GUNSTER

FLORIDA'S LAW FIRM FOR BUSINESS

The JOBS Act -

Jumpstart Our Business Startups Act

A "Potential Game Changer"

A Special Summary White Paper

SECURITIES AND CORPORATE GOVERNANCE

Disclaimer

INTRODUCTION

Rapidly advanced legislation dubbed the Jumpstart Our Business Startups Act (JOBS Act) was signed into law by President Obama on April 5, 2012. The JOBS Act fundamentally alters the way all companies raise capital, not just small and micro-cap companies as has been repeatedly reported in the press. Principles established in 1933 have been updated to reflect 21st century reality. These changes, while chided by critics as inviting fraud and reducing the protections for investors, have been described by President Obama as "potential game changers."

What does the JOBS Act mean to you and your company? How do you take advantage of this new law to help grow your company to the next level? Are there any pitfalls or downsides to the JOBS Act? In this Summary White Paper we try to answer those questions by detailing how the JOBS Act was designed to work.

Put simply, the JOBS Act seeks to invigorate the capital markets by removing restrictions on capital raising. Specifically, the JOBS Act:

- Permits "crowdfunding" (raising capital in small amounts from many people usually via the Internet to finance a start up);
- Eliminates the ban on public solicitation of investors by companies seeking financing in a private offering;
- Creates a new Regulation A+ offering exemption;
- Raises the threshold for required registration as a public company from 500 to 2,000 shareholders (1,500 of whom must be "accredited investors" under the Regulation D standard);
- Raises the threshold for required registration as a public company for banks and bank holding companies from 500 to 2,000 shareholders;
- Creates a new category of securities issuer called an "Emerging Growth Company" or "EGC" for short; and
- Provides for an "IPO on-ramp" to phase in costly SEC reporting and compliance requirements such as internal controls audits, Say-on-Pay votes, and new accounting pronouncements over a five-year period for an EGC.

The implementation period varies. Relief from overly burdensome regulations for EGCs seeking to go public is effective immediately. In addition, companies (other than banks and bank holding companies) may immediately have up to 2,000 shareholders, including up to 500 nonaccredited investors, without triggering registration with the SEC. Other relief is dependent upon the SEC adopting implementing rules. For example, the SEC must adopt rules within 90 days of the effective date of the JOBS Act to eliminate the ban on general solicitation and advertising on private offerings, within 270 days to implement the crowdfunding provisions, and within one year to increase the maximum number of shareholders for banks and bank holding companies. There is no deadline for the SEC to adopt rules to implement the changes to Regulation A.

TITLE I - REOPENING AMERICAN CAPITAL MARKETS TO EMERGING GROWTH COMPANIES

Citing a dramatic decline in initial public offerings since the passage of the Sarbanes-Oxley Act of 2002 and studies showing that newly public companies disproportionately create new jobs, Congress and the President suspended a number of regulations that apply to initial public offerings for a certain type of issuer. The JOBS Act creates a new type of issuer called an "Emerging Growth Company," or EGC for short. While the name "EGC" gives the connotation that it applies to smaller companies, the definition is actually quite broad. An EGC is any issuer that had total annual gross revenues of <u>less than $1 billion</u> during its most recently completed fiscal year. An issuer will remain an EGC until the last day of the fiscal year following its five year anniversary of its IPO or until (i) its total annual revenue exceeds $1 billion; (ii) it issues $1 billion in nonconvertible debt over a three year period; or (iii) it becomes a so-called “large accelerated filer” (an issuer whose equity securities held by nonaffiliates is worth at least $700 million). Based on current estimates, approximately 90% of all companies going public will be deemed to be EGCs. By qualifying as an EGC, an issuer will receive the following benefits (known as the “IPO on-ramp”):

Reduced Executive Compensation Disclosures. Some of the more burdensome and controversial regulations over the past several years pertain to executive compensation disclosure. Under the JOBS Act, EGCs are exempt from “Say-on-Pay” and “Say-on-Golden Parachutes” votes and, regardless of whether an issuer immediately loses its EGC status, an EGC can delay the Say-on-Pay and Say-on-Golden Parachutes votes for at least three years after its IPO. In addition, EGCs are exempt from two controversial, but not yet adopted, rules required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. These two Dodd-Frank provisions require a public company to disclose to its shareholders (i) the relationship between executive compensation actually paid and the financial performance of the issuer and (ii) an executive compensation ratio comparing the median of the annual total compensation of all employees of the issuer to the total compensation of the issuer’s Chief Executive Officer. Finally, an EGC is treated as a “smaller reporting company” for purposes of other existing executive compensation disclosure rules. Thus, the decreased burden would include:

- Exemption from providing a Compensation Discussion and Analysis (CD&A);
- Reduction in the number of “named executive officers.” A smaller reporting company must disclose executive compensation information for only its principal executive officer and its next two highest paid executive officers compared to a larger company that must disclose executive compensation information for its principal executive officer, principal financial officer, and its next three highest paid executive officers;
- Shortening executive compensation to two years from three years;
- Elimination four compensation tables: Grants of Plan-Based Awards, Option Exercises and Stock Vested, Pension Benefits, and Nonqualified Deferred Compensation; and
- Elimination of narrative disclosure of the issuer’s compensation policies and practices as they relate to the issuer’s risk management.

