot qualify as an EGC[2] and a company that was not an EGC at the time of its IPO cannot become an EGC at a later date.

Public reporting companies that have not completed an IPO (and become reporting companies due to a large shareholder base or due to issuance of registered debt) may also qualify as EGCs and may remain so indefinitely to the extent that they do not sell common equity in a registered public offering.

Issuers of asset-backed securities and investment companies registered under the Investment Company Act of 1940 are not eligible to become EGCs. However, business development companies are eligible to become EGCs.

The SEC staff has clarified that all non-convertible debt securities, whether or not still outstanding, are to be counted against the $1 billion limit. However, debt securities issued in an A/B exchange offer will not be counted. The SEC staff has also clarified that "non-convertible debt" means any non-convertible debt *security*, whether or not issued in a registered offering, and would not include bank debt.

An EGC should identify itself as such on the cover page of the prospectus.

IPO-related accommodations. EGCs benefit from the following IPO-related accommodations.

- ***Confidential filings***. An EGC is permitted to submit a draft registration statement prior to its "initial public offering date" for SEC review on a confidential basis, as long as a public filing is made at least 21 days prior to the roadshow for the offering. (The initial public offering date is the date of the first sale of common equity securities pursuant to an effective registration statement under the Securities Act.) The public filing must include the initial confidential submission and all amendments thereto.

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[2] A public sale of debt on or prior to December 8, 2011 will not preclude a company from qualifying as an EGC.

Confidential filings are to be submitted to the SEC staff via secure email system in searchable PDF format.

SEC comment letters relating to the registration statement and the company's responses will be deemed confidential information and will not be made public through the SEC's EDGAR system until at least 20 business days following the effective date of the registration statement for the IPO.

The SEC staff has indicated that EGCs can use the confidential filing process for pre-IPO offerings of debt securities, including a Form S-4/F-4 for an A/B exchange offer. The SEC staff has interpreted the definition of "initial public offering date" broadly, indicating that it can be triggered by an offering of common equity pursuant to an employee benefit plan registered on Form S-8, as well as selling shareholder secondary offerings registered on a resale registration statement.

Foreign private issuers ("FPIs") can use the EGC confidential submission process to the same extent as a domestic company if they otherwise qualify as an EGC. A FPI that is not an EGC may otherwise be able to qualify for confidential submission under the SEC's existing policies and procedures for FPIs. The confidential submission policy for FPIs has been changed as of May 30, 2012 to require FPIs to file publicly draft registration statements that were confidentially submitted and any related correspondence with the SEC, at the time they publicly file their registration statements.

Any confidential submissions must be substantially complete and must include a signed audit report covering the audited financial statements. As confidential submission does not technically constitute a filing, the registration statement need not be signed and need not include the consents of the auditors and other experts.

The confidential submission process is not available for any filings under the Securities Exchange Act of 1934 (the "Exchange Act"). FPIs will, therefore, be unable to use the confidential submission process established under the JOBS Act for a registration statement on Form 20-F or 40-F used in connection with a listing on a U.S. stock exchange.

- ***Pre-IPO marketing***. The JOBS Act permits an EGC or any person authorized to act on its behalf (including an underwriter) to communicate with potential investors prior to public filing of a registration statement, as long as the investors are either qualified institutional buyers ("QIBs") or institutional accredited investors. This will allow companies to "test the waters" and determine whether there is sufficient market interest before proceeding with a public offering. The SEC staff has provided guidance stating that a company will need to determine whether it qualifies as an EGC each time it makes any test-the-waters communication. If a company loses its EGC status by the time it publicly files its registration statement, the company would not retroactively lose the ability to have relied on EGC status for prior test-the-waters communications.

  Test-the-waters communications that comply with the requirements of the JOBS Act will not be treated as roadshows by the SEC. However, until the SEC provides further guidance on pre-IPO marketing, issuers and underwriters should proceed carefully to ensure that test-the-waters communications do not appear to constitute a formal roadshow (which, as noted above, cannot be commenced until 21 days after a public filing of the IPO registration statement). For example, in the absence of further guidance, issuers should avoid formal management presentations even if limited to QIBs and institutional accredited investors.

Test-the-water communications are permitted in connection with public offerings other than IPOs; however, EGCs need to consider the requirements of Regulation FD post-IPO. The SEC staff may request copies of test-the-water communications (as well as research reports) and may compare them against the registration statement for consistency.

