

April 2, 2012

On March 27, 2012, the House passed the JOBS Act, as amended by the Senate on March 22, 2012. President Obama signed the bill into law on April 5, 2012.

The JOBS Act substantially changes a number of laws and regulations in a way that is designed to make it easier for emerging companies to raise capital privately and stay private longer. The Act also is designed to make it easier for companies to go public and reduce regulatory burdens on certain newly public companies. We highlight below key provisions of the JOBS Act and what they mean for entrepreneurs.

I. Increases the "Private" Holder Cap from 500 to 2,000

Overview:

Under current law, issuers are generally required to register a class of securities with the Securities and Exchange Commission, or SEC, if the securities are held of record by 500 people or more, making them subject to the burdensome reporting obligations applicable to public companies, including obligations to file detailed annual and quarterly reports with the SEC.

The JOBS Act significantly increases the threshold to 2,000 holders of record, provided that no more than 499 of those 2,000 holders of record do not qualify as "accredited investors" under SEC rules. The new rule excludes from these calculations people who obtained equity under the company's equity compensation plans and investors who purchased securities pursuant to the crowdfunding exemption discussed in this alert.

Effectiveness:

The increased shareholder thresholds are effective immediately upon enactment of the JOBS Act. The SEC is required to adopt rules to revise the definition of "held of record"; there is no specified deadline for SEC rulemaking.

What this means for entrepreneurs:

- More Control over the Timing of Going Public. Under the new rule, companies with 500 or more shareholders may be able to stay private longer, enabling them to defer the cost, public scrutiny and increased liability of being publicly-traded and increasing their ability to time their initial public offerings based on market conditions.
- Hiring and Expansion Decisions Less Impacted by Potential Reporting Requirements. Entrepreneurs often attract
 talent in part by granting stock options, restricted stock or other equity awards. Under existing SEC rules, successful private
 companies often find themselves approaching the 500-holder limit simply as a result of hiring needed personnel, potentially
 compelling them to reveal copious amounts of information to the public, and competitors, before they are ready. As a result
 of the JOBS Act, fast-growing companies may be able to maintain otherwise effective equity compensation strategies without
 worrying that their equity compensation practices will lead them prematurely into registration as a public company.
- Potential Impact on Secondary Markets. Because companies will be able to stay private longer, it is possible that we will see a larger, more robust market for secondary sales of shares of private companies. However, we expect many entrepreneurs and investors to continue to explore increasingly restrictive policies with respect to secondary sales of their companies' securities, particularly on secondary exchanges. Entrepreneurs will want to review their current organizational documents and related shareholder or investor rights agreements and consider whether they should be revised in light of increased secondary sale activity and the revised shareholder threshold.

II. Eliminates the Prohibition Against General Solicitation and Advertising in Certain Private Offerings

Overview:

Private companies that sell equity securities to venture, angel or private equity investors have long relied on an

exemption from public registration, Rule 506 of Regulation D, that permits sales of shares to sophisticated investors subject to certain limitations, including that the company not engage in "general solicitation" or advertising of the offering. The JOBS Act expands Rule 506 to permit general solicitation and advertising for private offerings under Rule 506 if all purchasers qualify as "accredited investors" under SEC rules.

Effectiveness:

Requires implementing rules to be issued by the SEC within 90 days following the enactment of the JOBS Act.

What this means for entrepreneurs:

- Reach a Wider Pool of Investors. Start-ups have increasing access to tools that allow them to communicate with large numbers of potential investors, including blogs, e-mail newsletters and investing communities like AngelList. By lifting the restriction on general solicitation, entrepreneurs will be able to use these tools and others to announce their intentions to raise funding without a concern that they are thereby undermining their ability to rely on Rule 506. Essentially, entrepreneurs can advertise the existence of the offering to the general public, which may help them reach potential investors who would not otherwise have known about the offering. However, in order to stay within the boundaries of a Rule 506 private offering, they cannot sell to the general public—if they engage in general solicitation, all purchasers must be accredited investors.
- Consider Impact of Breadth and Scope of Solicitation. Entrepreneurs should consider what types of solicitation and advertising are appropriate for their businesses. Entrepreneurs may want to consider what impact, positive or negative, any such solicitation or advertising may have on the entrepreneur's or company's image or credibility, the company's operations and ability to attract appropriate investors.
- Obligation to Verify Accredited Investor Status. Issuers are required take "reasonable steps" to verify that purchasers of
 securities are accredited investors, using steps that will be determined by the SEC. Companies should review with their
 counsel how to confirm that all investors qualify, and we will monitor any additional guidance that may come from the SEC in
 this regard.