Reduced Financial Disclosures and Relief from Accounting Pronouncements. The JOBS Act substantially reduces the cost of financial and accounting compliance for EGCs. An EGC need only present two years (reduced from three years) of audited financial statements with its initial registration statement. Similarly, an EGC’s Management’s Discussion and Analysis (MD&A) and selected financial data need not relate to any period prior to the EGC’s disclosed audited financial statements. An EGC is exempt from complying with any new or revised accounting standard until such date that private companies are required to comply (assuming the standard would be applied to private companies). Most importantly, while an issuer is an EGC, it is exempt from the internal control attestation requirement.

Relief from New PCAOB Requirements. To counter some of the more controversial and potentially expensive proposals announced by the Public Company Accounting Oversight Board (PCAOB), including the proposals to mandate auditor rotation every five years and to expand the auditor report, an EGC is exempt from complying with all newly adopted PCAOB rules while the issuer remains an EGC.

Greater Ability to Market an Offering. Under the JOBS Act, several provisions enhance the EGC’s ability to market its registered offerings. Investment banks are now expressly permitted to publish or otherwise distribute research reports on an EGC at any time before, during, or after any offering, including an IPO, of the EGC’s securities without the concerns of gun-jumping. Previously, research reports, particularly those by investment banks participating in the offering, could be deemed “offers” under the Securities Act of 1933. In addition, the JOBS Act eliminates the post-IPO quiet period for EGCs that prohibited underwriters of the IPO from publishing research on the issuer for 25 days after the offering (40 days if the underwriter served as a manager or co-manager).

Finally, the JOBS Act significantly relaxes the current gun-jumping restrictions by permitting EGCs (directly or through any person authorized to act on its behalf) to communicate with potential investors (limited to qualified institutional buyers or institutions that are accredited investors) prior to having a registration statement go effective. These "testing the waters" provisions allow EGCs to make oral or written communications to determine whether such investors would be interested in an offering prior to filing a registration statement. The JOBS Act does not require the "testing the waters" materials to be filed with the SEC.

Ability to Maintain Confidentiality of Disclosures to the SEC. An EGC will no longer have to endure the very public process of submitting its initial registration statement to the SEC, receiving comments from the SEC, and responding and (potentially) changing its legal and accounting disclosures. Under the JOBS Act, an EGC may confidentially submit to the SEC its draft registration statement, provided that, the submission and later amendments are made public at least 21 days prior to the issuer commencing a road show to markets its securities. Comment letters and company response letters will be deemed to constitute confidential information, and therefore, will not be made publicly available.

Opt-In Right. One of the potential drawbacks of the reduced disclosure requirements for EGCs may be the effect on the marketability of the offering. In fact, an EGC's ability to defer compliance with certain accounting pronouncements may make the EGC's financial statements incomparable to its competitors. Consequently, the EGC (or its underwriter) may determine that certain disclosures eliminated by the JOBS Act are necessary to successfully market the offering. As a result, an EGC may choose to forgo certain exemptions on an "a la carte" basis; provided, however, with respect to financial accounting standards, an EGC must (i) make a choice whether or not to comply with the accounting standards to the same extent as non-EGCs at the time the EGC files its first registration statement; (ii) comply with all or none of the accounting standards to the same extent as non-EGCs; and (iii) if the EGC elected to comply with the accounting standards to the same extent as non-EGCs, continue to comply as long as the EGC remains an EGC.