Underwriters may be reluctant to engage in pre-IPO marketing because prospectus liability under Section 12(a)(2) of the Securities Act would still attach to any statements, whether written or oral. In addition, it may be difficult to draw the line between determining whether there is sufficient market interest (which is permitted) and the solicitation of orders (which is not permitted).

- ***Financial statements***. EGCs are permitted to include only two years of audited financial statements in an IPO registration statement rather than the three years previously required (and the related MD&A and selected financial data sections need only cover two years). Similarly, an EGC need not include in other registration statements audited financial statements for any period prior to the earliest audited period presented in its IPO registration statement. If, as a result of a significant acquisition, an EGC would otherwise be required under Regulation S-X to include three years of a target's audited financial statements in the EGC's registration statement, the SEC staff would not object if the EGC only included two years of audited financial statements in the registration statement. Also, if an EGC would otherwise be required to present a ratio of earnings to fixed charges under Item 503(d) of Regulation S-K, the EGC may present that ratio for the same number of years for which it provides selected financial data disclosure, rather than the otherwise required five years.

  Once public, an EGC will need to include three years of audited financial statements in its Form 10-K or Form 20-F. As a practical matter, an EGC will not include in its first Form 10-K or Form 20-F audited financial statements for any period prior to the earliest audited period presented in its IPO registration statement.

- ***Executive compensation***. EGCs have the option of complying with disclosure requirements applicable to smaller reporting companies with respect to executive compensation. This means, among other things, that the compensation section in an IPO registration statement and annual proxy statement need not include a Compensation Discussion and Analysis ("CD&A") and need only disclose the compensation of three (rather than five) executives (the CEO plus the next two most highly paid executives). The tabular disclosure requirements are also significantly reduced for EGCs.

Reduced reporting requirements post-IPO. Following an IPO, EGCs are exempt from a variety of requirements to which they would otherwise become subject as public companies.

- ***Sarbanes-Oxley Section 404(b)***. EGCs are exempt from the requirement to obtain an auditor attestation report on internal controls under Section 404(b) of the Sarbanes-Oxley Act. EGCs are still required to disclose management's assessment and conclusions regarding the effectiveness of internal controls.

- ***Say-on-pay***. EGCs are exempt from the Dodd-Frank Act requirement to hold shareholder advisory votes on executive compensation and golden parachutes. Once a company loses its EGC status, it will be required to hold a say-on-pay vote no later than (i) three years after losing EGC status if it was an EGC for less than two years after completing its IPO or (ii) one year after losing EGC status for all other companies.

- ***Executive compensation***. As noted above, EGCs are permitted to comply only with the compensation disclosure requirements applicable to smaller reporting companies. In addition, they are exempt from the Dodd-Frank Act requirements to disclose (i) the relationship between executive compensation and company performance and (ii) the ratio between the CEO's compensation and the median compensation of all other employees (these new Dodd-Frank requirements have yet to be implemented by the SEC).

- ***New accounting standards***. EGCs are not required to comply with any new or revised financial accounting standard (meaning a standard issued after April 5, 2012) until private companies are also required to comply with that standard. For example, foreign private issuers that reconcile their financial statements to U.S. GAAP may take advantage of the extended transition periods for complying with new or revised financial accounting standards in their U.S. GAAP reconciliation.

  EGCs are not permitted to selectively comply with new accounting standards in part but not in whole. Instead, an EGC must either avail itself of the exemption from, or be subject to, the application of all new accounting standards. EGCs should disclose that they are electing to delay complying with new accounting standards, the date on which the compliance with such standards becomes mandatory for companies that are not EGCs and the date that the EGCs will adopt the accounting standards.

  Once an EGC decides to opt in, it must disclose this decision prominently in its first filing following the decision, and the decision is irrevocable. An EGC that has opted out of compliance with new accounting standards is always free to opt in, but may not subsequently opt out.

- ***New auditing standards***. EGCs are exempt from any rules adopted by the Public Company Accounting Oversight Board ("PCAOB") requiring mandatory audit firm rotation or a supplemental auditor discussion and analysis. Any additional PCAOB rules adopted after April 5, 2012 will not automatically apply to the audit of an EGC unless the SEC determines that such requirements are in the public interest, considering both the protection of investors and the promotion of capital formation.

Practical implications. It remains to be seen how many companies that qualify as EGCs will take advantage of the accommodations afforded by the JOBS Act. While many of the provisions, including the relaxed audit standards and financial and compensation disclosure requirements and deferral of the internal control audit, will translate into cost savings, some companies and underwriters may perceive an advantage in launching an IPO with "best-in-class" disclosure and corporate governance standards.

