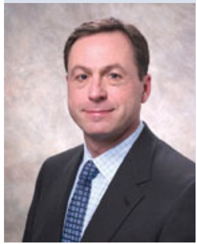
Notes Bearing Interest

Published by the Business Law Section of the North Carolina Bar Association • Section Vol. 34, No. 1 • November 2012 • www.ncbar.org

The Chair's Comments


Christopher Capel

The section's first council meeting of the 2012-2013 fiscal year in September had a particularly full agenda. As we gear up for the upcoming long session at the General Assembly, the matters covered included several legislative items. First, the council considered and approved a proposed re-write of the North Carolina LLC Act. This has been a multi-year effort of the section's LLC Act Revision Task Force, chaired by Warren Kean, and coordinated with the tax section. Thank you to Warren and many others who worked on this project. In general, the revisions to the LLC Act are intended to more clearly, concisely, and effectively achieve and implement the stated public policy objective of the Act: "to give maximum effect to the principle of freedom of contract and to the enforceability of operating agreements."

The council also considered and approved proposed amendments to the N.C. Business Corporations Act, which are in response to amendments to the Model Business Corporations Act. These amendments were produced by the section's Business Organizations Committee, chaired by Ward Wellman, and cover the following: permit a corporation's board of directors to delegate to officers the authority to issue rights, options, warrants and shares; modify provisions regarding the holding of shareholders meetings by means of electronic remote communication; clarify that "force-the-vote" provisions in merger agreements and other agreements, providing for a corporate transaction requiring shareholder approval, are effective; permit "short form" mergers among 90% owned subsidiaries; and create a bright-line safe harbor for asset sales not requiring shareholder approval. Thank you to Ward and his committee members for their

Continued page 2

The JOBS Act Becomes Law

By Benji T. Jones

On April 5, 2012, the "Jumpstart Our Business Startups Act" (JOBS Act) became law. The stated intent of the JOBS Act is to reduce certain capital raising restrictions currently faced by many companies, both by loosening regulations governing private securities offerings and by easing the road to public securities offerings for so-called "emerging growth companies." The JOBS Act implements sweeping changes to various aspects of the Securities Act of 1933, as amended (Securities Act), the Securities Exchange Act of 1934, as amended (Exchange Act), and other related laws and regulations.

Although much of the JOBS Act became effective immediately, significant rulemaking and guidance from the Securities and Exchange Commission (SEC) and other regulatory agencies will be necessary to fully implement its provisions. The true effect of the JOBS Act will depend in large part on the choices the SEC makes in designing these rules and regulations. As highlighted in more detail throughout this issue, the staff of the SEC has begun addressing questions raised by the JOBS Act to provide guidance on how companies can take advantage of those provisions of the JOBS Act that are immediately effective within the context of existing SEC rules and practice.

Continued page 3

Inside this Issue...

16 | Beware Proposed 2012 Formal Ethics Opinion 7: Copying Represented Persons on Email Communications
By Carol Eubank

17 | By the Numbers
By Haley Hanes

NORTH CAROLINA BAR ASSOCIATION
SEEKING LIBERTY & JUSTICE

Save the Date | 2.22.13 Joint Program with International Law see page 15

Notes Bearing Interest

Published by the Business Law Section
of the North Carolina Bar Association

Section Vol. 34, No. 1 • November 2012

Editor
James P. Beckwith Jr.

Chair
Christopher B. Capel

Immediate Past Chair
Stephen M. Lynch

Vice Chair
Kenneth G. Carroll

Secretary
David S. Coward

Treasurer
Robert D. Kidwell

Section Council
Diana S. Allen
Mark T. Cain
Richard J. Crow
Edgar B. Fisher III
Karen A. Gledhill
Robert D. Kidwell
Gregory R. Kilpatrick
Stephen F. Later
Carolyn W. Minshall
Kevin A. Prakke
Steven Virgil

Chair's Comments, *continued from page 1*

efforts.

These two proposed bills were submitted for approval to the Board of Governors in early October. This is part of a relatively new process embodied in the Bar's Legislative Policy and Procedures. This process allows for vetting of proposed legislation at the BOG level and among interested sections, in order to receive the Bar's imprimatur and be submitted to the General Assembly.

The section was also involved in two other pieces of legislation, which were adopted during the short session of the legislature. One involves amendments to Article 9 of the UCC, shepherded by the section's Commercial Law and UCC committee, co-chaired by Rick Brown and Armand Perry. The other is a re-write of the NC banking laws, monitored and commented on by the section's Task Force on Modernization of the North Carolina Banking Law, chaired by Geoff Adams. These new laws are elaborated on elsewhere in this issue. We appreciate the work of these committees.

Another committee of the section that is particularly active is the Forms Initiative, chaired by Carolyn Minshall. There are now approximately 65 forms available at the section's webpage, accessible by section members only. This is an area where we have a need for additional help. Please contact me if you have an interest in supporting this very worthwhile project with Carolyn. Thank you, Carolyn.

Please "save the date" for our annual meeting and related CLE in Pinehurst on Thursday afternoon and Friday, February 21 and 22, 2013. For the last few years we have partnered with the Corporate Counsel Section and the International Law Section on this event; this year Corporate Counsel will have a separate annual meeting event at the Bar Center in Cary. The Pinehurst event is in the final planning stages and I'm confident will prove to be another outstanding opportunity. Our program planners are Gene Jones and Jennifer Weaver, joined by Sean King of the International Law and Practice Section. Thank you to them and their committee members, as well as vice chair, Ken Carroll, the section's CLE chair, for developing this program.

Since our last newsletter, the Bar Association has re-launched ListManager (as a replacement to ListServ). You should have received an email from "Business Law" around August 1st. To be included in the section's ListManager system, you'll need to opt-in/subscribe as described in that email. I encourage you to do so and to use it to interact with your fellow business lawyers.

Jim Beckwith has pulled together another great newsletter in this issue. I know that you will find several items of interest. Thanks, Jim.

Thank you for all you do to support our section. I look forward to hearing from you. •

Capel is a partner with Smith, Anderson, Blount, Dorsett, Mitchell & Jernigan, LLP.

Stay Tuned!

The winter issue of NBI will include a legislative update to discuss the banking bill and the spring issue will discuss the amendments to Article 9.

© 2012 North Carolina Bar Association. Views and opinions expressed in articles published herein are the authors' only and are not to be attributed to Notes Bearing Interest, the Business Law Section or the NCBA unless expressly stated. Authors are responsible for the accuracy of all citations and quotations. No portion of the publication may be reprinted without permission.