III. Crowdfunding

Overview:

Securities laws will be amended to provide a new "crowdfunding" exemption from registration, meaning that private companies will be allowed to raise up to \$1 million over a 12 month period from an unlimited number of investors, including unsophisticated investors, through "crowdfunding".

Key conditions of the "crowdfunding exemption" are:

- \$1,000,000 Annual Cap. The aggregate amount sold to all investors in any 12-month period in reliance on this exemption cannot exceed \$1,000,000.
- Investor Limits. Investors with annual income or net worth of more than \$100,000 can invest up to 10% of their annual income or net worth, not to exceed an aggregate of \$100,000. Thresholds are lower for investors with annual income or net worth of less than \$100,000.
- Portals and Intermediaries. The transaction must be conducted through an intermediary that is registered with the SEC as a "funding portal" or broker and registered with a self-regulatory authority. In addition, intermediaries must provide disclosures to investors regarding the level of risk of the offering and comply with other SEC regulations.
- Company Disclosures. Issuers must file with the SEC and provide to investors and intermediaries basic information about the issuer, including its financial statements, its officers, directors, 20% shareholders and the risks related to the offering.

Effectiveness:

The crowdfunding exemption is immediately effective upon enactment of the JOBS Act. Various provisions require implementing rules to be issued by the SEC, which must carry out such measures within 270 days after the enactment of the JOBS Act.

What this means for entrepreneurs:

- Expands Funding Options; Presents Management Challenges. Crowdfunding offers an interesting new method of
 funding outside of traditional angel or institutional investors, but to the extent that, through crowdfunding, a company finds
 itself with a large base of unsophisticated investors, the company should expect to spend substantial time and resources
 related to the administration and communication challenges inherent in that type of shareholder base. For example, items
 such as shareholder actions may be more challenging to manage and may require more detailed communication or extended
 time to complete.
- Implications for Subsequent Financings, M&A Events or Other Corporate Transactions. Entrepreneurs should consider the implications of having a large number of unaccredited or unsophisticated investors in their shareholder base, including potential limitations that crowdfunding may have on the ability to attract later funding from venture capital firms or other institutional sources or to sell or restructure the company. Institutional investors will generally prefer to avoid private companies with a large base of unsophisticated shareholders. Equity financings, M&A events and corporate restructurings almost invariably involve the requirement to obtain some level of shareholder approval and may require the company to utilize an exemption from applicable securities laws to effect the transaction. As a general matter, if a company has a large base of unaccredited and/or unsophisticated stockholders, equity financings, M&A events and corporate restructurings may be significantly more difficult and expensive from a legal point of view.
- Slightly Enhanced SEC Reporting Requirements. A company using crowdfunding must still file basic information with the SEC, including names of directors and officers and holders of more than 20% of the company's shares, plus a description of the business and financial condition. Some of this information would not be required of companies that obtain funding through existing exemptions.
- Costs Associated with Intermediaries or "Funding Portals". A company that chooses to raise money under crowdfunding
 will be required to use an intermediary as a "funding portal" to conduct the transaction. A few companies that anticipated the
 new law have already started preparing their operations in this regard, but we do not yet have a sense what intermediaries
 will charge for their services related to crowdfunding transactions. At the outset, we would expect significant variations in
 price and in operational effectiveness among these new intermediaries.

IV. Introduces the "Emerging Growth Company"—On-ramp to SEC Registration

Overview:

The JOBS Act makes it easier for "Emerging Growth Companies," or EGCs (companies with less than \$1 billion of revenue), to go public by reducing regulatory burdens associated with going public and creating a transitional on-ramp that phases in certain SEC compliance measures over a period of time following an EGC's IPO. EGC status is not available to any issuer that priced its IPO before December 9, 2011.

EGCs will benefit from IPO procedural changes:

- EGCs will only need to provide two years of audited financials instead of three years, with no selected financial data for prior periods
- EGCs will be permitted to make pre-filing offers to investors to "test the waters", without being subject to current "gunjumping" restrictions on pre-offering communications
- Investment banks will be permitted to publish research reports about an EGC immediately after they become public companies
- EGCs will be permitted to begin the SEC registration process on a confidential basis
- For newly public EGCs, the JOBS Act scales back certain governance and disclosure requirements for up to five years:
- Exemption from "say-on-pay" votes
- More limited executive compensation disclosure
- Exemption to from requirement to hire an independent auditor to attest to the company's internal financial controls
- · Subject to the longer phase-in periods for new or revised financial accounting standards

Effectiveness:

Effective immediately upon enactment of the JOBS Act.