The SEC staff has provided guidance stating that EGCs may avail themselves of some or all of the scaled disclosure provisions (except that issuers cannot selectively comply with new accounting standards). For example, an EGC may choose to use the confidential filing option but not use the relaxed financial or compensation disclosure requirements. Additionally, so long as a company remains an EGC, it may change its approach to the scaled disclosure provisions from time to time.

It is also important to remember that EGCs remain subject to the general liability provisions of the federal securities laws, including the strict liability provisions of the Securities Act and Rule 10b-5 under the Exchange Act, and that disclosure decisions may be evaluated in light of these provisions. For example, the SEC staff has suggested that if an EGC chooses to omit financial information (for example, the earliest year of the last three years of audited financial statements) that shows a negative trend, it should consider whether disclosure regarding such trend would be material to an investor's understanding of the business and, therefore, should be addressed in the EGC's IPO registration statement (for example, in the risk factors or MD&A).

Typically, Rule 144A offerings follow disclosure standards of SEC-registered offerings. In light of the relaxation of the requirements in respect of EGCs, new market practice is likely to develop that tracks the standards applicable to EGCs in Rule 144A offerings, perhaps irrespective of whether or not the issuer could qualify as an EGC.

As there are consequences to losing EGC status, EGCs will need to monitor their status, including during the IPO process.

Foreign private issuers. The SEC staff has provided guidance stating that a FPI that qualifies as an EGC may avail itself of the scaled disclosure requirements to the extent relevant to the form requirements for FPIs. However, the SEC staff has also stated that a FPI that avails itself of any of the benefits available to an EGC will be treated as an EGC for all purposes. This means that a FPI that elects to be an EGC will not be entitled to make a confidential submission under the procedures applicable to FPIs and, instead, will be required to publicly file its confidential submission at least 21 days before the roadshow.

MJDS issuers. The SEC staff has provided guidance stating that an MJDS-eligible Canadian issuer may avail itself of the test-the-waters amendments to the Securities Act of 1933 and delayed compliance with Section 404(b) of the Sarbanes-Oxley Act.

Research

The JOBS Act liberalizes, in several significant ways, the current regulatory restrictions on research analysts and research reports. Investment banks will now be permitted to publish research reports relating to an EGC at any time before or during a public offering of the EGC's securities, including its IPO, even if the banks are participating in the offering. Under current rules, banks participating in an IPO cannot publish research in advance of the IPO. Section 105 of the JOBS Act specifically provides that the publication by a broker-dealer of a research report relating to an EGC that is offering equity securities will not "constitute an offer for sale or an offer to sell a security" even if the broker-dealer is participating in the offering. In addition, the SEC and FINRA are prohibited from maintaining or adopting any rule restricting the publication of research on an EGC within any time period after an IPO or before the expiration of any related lock-up arrangement.

Research analysts will also be permitted to participate in meetings with an EGC together with investment banking staff. Under current regulations implemented a decade ago in connection with the Global Research Settlement, research analysts were excluded from such meetings unless a compliance officer was present, as a means of preventing conflicts of interest.

SEC Chairman Mary Schapiro has criticized the research provisions of the JOBS Act and it remains to be seen how the current practices of research analysts will change. A number of restrictions on analysts are not impacted by the legislation, including a restriction on solicitation of investment banking business and the requirement that research analysts certify that the views they express in their research reports accurately reflect their personal views. It also remains to be seen whether firms still subject to the Global Research Settlement will be able to avail themselves of the full flexibility afforded by the JOBS Act without first procuring a court order amending the terms of that settlement.

Publicity in Private Offerings

Title II of the JOBS Act substantially eases the current restrictions on publicity in private offerings. These changes will become effective only after the SEC adopts implementing rules, which it is directed to do within 90 days of enactment of the JOBS Act.

Regulation D offerings. The JOBS Act directs the SEC to modify Rule 506 of Regulation D under the Securities Act to eliminate the prohibition on "general solicitation and general advertising," so long as all *purchasers* in the offering are accredited investors. Issuers will be required to take reasonable steps to verify that purchasers are accredited investors using methods prescribed by SEC rulemaking. The new rules will apply to investment funds relying on Sections 3(c)(1) and 3(c)(7) of the Investment Company Act of 1940 (the "Investment Company Act") and will allow such funds to attract investor interest by means of broad-based advertising. Such funds will still be restricted under the Investment Company Act from making a "public offering;" however, the JOBS Act explicitly provides that general advertising or general solicitation under amended Rule 506 will not constitute a public offering for purposes of the federal securities laws.