NORTH CAROLINA
BAR ASSOCIATION
SEEKING LIBERTY & JUSTICE

JOBS Act, *continued from page 1*

This issue of Notes Bearing Interest provides an overview of the most significant aspects of the JOBS Act for practicing attorneys and highlights what they mean for smaller and emerging companies.

Flexibility for Private Companies – New and Expanded Registration Exemptions

The JOBS Act aims to provide more flexibility for private companies raising capital by (1) lifting the cap on Regulation A offerings from $5 million to $50 million; (2) creating an exemption for so-called "crowdfunding" offerings; (3) eliminating the prohibition on general solicitation or advertising for offerings under Rule 506 of Regulation D to accredited investors and for secondary sales under Rule 144A to qualified institutional buyers (QIBs); and (4) significantly increasing the threshold of holders of record that triggers registration under the Exchange Act.

Offering Threshold for Regulation A Offerings Raised from $5 Million to $50 Million

Historical Overview. Before enactment of the JOBS Act, Regulation A (often called the "mini-public offering" exemption) allowed companies to "test the waters" for interest in a proposed offering of up to $5 million without limiting solicitations to a particular type of investor and while avoiding certain of the more onerous disclosure requirements typically associated with a traditional IPO. However, no corresponding exemption from state "blue sky" registration requirements was available for these Regulation A offerings. As a result, due to the cost of state "blue sky" registration and SEC review and the low offering threshold of $5 million, companies rarely used the Regulation A exemption.

New Broadened "Regulation A+" Exemption. Title IV of the JOBS Act establishes a new and expanded exemption similar to Regulation A (informally referred to as Regulation A+) that aims to address these problems by:

- raising the offering threshold from $5 million to $50 million (which limit may be raised by the SEC in the future) for offerings made in any 12-month period, and

- exempting these offerings from state "blue sky" registration (but not antifraud regulation) if they are made on a national securities exchange or to "qualified purchasers," as to be defined by the SEC.

Freely Tradable. Consistent with their historical treatment under Regulation A, the securities offered and sold under Regulation A+ will not be deemed "restricted securities" for Rule 144 resale purposes and will not be subject to corresponding transfer restrictions or holding period requirements.

Disclosure and Antifraud Requirements. Companies making offerings under Regulation A+ will be required to file audited financial statements and make other periodic disclosures with the SEC, as determined by rules yet to be adopted by the SEC. Companies issuing securities under Regulation A+ will be subject to civil liability for false or misleading statements or omissions in communications involved in the offering.

Effectiveness. The SEC must issue rules to implement the new Regulation A+ exemption. No deadline for the issuance of these rules is imposed by the JOBS Act. To date, the SEC has not taken any action to implement the new Regulation A+ exemption.

Impact of Regulation A+

- The Regulation A+ offering exemption may be appealing to late-stage companies as it enables them to broaden the universe of potential investors and to avoid some of the offering restrictions imposed by Rule 506, while potentially limiting the time and costs associated with a full-blown public offering. Securities issued under Regulation A+, unlike those sold in Rule 506 offerings, are freely tradable, which may be more appealing to investors in late-stage companies. This, in turn, could ultimately lead to a more robust trading market in private company securities.

- Federal preemption of state "blue sky" registration applies only to those Regulation A+ offerings made on a national securities exchange or to "qualified purchasers." The SEC has yet to define the category of "qualified purchasers," a term which has been used under federal securities laws since 1996. Until it does, only those companies that actually have shares listed and traded on a national securities exchange will benefit from federal preemption. All other Regulation A+ offerings would remain subject to state "blue sky" registration requirements, which involve "merit" review in some states. As a result, until the SEC defines "qualified purchaser," practitioners should continue to assess the impact of an offering under applicable state "blue sky" laws. (*See* "Key Questions for Navigating the 'Blue Sky' of North Carolina" on page 9 of this issue.) Compliance with state "blue sky" laws may significantly increase the time and cost associated with Regulation A+ offerings for many companies. Opinions differ on whether raising the per year limit for Regulation A+ offerings to $50 million will actually increase its use. (*See* "Studies Required by the JOBS Act" on page 11 of this issue.)

New Crowdfunding Exemption

Overview. Title III of the JOBS Act creates a new "crowdfunding" exemption that allows U.S. private companies to raise small amounts of capital from an unlimited number of individuals, including unso-

Continued page 4

phisticated investors, without having to comply with the Securities Act registration requirements.

Limitations. New Section 4(a)(6) of the Securities Act imposes the following limitations on crowdfunding programs:

• the aggregate amount of securities sold to all investors within any 12-month period, including all amounts sold over the Internet, may not exceed $1 million,

• the aggregate amount of securities sold to an individual investor by an issuer within any 12-month period, including all amounts sold over the internet, may not exceed:

• the greater of $2,000 or 5% of the annual income or net worth of such investor—if either the annual income or the net worth of such investor is less than $100,000, and

• 10% of the annual income or net worth of such investor—not to exceed a maximum aggregate amount sold of $100,000—if either the annual income or net worth of the investor is equal to or more than $100,000.

• sales must be conducted through a registered broker-dealer or a special funding portal. Intermediaries must satisfy several requirements imposed by, and provide disclosures to investors (and the SEC) set forth in Title II of the JOBS Act and must comply with other regulations to be adopted by, the SEC. (*See* "Crowdfunding Limitations and Requirements" on page 12 of this issue for an overview of the regulatory requirements imposed on crowdfunding intermediaries by the JOBS Act.),

• companies must file with the SEC, and provide to investors and intermediaries, certain information about the company (including financial statements), its officers, directors and significant shareholders, risks related to the offering and certain other information determined by rules adopted by the SEC, each in varying levels of depth depending on the target amount of capital to be raised. (*See* "Crowdfunding Limitations and Requirements" on page 12 of this issue.)

Resale Restrictions. Securities acquired through crowdfunding offerings will be subject to resale restrictions for a one-year period unless sold to accredited investors, resold to the company, sold in a registered offering, or transferred in connection with the divorce or death of a purchaser.

Preemption. The JOBS Act preempts (effectively eliminating) state "blue sky" regulation of offerings that meet these requirements (but state antifraud laws are still applicable to such offerings).

Effectiveness. The crowdfunding exemption became law upon enactment of the JOBS Act, but companies may not rely on this exemption until the SEC promulgates implementing rules and regulations, which must occur within 270 days of the JOBS Act's enactment (or by early-Jan. 2013). To date, the SEC has not taken any action to implement the new crowdfunding exemption.

