NIESAR & VESTAL LLP
ATTORNEYS AT LAW

90 NEW MONTGOMERY STREET 9TH FLOOR
SAN FRANCISCO, CALIFORNIA 94105
TELEPHONE (415) 882-5300
FACSIMILE (415) 882-5400
www.nvlawllp.com

Law Alert

To: Firm Clients and Contacts

From: Niesar & Vestal LLP

Date: July 27, 2012

Re: **JOBS Act: (Potentially) Good News for Startups Looking to Raise Money**

The Jumpstart Our Business Startups Act or JOBS Act was enacted into federal law on April 5, 2012 and is intended to make capital raising easier for startups and small companies, which are seen as an engine of job creation and economic growth.

Some provisions of the JOBS Act were immediately effective and did not require SEC rulemaking, while other provisions will not become effective until the SEC adopts implementing rules. The following is an outline of the key provisions of the JOBS Act and when they take effect.

General Solicitation and General Advertising To Be Allowed in Certain Private Placements (Not Yet Effective)

Title II of the JOBS Act requires the SEC to (i) amend Rule 506 of Regulation D, the most commonly used private placement exemption from registration under the Securities Act of 1933 (the "Securities Act"), to allow general solicitation and general advertising, provided that the securities are sold only to persons the issuer reasonably believes to be accredited investors, and (ii) amend Rule 144A under the Securities Act, another private placement exemption, to allow general solicitation and general advertising, provided that the securities are sold only to persons the issuer reasonably believes to be Qualified Institutional Buyers ("QIBs"). These provisions will take effect only after SEC rulemaking, which has not yet occurred (the SEC has missed the deadline set by the JOBS Act of July 4, 2012).

New Exemption for Crowdfunding (Not Yet Effective)

Title III of the JOBS Act creates a new capital-raising strategy known as "crowdfunding" where the general public can take small stakes in a company over the Internet without the company needing to register the offering under the Securities Act. These provisions will take effect only after SEC rulemaking, which has not yet occurred (the JOBS Act has set a deadline of December 31, 2012).

Once the new rules are in place, crowdfunding offerings will be exempt from registration provided they meet certain criteria:

- Not more than $1 million of securities sold over a 12 month period

- Total amount sold to any investor capped at: (i) the lesser of $2,000 or 5% of the investor's net worth or annual income, for investors with annual income or net worth less than $100,000; and (ii) the lesser of $100,000 or 10% of the investor's net worth or annual income, for investors with annual income or net worth of $100,000 or more

- Issuer must be a domestic private (non-reporting) company

- Securities sold may not be transferred for one year (except to family members or accredited investors)

- Securities must be sold through an intermediary that is registered with the SEC as either a broker-dealer or a funding portal[1]. Intermediaries must:

    - Provide investors with risk related disclosures and other investor education materials
    - Ensure investors review disclosures and affirm their understanding of the risks
    - Reduce the risk of fraud through background checks on officers, directors and 20% shareholders of the issuer
    - Make available to the SEC and potential investors issuer disclosures at least 21 days prior to sale
    - Provide proceeds to the issuer only when the target offering amount is reached and allow investors to cancel their commitments to invest, as the SEC shall determine appropriate in its rulemaking

[1] A funding portal is a new type of intermediary performing more limited functions than a broker. In order to qualify as a funding portal, the intermediary may not offer investment advice, solicit purchases, sales or offers to buy securities offered on its website, compensate persons for such solicitation based on the sale of securities offered on its website, and handle investor funds or securities.

- Issuers must:
    - Provide to the SEC, investors and intermediaries basic corporate information, names of officers, directors and 20% shareholders, description of business and business plan, use of proceeds, target offering amount and deadline to reach target, regular updates on progress toward meeting target, price of securities and method of determining price, and risk factors
    - Provide to the SEC, investors and intermediaries income tax returns and financial statements certified by the principal executive officer (if offering under $100,000), financial statements reviewed by an independent public accountant (if offering between $100,000 and $500,000) or audited financial statements (if offering over $500,000)
    - Refrain from advertising the terms of the offering except through notices that direct investors to the intermediary
    - File annual reports with the SEC covering their results of operations and financial statements

Securities acquired in a crowdfunding offering will be exempt from registration or qualification under state securities laws. States may not require a filing fee for such offerings except for the state of the issuer's principal place of business or the state in which purchasers of 50% or more of the total amount raised are residents. However, states still have authority over unlawful or fraudulent conduct by intermediaries and issuers.

New Exemption for Small Offerings of up to $50 Million (Not Yet Effective)

Title IV of the JOBS Act requires the SEC to create a new exemption from registration under the Securities Act, similar to existing Regulation A, for small offerings of up to $50 million in a 12 month period. The SEC will likely implement this new rule by amending Regulation A to increase the maximum size of offering from $5 million to $50 million. These provisions will take effect only after SEC rulemaking, which has not yet occurred, and the JOBS Act has set no deadline for this rulemaking.

Issuers that take advantage of the new exemption, once implemented, will not be subject to the ongoing reporting requirements applicable to public companies. However, they will still be required to file annual audited financial statements with the SEC and may be required to provide other periodic disclosures about their business operations and financial condition. As in a registered offering, securities sold under this new exemption may be offered and sold to the public and will not be restricted securities, but SEC review of the offering document will be required, making it more like a simplified registration process rather than a true exemption from the registration requirements. Issuers will need to comply with state securities laws unless sales of securities are only made to qualified purchasers or the issuer lists its securities on a national stock exchange (the latter of which will trigger ongoing reporting requirements and negate one of the benefits of the new exemption).