The JOBS Act also creates an exemption from broker-dealer registration for certain persons in connection with the issuance of securities in compliance with Rule 506. Persons who facilitate offers, sales, purchases or negotiations with respect to securities issued in compliance with Rule 506, persons who permit general solicitations or general advertisements by issuers of such securities, persons who co-invest in such securities and persons who provide ancillary services with respect to such securities will not be required to register as broker-dealers. However, compensation may not be paid, and such persons may not be in possession of customer funds or securities, in connection with the purchase and sale of the securities.

Rule 144A offerings. The JOBS Act similarly directs the SEC to modify Rule 144A under the Securities Act to provide that securities sold under Rule 144A may be *offered* to persons other than QIBs, including by means of general solicitation and advertising, so long as the securities are only *sold* to persons reasonably believed to be QIBs. While the JOBS Act makes no reference to "direct selling efforts" under Regulation S, which would call into question the ability to undertake a Rule 144A offering in the United States while engaging in general solicitation or general advertising, concurrently with a Regulation S placement offshore, the SEC Staff has stated informally that the SEC staff believes that footnote 64 to the Regulation S adopting release should permit an issuer to take advantage of Rule 144A as modified without losing the benefit of Regulation S for the offshore tranche. That footnote provides that legitimate selling activities made in connection with the sale of securities in compliance with Rule 144A will not result in directed selling efforts.

Practical impact. These amendments could radically change the way private companies and private funds communicate with investors and raise capital, with broad-based advertisements in print, radio, television and online now permissible. As a practical matter, the impact may be less dramatic, at least in the near term. Issuers of securities will remain subject to the general antifraud provisions of the securities laws, including Rule 10b-5, and may be reluctant to assume the additional risk that broad-based advertising implies. In addition, given that the ultimate participants in an offering must all be accredited investors or QIBs, it may not be cost-effective for funds and private companies to engage in broad-based advertising and solicitation for offerings.

Other Private Capital Reforms

Increased shareholder threshold for Exchange Act registration. The JOBS Act has raised the threshold that triggers Exchange Act registration under Section 12(g) based on the number of shareholders. In lieu of the previous threshold of 500 holders of record, companies will now be required to register only when they have more than $10 million in assets and a class of their equity securities is held of record either by 2,000 persons or by 500 persons who are not accredited investors. The higher threshold will also apply to private funds relying on Section 3(c)(7) of the Investment Company Act.

In addition, the definition of “held of record” was modified to exclude securities held by persons who received such securities pursuant to an employee compensation plan in transactions that were exempt from registration (with the SEC directed to adopt safe harbor provisions to assist companies in determining whether they may exclude the securities). Securities purchased under the so-called “crowdfunding” provisions (discussed below) are also excluded from the definition of “held of record.”

For banks and bank holding companies, the registration threshold is 2,000 persons and the threshold that permits deregistration (under both Section 12(g) and Section 15(d) of the Exchange Act) has changed from 300 persons to 1,200 persons. The threshold that permits deregistration for all other companies remains 300 persons.

The SEC staff has clarified that an issuer is not required to register under the Exchange Act if it does not meet the higher shareholder threshold under the JOBS Act, even if the requirement to register was triggered prior to the enactment of the legislation on April 5, 2012. The SEC staff has also clarified that the amendments to the Exchange Act registration threshold are immediately effective, notwithstanding that the JOBS Act directs the SEC staff to adopt by rulemaking “safe harbor” provisions with respect to the exclusion for securities received pursuant to employee compensation plans.

Crowdfunding. The term “crowdfunding” refers to accessing small amounts of capital, principally through online platforms. The JOBS Act creates a new crowdfunding registration exemption for private companies selling securities, provided that not more than $1 million of securities are sold in a rolling 12-month period and the aggregate amount sold to any one investor during that period is capped at a specified level based on the annual income or net worth of the investor. If an investor's annual income or net worth is less than $100,000, then the aggregate amount sold to the investor cannot exceed the lesser of $2,000 or 5% of the investor's net worth or annual income. If an investor's annual income or net worth is $100,000 or more, then the aggregate amount sold to the investor cannot exceed the lesser of $100,000 or 10% of the investor's net worth or annual income. These amounts will be indexed for inflation every five years.