Impact of Crowdfunding Exemption

• The new crowdfunding exemption has been, and will likely continue to be, hotly debated. Supporters believe crowdfunding could revolutionize startup investing. Skeptics argue that crowdfunding will have unintended consequences, from fraud to a bubble of epic proportions. What is certain is that funding portals and companies seeking to take advantage of this new process will be required to comply with a number of new rules and regulations, most of which are not yet known. The JOBS Act gives the SEC nine months to adopt rules governing crowdfunding and registration requirements for "funding portal" intermediaries. Companies and intermediaries using crowdfunding to raise investment capital before the new rules are adopted will need to register the offering or find an applicable exemption from registration requirements under existing rules and regulations.

• A company that chooses to use crowdfunding to raise capital will be required to use an intermediary as a "funding portal" to conduct the transaction, which will add costs to the transaction. Expect to see numerous new ventures trying to take advantage of the new "funding portal" line of business. Initially, we may see significant variations in price, operational effectiveness, and compliance among these new intermediaries. It will be important for companies and their advisors to take the time to fully investigate intermediary options, particularly as rules are announced and market practice develops, and to select the most reputable, cost-effective intermediary possible.

Impact of Crowdfunding and Regulation A+

• Companies utilizing these provisions will be required to disclose a significant amount of information to investors. This type of information (much of which would not be required in connection with an offering to accredited investors under Rule 506) is costly to prepare and will be subject to public scrutiny (by the media, competitors and others) through required SEC filings. While the JOBS Act sets forth certain minimum standards to be met (for example, *see* "Crowdfunding Limitations and Requirements" on page 12 of this issue), SEC rulemaking is needed before the full extent of disclosure obligations is known as it applies to each new exemption. In most cases, the disclosure will involve (at a minimum) a public filing of financial statements as well as detailed information about the company and its operations.

• Use of crowdfunding or Regulation A+ could add a large number of unsophisticated investors to a company's shareholder base. This could cause significant challenges for management and make it harder for a company to secure subsequent venture-backed financings or to engage in significant corporate transactions in the future. Items such as shareholder actions or approvals may be more chal-

lenging to manage and may require more detailed communications or extended time to complete. Investors with less experience and lower risk thresholds may also be more likely to raise conflicts with management or instigate litigation against the company should the expected return of their investment go unrealized. For these and other reasons, venture capital firms or other institutional investors may avoid private companies with a significant base of unsophisticated shareholders. In addition, it may be more difficult to implement a restructuring, merger, or acquisition event that requires the company to utilize an exemption from securities laws when the company has a large number of unaccredited investors.

Removal of Ban on General Solicitation in Rule 506 Offerings

General Solicitation for Rule 506 Offerings. Private companies have historically relied on the Rule 506 "private placement" safe harbor in order to sell securities without registration with the SEC. Rule 506 of Regulation D permits sales of securities to sophisticated investors, subject to certain limitations, including the requirement that the company and its agents refrain from engaging in "general solicitation" (activities that would broadly solicit investors with whom they had no previous relationship) or advertising of the offering. Title II of 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," as defined under established SEC rules and regulations.

Expansion of Rule 144A. Title II of the JOBS Act also directs the SEC to adopt rules to permit general solicitation and advertising in connection with the resale of such securities under Rule 144A, provided that such sales are made to QIBs.

Verification. Sellers must take reasonable steps to verify that purchasers are accredited investors or QIBs. On Aug. 29, 2012, the SEC proposed amendments to Rule 506 of Regulation D and to Rule 144A under the Securities Act in order to remove the prohibition on general solicitation in offers and sales of securities under those rules. Under these recently proposed rules, the SEC would not provide a list of specific methods by which an issuer could satisfy the verification requirement. Instead, the SEC indicated that this would involve an objective determination, based on the particular facts and circumstances of each transaction. However, the proposed rules do identify a number of factors that issuers should consider in deciding whether their verification process is reasonable, including:

- the nature of the purchaser and the type of accredited investor potential investors are claiming to be;

- the amount and type of information the issuer has received about the purchaser (i.e., the more information an issuer has indicating that the prospective purchaser is accredited, the fewer steps it would have to take, and vice-versa);

- the nature of the offering, including the manner by which the investor was solicited (i.e., an issuer would likely be required to take greater measures to verify the accredited status of an investor responding to a public website solicitation than that of an investor solicited from a database of pre-screened accredited investors maintained by a reasonably reliable third party, such as a registered broker-dealer); *and*

- the terms of the offering, such as a minimum investment amount.

Generally speaking, the SEC has indicated that simply asking a prospective investor to "check the box" or sign a form indicating accredited investor status, in the absence of other information about the investor, is not sufficient. Additionally, the SEC has indicated that issuers should retain adequate records documenting the steps taken in the verification process.

Note that the proposed rules do not alter the current so-called "quiet" 506 offering, the safe harbor under which issuers may conduct Rule 506 offerings without the use of general solicitation.

Effectiveness. The SEC was required to implement rules within 90 days of the JOBS Act's enactment (or by early-July 2012); however, the proposed rules (originally announced in late August) remain subject to a 30-day comment period and then will only become operative once formally adopted by the SEC. Until final rules are adopted, the ban on general solicitation remains in place.

Impact of Removal of Ban on General Solicitation in Rule 506 Offerings

- Federal and state antifraud regulations continue to apply to Rule 506 offerings (as well as crowdfunding and Regulation A+). These regulations, combined with the continued ban on the use of general solicitation and advertising in private placements under former Section 4(2), now Section 4(a)(2) of the Securities Act (the most commonly used "fall-back" exemption for Rule 506 offerings) and state regulation that may continue to apply to such offerings (at least to the degree not pre-empted by the JOBS Act), could have a restraining effect on the unfettered use of public advertising or general solicitation in the offer and sale of securities, even if limited to accredited investors and QIBs.

- Changes imposed by Title II of the JOBS Act may significantly alter the manner in which companies offer securities to accredited investors. Because the ban on general solicitation has been lifted, private companies and their agents should be able to use a number of new tools to reach qualified investors, such as blogs, e-mail newsletters, and investing communities. These changes should enable private companies to reach a much broader pool of investors, provided that sellers take reasonable steps to verify that those investors qualify as accredited investors. Expect to see changes to subscription and purchase agreements to reflect the verification procedures utilized to confirm a purchaser's qualification as an accredited investor or QIB. In addition, expect to see changes to agreements with placement agents to permit limited use of general solicitation and related

Continued page 6

changes to indemnification provisions.

