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## CLIENT ALERT

Capital Markets/M&A Practice Group Update

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### JOBS Act Could Increase Access to Capital for Emerging Growth Companies

On April 5, 2012, President Obama signed into law the Jumpstart our Business Startups Act, or JOBS Act. Although its practical implications will take some time to develop, we believe the JOBS Act could significantly enhance the opportunity for small, high-growth businesses to obtain funding needed for growth.

The JOBS Act, among other things, (1) eases the initial public offering, or IPO, process for companies that qualify as “emerging growth companies,” (2) relaxes the regulatory burden of being a public company for up to five years post-IPO, (3) allows private companies to raise capital through general solicitation of accredited investors, and (4) allows small companies to raise a limited amount of capital through unregistered “crowdfunding.” Critics of the JOBS Act, including the SEC, maintain that the Act too aggressively counteracts shareholder protections put in place to combat fraud.

#### IPO On-Ramp

Unlike other parts of the Act, the “IPO On-Ramp” provisions, which amend the Securities Act of 1933 and the Securities Exchange Act of 1934 to ease the regulatory burden of the initial public offering process for emerging growth companies, became effective immediately.

An emerging growth company is defined as a company going public after December 8, 2011 with annual gross revenues of less than \$1 billion during its most recent fiscal year. A company will retain this status until the earliest of the following:

- The last day of the first fiscal year in which its annual revenues exceed \$1 billion;
- The last day of first fiscal year ending after the fifth anniversary of its IPO;
- Its issuance, during the previous three-year period, of more than \$1 billion in non-convertible debt; and
- The date on which it qualifies as a “large accelerated filer,” which means it’s been public at least one year and has a public float of \$700 million or more.

To ease the IPO process for emerging growth companies, the JOBS Act permits communications with institutional investors to “test the waters” before an IPO. We believe this could result in “pre-deal” road shows becoming routine prior to initiating the IPO registration process in order to gauge institutional investor interest before expending lots of time and effort in the regulatory process. As was the case for smaller companies some years ago under the “SB” class of registration statements, the JOBS Act permits emerging growth companies to provide two, instead of three, years of audited historical financial statements in their SEC filings.

Generally, all SEC filings, including for IPOs, are available on the SEC’s web site. In the interest of encouraging smaller companies to initiate the IPO process, emerging growth companies are exempt from public filing until 21 days before their IPO road show. In other words, if a company initiates its IPO registration, but prior to a road show decides not to go through with the offering, the abandoned registration statement would never be disclosed publicly.

The JOBS Act relaxes the public company reporting requirements for emerging growth companies by easing disclosure obligations with respect to accounting and auditing matters (most importantly exempting them from Sarbanes-Oxley Act Section 404(b) auditor attestation of internal controls), as well as executive compensation (most importantly exempting them from “say-on-pay” executive compensation votes).

### **Increase in Private Company Shareholder Limit**

In addition, the JOBS Act makes it less likely that a private company will be forced to register as a public company by raising the threshold number of record shareholders triggering registration from 500 to 2,000. A company with 500 unaccredited record holders would also have to register. Importantly, the shareholder counts exclude those who got their securities through a company compensation plan, and excludes holders acquiring stock under the crowdfunding exemption described below.

### **Crowdfunding**

The JOBS Act creates a specific crowdfunding exemption from the registration requirements of the Securities Act of 1933. Crowdfunding, which has been used previously to raise money (but not sell securities) in the arts and charities (e.g., Kickstarter), involves the collection of small amounts of money from a large number of people.

An issuance of securities qualifies for the crowdfunding exemption from registration if:

- the amount of securities sold by the issuer in the preceding 12 months does not exceed \$1,000,000;
- in any 12-month period, no investor buys more than the greater of \$2,000 or 5% of his/her annual income or net worth (if those are less than \$100,000) or 10% of annual income or net worth otherwise, up to a maximum investment of \$100,000; and
- the issuer conducts the transaction through a “qualified intermediary,” which would be a new type of crowdfunding platform for private stock transactions.

In order to qualify for the crowdfunding exemption, the issuer must file with the SEC and make available to the investors a document that discloses, among other things: (1) the names of the company’s officers, directors and major stockholders; (2) the Company’s business; (3) income tax returns and financial statements for the preceding 12 months (reviewed by outside auditors if raising over \$100,000, and audited if raising over \$500,000); (4) the use of the proceeds; (5) the price of the securities and method for determining it; and (6) the ownership and capital structure of the company. Shares issued under the crowdfunding exemption may not be transferred within the first year after purchase, unless it is to the company, an accredited investor, or a family member in connection with a death or divorce.

The crowdfunding provisions of the JOBS Act will **not** be effective until the SEC adopts implementing regulations to handle company disclosure requirements and to govern the crowdfunding platforms, which it is supposed to do within 270 days after enactment.

### **General Solicitation in Primary and Secondary Sales of Securities**

The JOBS Act also requires the SEC to permit general solicitation of accredited investors and qualified institutional buyers under Rules 506 and 144A, respectively. Once implemented this should ease concerns of private companies that they cannot approach large investors, like venture capital funds, unless they have a pre-existing relationship.

### **Impact and Analysis**

The JOBS Act has the potential to significantly increase smaller companies’ access capital, but the practical impact in the markets has yet to be determined. Moreover, crowdfunding rule-making could curtail its benefits. If you have any questions regarding this client alert or the specific impact of the JOBS Act on you or your business, please call (919-781-4000) or email your Wyrick Robbins contact or one of the following members of our Capital Markets/M&A Practice

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