Can Have More Shareholders Before Required to Become Public Company (Effective Now)

Title V of the JOBS Act amends Section 12(g) of the Securities Exchange Act of 1934 to increase the number of shareholders a private company can have before it is required to become a publicly reporting company. These provisions took effect immediately.

Prior to the JOBS Act, Section 12(g) required a company to register its securities and become subject to ongoing reporting requirements if its securities were held of record by 500 or more persons and the company had total assets exceeding $10 million. Now, the shareholder threshold has been increased to 2,000 or more persons or 500 or more unaccredited investors. Excluded from the number of shareholders for purposes of these thresholds are those shareholders who received their shares pursuant to an employee compensation plan or in a crowdfunding offering (once that exemption is implemented).

Easier IPO and Ongoing Reporting Requirements for Smaller Companies (Effective Now)

Title I of the JOBS Act makes the initial public offering ("IPO") process and ongoing reporting requirements less burdensome for a new category of smaller issuer called an "emerging growth company" ("EGC"). These provisions took effect immediately.

An EGC is defined as a company with total annual gross revenues of less than $1 billion during its most recent fiscal year. An EGC will retain its status until either (i) five years have passed since its IPO, (ii) it has issued more than $1 billion of non-convertible debt securities over three years, or (iii) it becomes a large accelerated filer (i.e. reporting company for one year, one annual report filed and $700 million of common equity held by non-affiliates).

Benefits to EGCs in the IPO process include the following:

- EGCs are allowed to submit draft registration statements to the SEC for confidential review, provided that such draft statement and amendments are publicly filed no later than 21 days before the EGC conducts a road show for the offering.

- EGCs are allowed to include two years of audited financial statements in their registration statement instead of the three years normally required, and the related MD&A (Management Discussion and Analysis) and selected financial data sections only need to cover two years.

- EGCs are allowed to comply with the less extensive disclosure requirements applicable to smaller reporting companies with respect to executive compensation.

- EGCs and their agents are allowed to communicate with potential investors that are qualified institutional buyers or institutional accredited investors prior to or following the filing of a registration statement to "test the waters" and determine whether there is sufficient market interest before proceeding with the IPO.

- Underwriters participating in an offering for an EGC are allowed to issue research reports relating to the EGC at any time before, during and following the offering.

Benefits to EGCs in their ongoing reporting requirements include the following:

- EGCs are exempt from the requirement under Section 404(b) of the Sarbanes-Oxley Act of 2002 to obtain an auditor attestation report on internal controls.

- EGCs are exempt from the Dodd-Frank Act requirement to hold "say-on-pay" shareholder votes on executive compensation and golden parachutes.

Assessment of the JOBS Act

Although the JOBS Act clearly expands the options available to small companies seeking financing and substantially reduces regulatory burdens on and costs of fundraising for smaller companies, whether the JOBS Act leads to its desired effects on fundraising, job creation and economic growth remains to be seen.

Once the restrictions on publicity in private placements are relaxed, private companies will have the freedom of finding potential investors through broad-based advertisements in print, radio, television and online. However, engaging in broad-based advertising may bring with it a higher risk of violating the general antifraud provisions of the securities laws, which may discourage some issuers. Moreover, issuers relying on the new rules will be required to take reasonable steps to verify that purchasers are accredited investors/QIBs, using methods prescribed by the SEC. It is unclear whether the new SEC rules will allow the current self-certification from investors commonly used in Regulation D offerings or whether a higher level of due diligence will be required. Finally, given the ultimate purchasers in the private placement must all be accredited investors/QIBs, broad-based advertising and solicitation may not be the most cost effective way of targeting these groups.

The new crowdfunding exemption may look attractive at first glance, as it allows private companies to sell securities over the internet to the public without registration with the SEC, but the numerous requirements for having a valid crowdfunding offering, e.g. strict caps on the amounts received from individual investors, requirement to sell through a registered intermediary, disclosure requirements and limitations on advertising, which will not be clarified in detail until the SEC rulemaking, may render the exemption less user-friendly. The JOBS Act also specifically authorizes any investor in a crowdfunding offering to bring a civil action for rescission or damages against the issuer for material misstatements or omissions in disclosures provided to the investor. Finally, it is uncertain whether the SEC will meet the December 31, 2012 deadline for implementation given the SEC missed the July 4, 2012 deadline for lifting the ban on general solicitation for private placements.

The existing Regulation A exemption for small offerings has not had widespread use due to the low $5 million maximum offering size, the lengthy period to clear SEC comments and the need to comply with state securities law requirements. The new small offering exemption for fundraisings of up to $50 million may have greater appeal, although issuers will still have some ongoing reporting requirements, they will still have to deal with SEC comments and they will still need to comply with state securities laws (unless they are willing to limit purchasers to qualified purchasers or list on a national stock exchange and become subject to full blown ongoing reporting requirements). Also, as the JOBS Act has not set a deadline for the necessary SEC rulemaking to implement this new exemption, it is uncertain when the provisions will take effect.

The creation of the EGC category of issuers appears to make it more economically feasible for middle-market companies to go public and remain public; however, it is unknown how many companies qualifying as EGCs will take advantage of the benefits provided to them by the JOBS Act. While the relaxed audit standards and disclosure requirements may translate into cost savings, some EGCs may nevertheless prefer to conduct their IPO in accordance with the standard "best practice" disclosure rules pre-JOBS Act, as this may give them more credibility and attractiveness in the eyes of investors. For those EGCs who choose to rely on the less stringent disclosure standards, it will probably be prudent to include a risk factor in their registration statement that such reduced transparency might make their stock less attractive to investors and may make it more difficult for them to raise additional capital.