Relaxed Thresholds for Exchange Act Registration and Reporting

Historical Overview. Previously, the Exchange Act generally required companies with total assets exceeding $10 million to register with the SEC if a class of securities was held of record by 500 or more persons, making such companies subject to the burdensome reporting obligations applicable to public companies.

Expanded Threshold to Trigger Reporting. Title V and Title VI of the JOBS Act amend Section 12(g) and Section 15(d) of the Exchange Act to raise the threshold for triggering mandatory Exchange Act registration for all companies other than banks and bank holding companies from 500 to 2,000 holders of record, so long as there are no more than 499 holders of record who are not "accredited investors." Holders of record who received their securities in exempt offerings under employee benefit plans or (subject to SEC rule making) in exempt crowdfunding offerings are excluded from these thresholds.

New Thresholds for Banks and Bank Holding Companies. The JOBS Act also raises the threshold for triggering mandatory Exchange Act registration for banks and bank holding companies to 2,000 record holders (with no limit on non-accredited investors). In addition, the JOBS Act raises the threshold that allows termination of registration and suspension of reporting obligations for banks and bank holding companies to 1,200 holders of record (the deregistration threshold for companies other than banks and bank holding companies remains unchanged, at fewer than 300 holders of record in most circumstances).

Effectiveness. The increased thresholds triggering Exchange Act reporting were effective immediately on enactment of the JOBS Act. The SEC must issue rules to implement these provisions no later than one year after enactment of the JOBS Act (in early-April 2013). The SEC also must adopt rules to revise the definition of "held of record," although the JOBS Act does not provide a deadline for such adoption. Other than the set of FAQs issued in April of this year, the SEC has not taken any formal action to implement these changes.

Impact of Relaxed Exchange Act Reporting Thresholds

• On April 11, 2012, the SEC staff issued a set of frequently asked questions (FAQs) designed to address preliminary questions under Title V and Title VI. Most of these FAQs address how reporting companies may use current rules to terminate Exchange Act registration, but they also clarify that those companies that triggered the Exchange Act reporting requirements as of a fiscal year-end before enactment of the JOBS Act would not need to register (to the extent they had not already done so).

• The new thresholds should allow private companies with large shareholder bases to stay private longer, thus enabling them to defer the cost, public scrutiny, and increased liability associated with being public reporting companies. Eliminating securities issued in crowdfunding offerings (subject to SEC rulemaking) and in exempt offerings under employee benefit plans lends additional flexibility for growth and expansion without triggering onerous registration and reporting under the Exchange Act. Expect to advise private companies on how to implement tracking systems to monitor the new thresholds imposed by the JOBS Act. Systems should be designed to track (and keep current) whether securities were issued to accredited investors, under employee benefit plans, or through crowdfunding.

• As companies grow and stay private longer and as the amount of freely tradable private company securities increases (whether issued under Regulation A+ or otherwise), it is possible that, with additional SEC guidance regarding applicable broker-dealer regulation, we will see the development of more robust trading markets for secondary sales of securities issued by private companies. Appropriately regulated secondary sales platforms could offer a solution to the problem raised by critics that unsophisticated investors will be stuck with illiquid crowdfunded securities. Alternatively, some private companies and their investors may see value in establishing restrictive trading policies to maintain control over the company's shareholder base. Companies should examine their current organizational documents and related investment agreements in light of these developments.

Public Offerings – IPO "On-Ramp" for "Emerging Growth Companies"

Title I of the JOBS Act creates a new category of public companies called "emerging growth companies" (EGCs). The legislation aims to make it easier for EGCs to raise funds in the public markets by creating a transitional process, or "on-ramp," by which EGCs can transition to the full rigors of SEC compliance over time. It also includes provisions intended to enable EGCs to communicate more freely with qualified investors to determine their interest in a potential public offering and to broaden analyst coverage of EGCs. Title I is designed primarily to help private companies go public; however, in some limited circumstances, existing public companies that qualify as EGCs may also be able to benefit from the provisions of Title I.

Annual Gross Revenues of Less than $1 Billion. An EGC is defined as any company that had less than $1 billion in total annual gross revenues during its last completed fiscal year. Generally, EGC status is not available to any company that conducted a federally registered sale of common equity securities (most commonly through an initial public offering of equity securities (IPO)) before Dec. 8, 2011. For these purposes, any company that engaged in a registered primary offering of common equity securities for cash, a registered offering of common equity securities under an employee benefit plan on a Form S-8 or a selling shareholder's secondary offering on a resale registra-

tion statement prior to that date would be ineligible for EGC status. A company that has had Securities Act-registered sales of securities other than common equity securities (such as non-convertible debt) can nevertheless qualify as an EGC. Prior private placements do not disqualify a company from EGC status.

EGC status is lost and full compliance with SEC reporting requirements is required after the earliest of:

- the last day of the company's fiscal year during which it generated more than $1 billion in annual gross revenues;

- the date on which the company becomes a "large accelerated filer" (at least 12 months of reporting history and $700 million in public float);

- the date on which the company has raised more than $1 billion in non-convertible debt in a three-year period; or

- the last day of the company's fiscal year following the fifth anniversary of the company's first sale of common equity securities pursuant to an effective registration statement (most commonly by IPO).

The SEC's Division of Corporation Finance has issued a series of FAQs and other guidance on interpreting the new EGC qualification requirements. The SEC has clarified, among other things, that:

- an issuer that completed its IPO after Dec. 8, 2011, but before the JOBS Act was enacted, and that qualifies as an EGC can file its next periodic report under the Exchange Act using EGC-scaled-down disclosures;

- an issuer should assess its EGC status at the time it conducts any activity permitted by EGCs. For example, test-the-waters communications conducted by an issuer, who at the time the communications occurred was an EGC (but later loses its status), will not be deemed offers in violation of Section 5 of the Securities Act;

- asset-backed securities issuers and registered investment companies do not qualify as EGCs, but business development companies may qualify as EGCs; and

- the total amount of debt securities issued in the preceding three years should be counted toward the $1 billion three-year rolling limit on non-convertible debt issuances, regardless of the amount of debt securities actually outstanding at the time of measurement. Double-counting for A/B exchange offers is avoided, however, as the debt securities issued in exchange for those issued in the corresponding private placement do not count towards the $1 billion limit.

Confidential Filings and Reduced Disclosures. The JOBS Act creates a new Section 6(e) of the Securities Act, providing for confidential SEC staff review of draft IPO registration statements. The initial confidential submission and all amendments thereto must be publicly filed no later than 21 days before the date on which the EGC begins the road show. (See "Confidential Filings: Logistics and Guidance" on page 13 of this issue.)