What this means for entrepreneurs:

- Enhanced Confidentiality in Registration Process. We have all seen the media feeding frenzy around the initial filing of the registration statements by high profile companies like Linkedln, Zynga, Groupon and Facebook, as various journalists, analysts and other commentators combed through them for financial information, compensation data and other insights on their businesses, and we have further seen how the SEC review process has led some companies to modify the way they present key business metrics or accounting information. Under the new rules, companies may initiate the review process with SEC examiners without releasing the full registration statement to the public, and may be able to resolve presentation and disclosure issues confidentially with the SEC before disclosing their registration statement to the public.
- Facilitates the Process of Going Public. For entrepreneurs contemplating an IPO, the ability to rely on scaled disclosure and more limited governance obligations should reduce the costs of going public.
- Eases A Newly-Public Company into SEC Compliance Measures. Newly-public companies may benefit from an eased
 transition to the public company regulatory regime. Once public, an EGC will have a limited transition period of one to five
 years, depending on the size of the company, during which the regulatory requirements will be scaled back, which should
 reduce compliance costs during this early period.
- Termination of EGC Status. After initial determination of EGC status, a company will remain an EGC until the earliest of:
 - Achieving annual gross revenue in excess of \$1 billion
 - o The fifth anniversary of its IPO
 - Issuing more than \$1 billion in non-convertible debt during a three-year period
 - o Becoming a "large accelerated filer" with at least \$700 million in public float

V. Raises Limit of Regulation A "Mini Public Offerings" from \$5 Million to \$50 Million

Overview:

Regulation A, often called the "mini public offering" exemption, currently allows companies raising less than \$5 million to avoid certain disclosure requirements typically associated with an IPO. Companies that file under Regulation A currently do not have to issue periodic reports to shareholders that are expected of conventional public companies. Regulation A offerings have only rarely been used by emerging companies to raise capital, in part because of Regulation A's low \$5 million threshold and requirement to prepare an offering circular for review by the SEC and distribution to investors. The JOBS Act will extend Regulation A exemptions for companies raising up to \$50 million, but will also expand the investor protection provisions for this larger offering exemption, including a requirement to file certain periodic disclosures with the SEC.

Effectiveness:

Requires implementing rules to be issued by the SEC. There is no deadline for SEC rulemaking.

What this means for entrepreneurs:

- Another Financing Alternative for Later Stage Rounds. Entrepreneurs may ask why they would want to rely on a Regulation A "mini public offering", which requires preparation of an offering circular and will require certain periodic disclosures, if they can raise capital by conducting a private offering under Rule 506 of Regulation D. While a Regulation D offering is exempt from registration, it is still subject to limitations that may not be appealing to a company (for example, offerings under Rule 506 limit purchasers to accredited investors). On the other hand, a full-blown registered public offering might be too time consuming or costly or could require more detailed disclosure than a company is prepared to make. Regulation A offerings may appeal to certain later-stage private companies where the incremental costs and burdens associated with conducting a Regulation A offering are not as significant as they would be for an earlier stage company.
- Flexibility of Regulation A Offering May Appeal to Institutional Investors. Unlike Regulation D offerings, securities
 offered and sold pursuant to Regulation A are publicly offered and are not "restricted securities." The securities are freely
 tradeable in the secondary market after the offering and no holding period applies to securities purchased in a Regulation A
 Offering. We expect that companies will seek to restrict trading in these securities through contractual trading restrictions or
 other means.
- Potential Precursor to an IPO. While a company is required to prepare an offering circular for a Regulation A offering, the
 preparation is generally simpler than preparing a prospectus for a registered offering. In addition, the experience of preparing
 a relatively simpler offering statement and complying with the relatively simple period disclosure provisions may provide

- helpful experience to a company's management team in readying for an eventual IPO.
- Expanded Investor Protection Provisions; Periodic Disclosures. The JOBS Act sets forth a number of specific parameters that govern the new \$50 million exemption, which are comparable to, but more expansive than, the requirements for a current offering under Regulation A. For example, the SEC will require audited financial statements to be included in the offering circular and may also require the issuer to file periodic disclosures regarding its financials, business operations, or other matters. We will monitor additional guidance and requirements that the SEC sets forth in this regard.

In this summary we have highlighted what we view as the most significant aspects of the JOBS Act as they impact emerging companies. If you have questions about any specific provisions of the JOBS Act, please contact a member of your Cooley team or any of the individuals named in this Alert.

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