TITLE II - ACCESS TO CAPITAL FOR JOB CREATORS

The ban on general solicitation and advertising in connection with certain private offerings has been substantially relaxed. This strict ban has been in place for nearly 80 years and has long been considered by the business community to be an obstacle to successful completion of private offerings. Critics of the ban claim the ban causes uncertainties for issuers over the marketing of their securities and imposes unnecessary costs on such issuers. The JOBS Act fundamentally alters the landscape for private offerings by:

Relaxing Restrictions on General Solicitation and Advertising. Private offerings that qualify under Rule 506 of Regulation D are deemed to be exempt from registration under the Securities Act because they do not involve a "public" offering. While this exemption has many potential advantages, including having no limit on the amount of securities that can be offered, the draconian ban on advertising and general solicitation has limited the effectiveness of Rule 506 offerings. The JOBS Act substantially relaxes the ban on the use of general solicitation and advertising in connection with certain private offerings made to accredited investors under Rule 506 by:

- eliminating this ban on general solicitation and advertising in connection with Rule 506 private offerings as long as all purchasers of the securities in any such offering are "accredited investors" under the Regulation D standards, and
- require the issuer to take "reasonable steps" to confirm the "accredited investor" status of all such investors. The SEC will provide guidance as to the nature of these "reasonable steps."

The elimination of this ban will vastly improve the effectiveness of the Rule 506 exemption by allowing issuers to actively market their securities in such an offering. Increased scrutiny on verifying the "accredited investor" status of all investors (which is a departure from pre-JOBS Act requirements) will help to prevent issuers from using these enhanced marketing efforts to sell securities to less sophisticated investors.

Expanding Availability of Rule 144A. Rule 144A currently provides a safe harbor exemption from registration for securities sold to purchasers that the seller reasonably believes are "Qualified Institutional Buyers" (QIBs). Resales of such securities are exempt from registration under the Securities Act. Issuers cannot directly rely on Rule 144A's exemption from registration, but this exemption has developed into an important exemption for issuers because they can sell securities to financial intermediaries, who can then resell them to an unlimited number of qualifying QIBs. Qualifying QIBs can then sell these securities among themselves. In some cases, this has developed into a robust market for the sale and resale of securities.

The JOBS Act makes an important beneficial change to Rule 144A. The availability of Rule 144A will be expanded so that securities sold under the Rule 144A exemption may be offered to purchasers who are not QIBs, including through general solicitation and advertising, provided that securities are resold only to persons that the seller (or a party operating on the seller's behalf) reasonably believes are QIBs. This change should substantially increase the potential effectiveness of the Rule 144A exemption.

Relaxing Certain Broker-Dealer Registration Requirements. Finally, the JOBS Act creates an exemption from required registration as a broker-dealer if the registration would have been required solely due to the following activities:

- maintaining a platform or mechanism that facilitates or permits offers, sales purchases, negotiations, general solicitation or similar activities by issuers of securities (regardless of how such activities are conducted);
- co-investing in an issuer's securities; or
- providing certain ancillary services, such as due diligence reviews or standardized documentation services.

These persons will have to comply with certain restrictions to qualify for this exemption from broker-dealer registration, including:

- receiving no compensation in connection with the purchase or sale of securities (it is not clear at this point if this prohibits all compensation or just compensation tied to the amount of securities sold);
- no possession of customer funds or securities in the purchase and sale process; and
- not being subject to certain Exchange Act disqualifications.

The practical effect of this new exemption is the likely creation of platforms for matching small companies with potential investors.

TITLE III - CAPITAL RAISING ONLINE WHILE DETERRING FRAUD AND UNETHICAL NON-DISCLOSURE ACT OF 2012 (CROWDFUNDING)

Crowdfunding is the practice by which a company raises capital through a large number of small individual investments. While each individual investment is small, the total amount of capital raised can be substantial. Crowdfunding transactions originated in connection with specific projects or initiatives, but these transactions have been evolving. An issuer's ability to use the Internet to immediately reach large numbers of people and coordinate their efforts has greatly facilitated crowdfunding's success as a capital raising method over the last several years despite the fact that selling securities through the use of crowdfunding was illegal.

The JOBS Act legalizes crowdfunding and brings it under the purview of the SEC. Specifically, the JOBS Act creates a new registration exemption that permits certain issuers to raise up to $1 million within any twelve month period, provided that the issuer is not an SEC reporting company. The maximum investment by any investor in such a transaction must be limited to:

- the greater of $2,000 or 5% of the investor's annual income or net worth within any twelve month period (if either the investor's annual income or net worth is less than $100,000); or
- 10% of the investor's annual income or net worth, not to exceed $100,000 (if either the investor's annual income or net worth is at least $100,000).

Further, the JOBS Act deems securities issued in a crowdfunding transaction to be "covered securities," thus pre-empting any state law's requirement to register such securities under state securities laws.