Relaxed Regulation of Communications and Analyst Coverage. Historically, oral and written offers designed to solicit interest (or to "test the waters") in a proposed public offering were prohibited while a company was contemplating an IPO or other public offering of securities. The JOBS Act eliminates these long-standing restrictions on communications (commonly referred to as "gun jumping") by allowing for direct oral or written communication with accredited investors and QIBs to ascertain their interest in an EGC public offering, even before a registration statement with respect to the proposed offering is filed.

In an effort to increase analyst coverage of EGCs, the JOBS Act also lifts historical restrictions on, and permits broader research analyst coverage of and participation in, EGC IPOs and public offerings. Section 105(a) of the JOBS Act amends Section 2(a)(3) of the Securities Act to exclude research reports on an EGC at any time before, during, or after any offering of the EGC's securities, including its IPO, without this constituting gun jumping or any other violation of Section 5 of the Securities Act. Publication and distribution is permissible even if the broker or dealer is participating in the offering.

Effectiveness. While these provisions have immediate effect, the SEC, its staff and other regulatory agencies (such as the Financial Industry Regulatory Authority (FINRA)) will need time to adopt formal rules and procedures before a number of the changes required and benefits intended by the JOBS Act can be fully realized. The SEC's Division of Trading and Markets recently issued FAQs and other guidance on the provisions relating to securities analysts and research reports, which clarified, among other things, that:

- The JOBS Act does not amend or modify the 2003 Global Research Settlement – a settlement reached by 12 broker-dealer institutions with the SEC and various self-regulatory organizations in connection with allegations of conflict of interest between such firms' research and investment banking functions. Therefore, the firms involved in the settlement cannot take advantage of the provisions of the JOBS Act relating to research reports on EGCs without violating the terms of the related court order.

- They interpret Section 105(b) of the JOBS Act as reflecting Congressional intent to allow analysts to participate in EGC management presentations with sales force personnel to avoid separate duplicative presentations at a time when senior management's resources are limited. However, because the JOBS Act did not affect the Global Research Settlement, only firms that are not bound by that court order can have analysts attend meetings with EGC management and investment banking personnel in connection with an IPO, such as pitch meetings, if they do not engage in otherwise prohibited conduct (such as using analysts to solicit investment banking business).

- Section 105(b) is interpreted narrowly so that it does not affect provisions of NASD and NYSE rules that relate to communications in the presence of investors (NASD Rules 2711(c)(5)(A) and (B) and NYSE Rules 472(b)(6)(i)(a) and (b)). The JOBS Act does not permit analysts to participate in road shows or otherwise engage in communications with customers about an investment banking transaction in the presence of investment bankers or company management. Other provisions of NASD and NYSE rules are not affected by the JOBS Act.

Continued page 8

• An EGC can continue to test the waters after filing of a registration statement in a manner consistent with Rule 15c2-8(e) of the Exchange Act, which generally requires that a copy of a preliminary prospectus be made available by a broker-dealer to persons associated with such broker-dealer who are expected to solicit customer orders. The SEC staff offered an example of how to do so in Question 1 of its Aug. 22 FAQs. In particular, the SEC staff noted that the "test-the-waters" provision of the JOBS Act does not change the meaning of the term "solicit customers' orders" for purposes of Rule 15c2-8(e).

The JOBS Act does not affect the requirements of Regulation AC, which governs the types of communications that constitute a research report for purposes of analyst certification.

Impact of IPO On-Ramp Developments

• The ability to rely on scaled-back disclosure obligations should reduce the costs of going public and on-going reporting requirements for companies that qualify as EGCs. It remains to be seen the degree to which investment banks will be willing to underwrite IPOs of EGCs that take full advantage of the disclosure exemptions or whether EGCs will "opt in" to stricter standards due to market pressures, lender requirements, or the desire for more transparent disclosure on specific issues. On April 10, 2012, the SEC's Division of Corporate Finance issued a series of FAQs providing valuable guidance on various timing and interpretation questions, particularly in light of the new opportunities to "test the waters" (with qualified investors) prior to conducting more "traditional" road shows. Companies and their underwriters will need to work together with their advisors, in consultation with the SEC staff, to determine how the new provisions may change historical timing and mechanics of filing and effectiveness. In addition, expect to see changes to underwriting agreements to reflect the changes imposed by Title I, including new representations, warranties, and/or covenants regarding an issuer's status as an EGC and the parties' agreements about the use of, and the accuracy of, any test-the-waters communications; as well as revisions to indemnification and contribution provisions to cover any test-the-waters communications.

• Historically, companies looking to conduct an IPO were required to publicly file registration statements, which subjected the company (and its sensitive financial information and other disclosure) to public scrutiny by the media, market participants, and competitors. In addition, the SEC review process could lead some companies to modify the way they present key business metrics or accounting information. Sometimes this review process also led to significant delays in, or withdrawal of, the offering, which created further embarrassment and public scrutiny. Under the new rules, EGCs are able to initiate the review process with SEC examiners without releasing the full registration statement to the public, thus allowing the company to avoid placing itself and its sensitive information in the public limelight prematurely.

• The ability to market an EGC offering to accredited investors and QIBs before, during, and after any filing is made, as well as the changes permitting analyst coverage of EGCs, represent drastic changes to historical limitations on "gun jumping." Since liability for omissions and misstatements continues to apply to these communications, market players may take a cautious approach towards broad use of these relaxed standards (particularly during the pre-offering period), at least until corresponding guidance and procedures can be formally adopted by the SEC and FINRA.

• The expanded communications rules, both in the IPO context (for EGCs) as well as the soon-to-be-adopted rules lifting of the ban on general solicitation and advertising for private offerings sold to accredited investors under Rule 506, should significantly impact the historical legal framework underlying the integration of public and private offerings for EGCs.[1] This may also lead to more companies pursuing a "dual-track" exit strategy by initiating the IPO process at the same time as pursuing an M&A auction sale process with potential acquirers.

• The JOBS Act will not affect marketability of a company as an investment target, so, in that sense, it does not address the underlying need for access to capital. However, to the extent a company is an attractive investment target, the JOBS Act should make it easier for the company to test the waters, and to ascertain preliminarily market interest, at lower cost and with lower legal and accounting fees.