The crowdfunding exemption has other conditions as well, including some that apply to intermediaries and others that apply to issuers. Among other conditions, intermediaries will have to be registered with the SEC as brokers or as "funding portals," the latter being a new type of intermediary that performs limited functions. Intermediaries will be tasked with a variety of duties and obligations. For example, intermediaries will be required to provide investors with certain information (such as disclosures related to risks and other investor education materials); ensure that investors review the disclosures provided, affirm their understanding of the risks and answer questions demonstrating an understanding of the risks; take measures to reduce the risk of fraud, including conducting background checks on officers, directors and holders of more than 20% of the shares of issuers; make available to the SEC and potential investors the disclosure required to be provided by issuers at least 21 days prior to any sale; undertake such efforts as the SEC determines appropriate to ensure that no investor has exceeded its cap on the aggregate amount of securities purchased; and provide proceeds to the issuer only when the target offering amount is reached or exceeded.

Issuers will be required to provide a limited amount of information to the SEC, investors and the relevant brokers or funding portals. Issuers will be unable to advertise the terms of the offering except through notices that direct investors to the broker or funding portal. Compensation of intermediaries will be subject to rules designed to ensure that recipients disclose receipt of compensation. Issuers will also be subject to requirements to provide information at least annually covering their results of operations and financial statements, as may be determined by the SEC.

The JOBS Act also addresses liability for misstatements and omissions in crowdfunding offerings and imposes a one-year lock-up on the securities sold, subject to certain limited exceptions.

The crowdfunding exemption is not available to foreign companies (note the term "foreign private issuer" is not used), SEC reporting companies, investment companies and companies excluded from the definition of investment company by virtue of Section 3(b) or Section 3(c) of the Investment Company Act.

Securities acquired pursuant to the crowdfunding exemption will be exempt from registration or qualification under state blue sky laws.

The SEC is directed to promulgate disqualification provisions and will need to promulgate other rules to address various aspects of the crowdfunding exemption.

Regulation A. The JOBS Act requires the SEC to add a new Securities Act exemption for issuance of up to $50 million of securities in any rolling 12-month period. It is expected that the SEC will comply with this requirement by increasing the threshold for offerings under

Regulation A (small offerings) from $5 million in a rolling 12-month period to $50 million during that period. Issuers using the revised Regulation A to offer securities will be required to file annually audited financial statements with the SEC. The SEC, through its rulemaking, may also choose to require issuers to provide periodic disclosures about the issuer, its business operations, its financial condition and other matters.

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 Questions concerning issues addressed in this memorandum should be directed to:

Mark S. Bergman +44 20 7367 1601 mbergman@paulweiss.com	Adam M. Givertz +1 416 504 0525 agivertz@paulweiss.com	David S. Huntington +1 212 373 3124 dhuntington@paulweiss.com
John C. Kennedy +1 212 373 3025 jkennedy@paulweiss.com	Edwin S. Maynard +1 212 373 3024 emaynard@paulweiss.com	Christopher J. Cummings +1 416 504 0522 ccummings@paulweiss.com

Lyudmila Bondarenko and Megan Cameron contributed to this client alert.

NEW YORK
1285 Avenue of the Americas
New York, NY 10019-6064
+1-212-373-3000

BEIJING
Unit 3601, Fortune Plaza Office
Tower A
No. 7 Dong Sanhuan Zhonglu
Chao Yang District, Beijing 100020
People's Republic of China
+86-10-5828-6300

HONG KONG
12th Fl., Hong Kong Club Building
3A Chater Road Central
Hong Kong
+852-2846-0300

LONDON
Alder Castle, 10 Noble Street
London EC2V 7JU
United Kingdom
+44-20-7367-1600

TOKYO
Fukoku Seimei Building, 2nd Floor
2-2, Uchisaiwaicho 2-chome
Chiyoda-ku, Tokyo 100-0011
Japan
+81-3-3597-8101

TORONTO
Toronto-Dominion Centre
77 King Street West, Suite 3100
P.O. Box 226
Toronto, ON M5K 1J3
Canada
+1-416-504-0520

WASHINGTON, D.C.
2001 K Street NW
Washington, DC 20006-1047
+1-202-223-7300

WILMINGTON
500 Delaware Avenue, Suite 200
Post Office Box 32
Wilmington, DE 19899-0032
+1-302-655-4410