Investor Protections. While the original bill passed by the U.S. House of Representatives largely left crowdfunding unregulated, the U.S. Senate added significant investor protections to placate some of the loudest critics of the JOBS Act. While critics have complained that the JOBS Act, in general, repeals too many investor protection laws, crowdfunding, because of its novelty and relatively unregulated nature, drew the harshest critics. Thus, significant investor protections in connection with crowdfunding were put into place in the final version of the law:

- crowdfunding must be conducted through a broker or "funding portal." A "funding portal" is an intermediary in a securities offering that satisfies certain requirements, including not offering investment advice or recommendations, not soliciting purchases, sales or offers to buy securities, and not compensating employees or others based on the sale of securities;
- ban on advertising the terms of the offering;
- restricting the transfer of securities sold under the crowdfunding exemption for one year;
- imposing personal civil liability under Section 12(a)(2) of the Securities Act for principals for material misstatements or omissions in connection with the offering; and
- requiring the issuer to file with the SEC (and to provide to investors and financial intermediaries) certain information about the issuer and its business, anticipated business plan, financial condition, and details of the proposed crowdfunding transaction (including such items as the proposed offering amount, the deadline to reach this proposed amount, the use of offering proceeds, and risks for purchasers). After concluding the offering, the issuer must provide annual financial statements to the SEC and investors.

The JOBS Act provides one investor protection in particular that may prove overly harsh (and overly costly) to companies taking advantage of the crowdfunding exemption. Depending on the size of the offering, the issuer would be required to provide different levels of financial information:

- income tax returns and financial statements certified by the principal executive officer of the issuer for offerings of less than $100,000;
- reviewed financial statements by a certified public accountant for offerings of more than $100,000, but not more than $500,000; and
- audited financial statements for offerings of more than $500,000.

Funding Portals. To act as a broker or funding portal intermediary for crowdfunding capital raises, the broker or funding portal must:

- register with the SEC and any applicable self-regulatory organization as a broker or funding portal;
- provide certain disclosures to potential investors relating to risks and other investor education materials and ensuring that potential investors review and acknowledge these disclosures;

- take certain actions to reduce the risk of fraud by issuers, including conducting background checks on issuer principals;
- make available to the SEC and potential investors any information that the issuer provides to investors and intermediaries; and
- confirm compliance by issuers with the limitations on investment amounts for crowdfunding transactions.

The crowdfunding provisions of the JOBS Act cannot go into effect until the SEC issues rules to implement them, which are expected to be issued no later than December 31, 2012. Once the crowdfunding exemption becomes effective, companies may begin to use crowdfunding as a financing method. While crowdfunding will primarily benefit small companies, it may be a viable alternative for other companies in certain situations, such as the financing of a specific project. Much of how the crowdfunding exemption will work in practice and the effect on capital raising, however, remains subject to SEC rulemaking.

TITLE IV - SMALL COMPANY CAPITAL FORMATION

One of Congress's goals in enacting the JOBS Act was to revive the rarely-used Regulation A registration exemption and provide companies with a viable option to raise a significant, but limited, amount of capital without having to file a full registration statement. Historically, companies have not used Regulation A to offer and sell securities because the cost of preparing the offering statement, a scaled-down version of a full registration statement, was relatively high given the $5 million cap on the exemption. Moreover, securities sold pursuant to Regulation A were not "covered securities" and, therefore, were not exempt from state registration requirements. Absent a coordinated exemption at the state level, an issuer offering securities under Regulation A would still be required to register such securities at the state level, adding to the overall cost. The JOBS Act amends the Securities Act by requiring the SEC to create a new registration exemption. The new exemption will, in essence, create a new version of Regulation A (sometimes referred to a Regulation A+) which may be more attractive and useful to companies by addressing many of the perceived shortcomings of the old Regulation A exemption.

The New Regulation A+ Exemption. The newly created Regulation A+ will be similar to Regulation A and will provide an exemption from registration for securities issued in accordance with the following terms and conditions:

- the aggregate amount of securities offered or sold in reliance on Regulation A+ within a 12-month period may not exceed $50 million (compared to $5 million under old Regulation A);
- an issuer may solicit interest in the offering prior to filing an offering statement on the terms and conditions prescribed by the SEC;
- an issuer will be subject to liability under Section 12(a)(2) of the Securities Act;
- an issuer will be required to file audited financial statements with the SEC annually;
- securities may be offered and sold publically and will not be "restricted securities"; and
- such other terms or conditions that the SEC determines are necessary for protection of the investing public such as requiring the issuer to prepare and file an offering statement with the SEC or disqualifying certain "bad actors" from offering securities pursuant to Regulation A+.

Preemption of State Registration Requirements. Unlike Regulation A, securities offered or sold pursuant to this new Regulation A+ exemption will be "covered securities" for the purposes of Section 18 of the Securities Act and will, therefore, not be subject to state blue sky law requirements provided that the securities are either (i) sold on a national securities exchange or (ii) sold only to "qualified purchasers" (as defined by the SEC, but generally an investor with more than $5 million in investments or a person who directs more than $25 million in investments).