• If a company is an attractive EGC IPO candidate, the JOBS Act makes a public offering a more attractive financing alternative. After adoption of the Sarbanes-Oxley Act of 2002 (SOX) and the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), fewer companies with a market cap of under $700 million have tried to access the public markets because of the high on-going costs of being public. The JOBS Act aims to address this concern by lowering costs for companies with market caps of less than $700 million.

Concluding Observations

Crowdfunding Successes and Failures. The JOBS Act allows anyone to become an investor through the crowdfunding exemption. Reputable funding portals should emerge that will facilitate crowdfunding. With that, we also expect there to be abuses and tales of money lost to fraudulent ventures.

Helpful Resources

A full copy of the JOBS Act is available at: ***http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.***

The staff of the SEC has a "spotlight page" on its website where you can find SEC guidance and FAQs issued on various aspects of the JOBS Act, submit and read public comments on SEC regulatory initiatives under the JOBS Act and a link to file a registration statement confidentially. This information is available at: ***http://sec.gov/spotlight/jobs-act.shtml.***

Various subscription services provide valuable resources on the JOBS Act (as well as many other issues that arise when advising public and private companies). Free trials for these services may be available. Recommended sites include:

Practical Law Company – ***http://us.practicallaw.com/***
The Corporate Counsel – ***http://www.thecorporatecounsel.net/home/***
IntelliConnect – ***http://www.intelliconnect.cch.com/***

End Note

1. This framework has been effected over the years by the "Blackbox" (and similar) No-Action Letters and, more recently, by the 2007 SEC Guidance on public/private integration. The framework for integration analysis reflected in these materials would nevertheless still apply for issuers who do not qualify as EGCs.

Key Questions for Navigating the "Blue Sky" of North Carolina

Below are a few questions and answers (Q&As) that may be found valuable in navigating the "blue sky" requirements in North Carolina. As mentioned above, although federal law preempts state regulation of securities offerings in certain situations, state "blue sky" laws remain applicable in many instances. These Q&As are high level answers to questions that may vary depending upon the facts and circumstances surrounding a particular securities offering. Practitioners should review the provisions of the North Carolina Securities Act (N.C. Act) and the rules and regulations promulgated thereunder before conducting any securities offering in North Carolina.

1. Didn't NSMIA "preempt" state regulation of private offerings? If so, why should we worry about "blue sky" regulation?

Federal "preemption" of state blue sky regulation provided by the National Securities Markets Improvement Act of 1996 (NSMIA) does not cover all private placements. It covers only a specific list of "covered securities," which includes securities sold in transactions complying with Rule 506 of Regulation D (Rule 506) under the Securities Act. In addition to securities offered pursuant to Rule 506, "covered securities" also includes (a) securities listed (or approved for listing) on the New York Stock Exchange, American Stock Exchange, or the NASDAQ Stock Market, and securities of the same issuer which are equal in rank or senior to such listed securities (Listed Securities); (b) securities sold to certain qualified purchasers (as yet not defined by the SEC); and (c) certain securities exempt under Section 3(a) of the Act (including government or municipal securities, bank securities and commercial paper). For these purposes, Rule 506 is the only type of "private placement" that benefits from NSMIA's pre-emption. Private offerings under any other exemption (like the statutory private placement exemption provided by Section 4(a)(2) of the Securities Act, Rule 701 for securities issued by private companies to employees under written compensation plans or offerings under Rule 504 or Rule 505 under Regulation D) are not preempted. In addition, while states may no longer require the registration of covered securities under NSMIA, the states may continue to require filings and the payment of fees for offers and sales of covered securities (other than Listed Securities) within their state. In addition, NSMIA preserved the right of the states to investigate and prosecute fraud and to require broker-dealer registration for covered securities offerings. As a result, although covered securities are no longer subject to substantive state review under NSMIA, it is still necessary to conduct blue sky analysis for private offerings, irrespective of whether the offering involves "covered securities" or not.

2. What State(s) regulate the offering?

An offering must comply with the requirements of each state that has jurisdiction over the offering.[2] To determine which state(s) have jurisdiction, first, ask: From where will the offer originate? This is typically the state where a company is headquartered but might also include where the closing occurs (if that state is different). Next, ask: Where will the offer be directed? This could involve any number of other states, depending on the structure of the offering. Attorneys seeking to advise clients on these issues will need to ask (and continually seek updates from) clients to confirm where each potential investor resides. It is worth noting that some states regulate "offers" and "sales" differently. Regulation may apply for offers into a state, even if there was never any acceptance or sale of securities in that particular jurisdiction.

3. Does the transaction involve a "Security"?

Regulation only applies to transactions involving "securities." Similar to the Securities Act, the N.C. Act broadly defines "security" to include common examples, such as notes, stocks and bonds and more flexible terms such as "investment contract." Generally speaking, when a transaction involves passive investors who hope to derive income from the efforts and management of others, it is more likely that the transaction involves the offer and sale of some form of securities. There are some particular nuances in the N.C. Act worth noting:

• Limited Liability Company (LLC) membership interests are presumed to be securities, unless the LLC is member-managed, with fewer than 15 members. In addition, if the LLC allows for pass-through taxation, it is considered a "Direct Participation Program," which can impact the analysis in North Carolina for private offerings outside of Rule 506. *See* Questions 5 and 6 below.

• While treated as "securities" under the N.C. Act, options, restricted stock and other interests in "an employees' stock or equity purchase, option, savings, pension, profit-sharing or other similar benefit plan" are exempt from the registration requirements of the N.C. Act under Section 78A-16(11). Antifraud and broker-dealer regulation nevertheless continue to apply.

Continued page 10

• A short-term promissory note (i.e., one due within less than nine months and meets other requirements) may be exempt from registration under the N.C. Act if it falls within the definition of "commercial paper."

• The N.C. Act has specific rules and regulations that apply to "viatical settlement contracts." Subject to certain exemptions (as set forth in Section 78A-2(13), a viatical settlement contract is as "an agreement for the purchase, sale, assignment, transfer, or devise of all or any portion of the death benefit or ownership of a life insurance policy or contract for consideration which is less than the expected death benefit of the life insurance policy or contract."

4. Does North Carolina have a Rule 506 exemption?

Yes. Consistent with NSMIA, if an offering meets the requirements of Rule 506, it will be exempt from the registration requirements under the N.C. Act (although antifraud and broker-dealer regulation and requirements to impose certain legends continue to apply). *See* Questions 7 and 8 below. Issuers relying on Rule 506 must provide the North Carolina Securities Division with:

• a copy of the Form D filed electronically with the SEC no later than 15 calendar days after the first sale of securities in North Carolina;

• a consent to service of process; and

• the payment of a $350 filing fee.