From a practical standpoint, the new Regulation A+ exemption may be a cost-effective way for companies to raise up to $50 million through the sale of unrestricted securities which, unlike securities issued under the Section 4(2) private offering exemption, will be freely tradable in the secondary market without any holding period requirement. Additionally, companies may be able to avoid state securities law requirements through the use of an underwriter that qualifies as a "qualified purchaser" such that the securities offered and sold will be covered securities and thus exempt from state registration requirements. Companies should continue to monitor the SEC rule-making process for further guidance.

TITLE V - PRIVATE COMPANY FLEXIBILITY AND GROWTH

For nearly 50 years, the Exchange Act has required companies with greater than $10 million in total assets and greater than 500 record holders of any class of equity security to register and make periodic filings with the SEC. Recently, this requirement has become a hindrance to companies seeking to raise capital and grow but were not yet willing or able to take on the additional burdens of becoming a public reporting company. The JOBS Act provides the following relief:

Increase in Shareholder Registration Threshold. The Exchange Act registration requirements has been revised to require a company to register with the SEC within 120 days after the last day of its first fiscal year on which the issuer has total assets exceeding $10 million and has a class of equity securities (other than an exempted security) held of record by either 2,000 persons in total or 500 persons who are not accredited investors. Previously, the threshold to register was 500 record holders. A company may de-register under the Exchange Act if the number of record holders decreases below 300 persons.

Exclusion of Certain Employee Shareholders from Total. The definition of "held of record" now excludes securities held by persons who received the securities pursuant to an employee compensation plan in transactions exempted from the registration requirements of the Securities Act. The SEC must also adopt safe harbor provisions to implement this exclusion.

Exclusion of Crowdfunding Shareholders from Total. In addition, the JOBS Act requires the SEC by rule to exempt, conditionally or unconditionally, securities acquired pursuant to an offering made under the new crowdfunding exemption from the registration provisions of the Exchange Act.

TITLE VI - CAPITAL EXPANSION

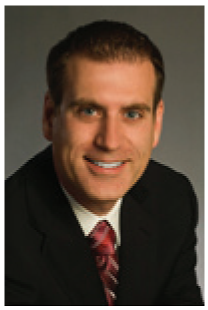
Similar to the shareholder registration threshold requirement for non-banks, banks and bank holding companies will benefit from amendments to the Exchange Act by permitting a greater number of record holders without triggering the registration requirement. The change is similar, but not identical, to the change applicable to non-banks.

Increase in Shareholder Registration Threshold for Banks and Bank Holding Companies. The Exchange Act will now require registration by an issuer that is a bank or bank holding company, not later than 120 days after the last day of its first fiscal year, on which the issuer has total assets exceeding $10 million and a class of equity security (other than an exempted security) held of record by 2,000 or more persons. Previously, the threshold to register was 500 record holders. Unlike for non-banks, there is no registration requirement based on the number of non-accredited investors for banks and bank holding companies. A bank or bank holding company may de-register under the Exchange Act when the issuer has fewer than 1,200 holders of record. The SEC is to issue final regulations no later than April 2013 to implement these provisions.

Understanding the newly passed Jumpstart Our Business Startups Act (JOBS Act) can be challenging. The JOBS Act is designed to invigorate the capital markets by removing restrictions on capital raising. **Gunster's Emerging Growth Companies Task Force** has a robust understanding of the legislation, its impact on public and private businesses and its intended impact on our economy. Gunster's Task Force is comprised of experienced attorneys from a cross-section of disciplines throughout the firm, including securities, banking, and technology practices. Led by David C. Scileppi and Bob White, Gunster's Task Force are a valuable resource to private companies who are looking to raise capital under these newly relaxed regulations.

Gunster's JOBS Act Taskforce

Task Force Leaders:



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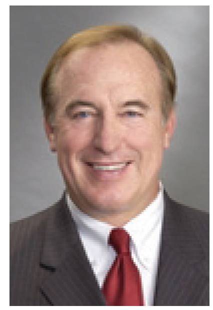

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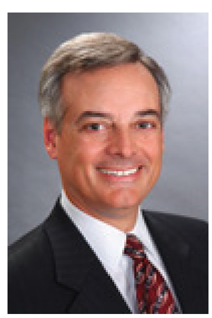

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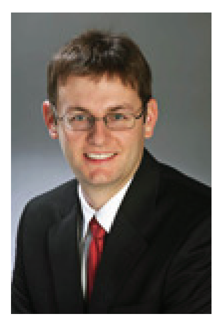

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