5. Are there private placement alternatives to Rule 506 in North Carolina?

Yes. Section 78A-17 of the N.C. Act provides two limited offering exemptions. First, Section 78A-17(9) provides that: "any offer to not more than 25 persons in North Carolina during a 12-month period is exempt if the seller reasonably believes that all buyers are purchasing for investment." In addition, a second limited offering exemption has been created by regulation based upon Section 78A-17(17), which authorizes the administrator to create, by rule, "limited offering transactional exemptions that are consistent with the objectives of compatibility with federal limited offering exemptions and uniformity among the states." Two other transaction exemptions listed in Section 78A-17 are notable. First, Section 78A-17(8) exempts any offer or sale to several types of institutional investors (typically mirroring the QIB definition on the federal level). Second, pursuant to Section 78A-17(11), any transaction based upon an offer to existing security holders is exempt if no commission is paid for solicitation for a North Carolina holder or the issuer first files notice of the terms of the offer in North Carolina.

Compliance with either of the limited offering exemption alternatives to Rule 506 under the N.C. Act requires careful planning and an assessment of various rules in light of the facts and circumstances of each particular offering. For example, the following conditions generally apply if an offering is being conducted in reliance upon Section 71A-17(17) and Rule 505 of Regulation D:

• the issuer, its officers, directors, 10% owners and other affiliates must not be disqualified under Rule .1207;

• no commission can be paid to a person not registered as a dealer for soliciting purchasers of securities sold to a North Carolina resident;

• the investors must either be accredited or meet a suitability standard specified by Rule .1206;

• any prospectus must contain a legend (as described below); and

• an initial filing accompanied by a fee of $150 must be made no fewer than ten business days before any sale in reliance upon the exemption (any amended Form D filed with the SEC must be filed in North Carolina no later than five business days after the initial filing with the SEC).

In addition, all sales of direct participation program securities (notably, LLC interests that provide for pass-through taxation) must comply with the registration requirement conditions imposed by Rule .1313. Rule .1313 generally imposes minimum investor suitability standards on offerings of direct participation program interests and requires an issuer or dealer(s) effecting sales to comply with various disclosure requirements and take steps to determine prior to the sale that each person purchasing the interest meets such standards.

Compare these requirements with Rule .1205, however, which provides that an issuer relying on Section 78A-17(9) in connection with a Rule 505 offering need not comply with any of the above conditions, if the securities are offered and sold only to persons who will be actively engaged, on a regular basis, in the management of the issuer's business.

6. Is there a "self-executing" private placement exemption in North Carolina?

Yes, in limited circumstances. Through a careful reading of Rule .1205, one can determine that there are no filing requirements, conditions, or fees imposed in North Carolina on an issuer relying on the federal level upon Section 4(a)(2) or 3(a)(11) of the Securities Act or Rule 504 of Regulation D and upon the Section 78A-17(9) exemption in North Carolina as long as the offering is for anything other than a direct participation program security or a viatical settlement contract.

Practically speaking, this means that a stock offering conducted under Section 4(a)(2) of the Securities Act could be covered by Section 78A-17(9) of the N.C. Act on a "self-executing" basis in North Carolina; however, antifraud and broker-dealer regulation would continue to apply and certain legends would be required to be included on the securities being offered. Contrast that outcome with an offering of direct participation program securities (such as interests in an LLC which allows for pass-through taxation). In that situation Rule .1205 imposes various conditions on an issuer and the structure of the offering (including those imposed by Rule .1313 discussed above) and requires the issuer to make a filing and pay a fee prior to any sale in the State.

7. Are there specific legends that should be included?

Yes. Securities that are not subject to registration under the Securities Act, but are subject to a filing requirement under the N.C. Act,

must include a legend specified in Rule .1316. Any prospectus that depicts a similar legend as required by federal law or the SEC also complies with this legend requirement. Rule .1316 also sets forth an additional legend that must be included on securities that are exempt under a state limited offering exemption or Rule 506.

8. Must issuers or their officers or directors conducting exempt offerings in North Carolina register as "dealers"?

Typically, if the offering is exempt from registration and no special commissions or fees are paid in connection with the transaction, then dealer registration is not required. In North Carolina, a dealer is defined as "any person engaged in the business of effecting transactions in securities for the account of others or for his own account." A person must register in North Carolina in order to transact business as a dealer, irrespective of whether the security being offered or sold is exempt from registration under the N.C. Act. Every applicant for registration as a dealer, including annual registration renewal, must be registered as a dealer with the SEC and pay a $300 fee for registration. The statute lists a number of exclusions from the definition of dealer, which includes an issuer if: (a) the security being offered is exempt under most (but not all) of the provisions of Section 78A-16 or (other than certain exemptions covering viatical settlement contracts) the transaction is exempt under Section 78A-17; (b) the security is registered under the N.C. Act and sold through a registered dealer; or (c) the total offering (within and without North Carolina) is limited to $2.5 million, the total number of purchasers (within and without North Carolina) is limited to 100, and no commissions are paid for soliciting any purchaser in North Carolina. In addition, an individual who represents an issuer in effecting transactions in a security described immediately above or a security covered under federal law is also excluded from the definition of a dealer, provided that no commission or other special remuneration is paid or given directly or indirectly for soliciting any prospective purchaser in North Carolina. Therefore, an issuer's officers and directors would typically not need to register as dealers in North Carolina, as long as the issuer itself was also excluded from the definition of dealer and the individuals do not receive additional compensation related to solicitation of potential purchasers of the offering.

End Notes

1. Most states (including North Carolina) have adopted a regulatory framework that mirrors the structure of federal regulation in that they (a) generally require registration of securities to be offered and sold in the state, unless an exemption from those regulation requirements are available, (b) impose antifraud liability on offerings (even if an exemption from registration is available) and (c) require brokers and dealers to register, unless an exemption applies. New York is the most significant exception to this rule, as it regulates the activities of companies as "broker dealers." A discussion of New York blue sky regulation is beyond the scope of this article; however, special care should be taken for any offerings that originate from or are directed into New York. Transactions that may otherwise be exempt in most other states often require filings to be made in New York before an offering commences.

Studies Required by the JOBS Act

The JOBS Act also requires the SEC to undertake various studies and to report the findings to Congress.

Decimalization. The JOBS Act required the SEC to examine the impact that decimalization has had on the number of IPOs since its implementation and the liquidity of small and middle company securities, with the goal of determining whether decimalization is an appropriate measure of tick size for EGC stocks. Decimalization is the transition to trading and quoting securities in increments of one penny instead of fractions of a dollar (with a minimum increment of one-sixteenth of a dollar, or 6.25 cents). Section 106 of the JOBS Act provides that, if the SEC determines that securities of EGCs should be quoted and traded using a minimum increment of greater than one penny, the SEC can designate a minimum increment that is greater than one penny but less than $0.10 by issuing rules within 180 days of the date of enactment of the JOBS Act (due by Oct. 2, 2012).

The SEC released its decimalization study on July 20, 2012. The SEC staff found that the shift to decimalization coincided with a sharp decline in smaller company IPOs. However, since there were several other events (such as enactment of SOX and the emergence of high frequency trading) that also occurred during this period, it was difficult to isolate the specific impact that decimalization may have had in the decline of smaller company IPOs. The SEC also found that the reduction in relative spreads caused by decimalization may have reduced broker incentives to promote small- and medium-cap stocks. The SEC staff concluded that the impact of increasing tick sizes for EGCs to levels greater than those currently in place, including whether such increase would lead to more IPOs or create unintended consequences, was undeterminable from the study's findings. Accordingly, it deferred proceeding with any specific rulemaking to increase tick sizes and, instead, recommended that it should consider additional steps to determine whether rulemaking should be undertaken in the future.

Overview of Regulation S-K. Section 108 of the JOBS Act requires the SEC to review Regulation S-K to determine how the current registration requirements can be updated to simplify the process and reduce related costs and burdens for EGCs. The SEC must report its recommendations for streamlining the registration process for EGCs to Congress within 180 days of the date of enactment of the JOBS Act (due by Oct. 2, 2012).

Regulation A. Section 402 of the JOBS Act also required the Government Accountability Office (GAO) to conduct a study on the impact of state blue sky laws on offerings made in reliance on Regulation A under the Securities Act. Key findings of the GAO's study released on July 3, 2012 include:

Continued page 12

JOBS Act, *continued from page 11*

• after peaking in 1998 (57 offerings), the number of completed Regulation A offerings has significantly declined to just one offering in 2011;

• while multiple factors contributed to this decline, a major factor was the increased attractiveness of Regulation D, which, unlike Regulation A, preempts state blue sky laws; and

• stakeholders interviewed by the GAO had differing opinions on whether simply raising the $5 million per issuer per year limit for Regulation A offerings to $50 million (as contemplated by Regulation A+) would increase its use.

Crowdfunding Limitations and Requirements

Title III of the JOBS Act imposes specific requirements on issuers who conduct, and on intermediaries acting as brokers or funding portals involved in, crowdfunding offerings. These requirements are in addition to, and may be further qualified by, additional rules to be adopted by the SEC.

Crowdfunding Issuers. New Section 4A(b) of the Securities Act requires each crowdfunding issuer to file with the SEC, provide to investors and the broker or funding portal, and make available to potential investors:

• its name, legal status, physical address and website address;

• the names of its directors, officers and 20% shareholders;

• a description of its business and anticipated business plan;

• a description of its financial condition. For offerings that, together with all other crowdfunding offerings by the issuer in the past 12 months, have, in the aggregate, target offering amounts of

• < $100,000: the issuer must provide income tax returns for its most recently completed year (if any) and financial statements certified by the principal executive officer as being true and complete in all material respects;

• > $100,000 but < $500,000: the issuer must provide financial statements reviewed by a public accountant that is independent of the issuer; and

• > $500,000 (or such other amount as the SEC establishes by rule): the issuer must provide audited financial statements;

• a description of the intended use of the proceeds;

• the target offering amount, the deadline to reach the target offering amount and regular updates regarding the progress towards meeting the target offering amount;

• the price to the public of the securities or the method for determining the price. Each investor must be provided in writing, prior to sale, the final price and all required disclosures, with a reasonable opportunity to rescind its commitment to purchase the securities;

• a description of the ownership and capital structure of the issuer, including a description of:

• the terms of the offered securities and each other class of the issuer's securities, including how such terms may be modified and a summary of the difference between such securities being offered may be materially limited, diluted or qualified by the rights of any other class of security of the issuer,

• how the issuer's principal shareholders' exercise of their rights could negatively affect the purchasers of the securities being offered,

• the name and ownership level of each shareholder holding more than 20% of any class of the issuer's securities,

• how the offered securities are being valued, and examples of methods for how the issuer may value its securities in the future, and

• the risks to purchasers of the securities relating to minority ownership in the issuer and future corporate actions, including additional share issuances, a sale of the issuer or assets of the issuer or transactions with related parties; and

• such other information that the SEC may prescribe by rule.

In addition, crowdfunding issuers may not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker and may not compensate any person to promote its offering through communication channels provided by a broker or funding portal (without taking steps established by SEC rules). In addition, at least once a year, crowdfunding issuers must also file with the SEC and provide to investors its financial statements and reports of its results of operations, in compliance with rules adopted by the SEC.

Brokers and Registered Funding Portals. New Section 4A(a) of the Securities Act provides that "any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others" pursuant to the new crowdfunding exemption must: (1) register with the SEC as a broker or as a funding portal, (2) register with any applicable self-regulatory organization and (3) provide such disclosures as the SEC determines appropriate. Section 4A(a) adds a litany of additional requirements imposed on brokers and registered funding portals acting as intermediaries for crowdfunding offerings, which require additional SEC rulemaking, including, among others, the obligation to:

• ensure that each investor participating in a crowdfunding offering reviews investor-education information, positively affirms that the investor understands that the investor is risking the loss of the entire investment and that the investor could bear such a loss; and answers questions demonstrating—

• an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers,

• an understanding of the risk of illiquidity, and

• an understanding of such other matters as the SEC determines appropriate, by rule;

• take such measures to reduce the risk of fraud with respect to such transactions, including obtaining a background and securities enforcement regulatory history check on each officer, director, and 20% shareholder of every issuer whose securities are offered by such person;

• not later than 21 days (or such other period as the SEC may establish) prior to the first day on which securities are sold to any investor, make available to the SEC and to potential investors any information provided by the issuer pursuant to crowdfunding regulations (previously discussed);

• ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, and allow all investors to cancel their commitments to invest;

• make such efforts (as determined by SEC rulemaking) to ensure that no investor in a 12-month period has purchased securities offered pursuant to the crowdfunding exemption, in the aggregate, from all issuers, exceeds the individual investment limits;

• take steps (to be prescribed by the SEC) to protect the privacy of information collected from investors;

• not compensate promoters, finders or lead generators for providing personal identifying information with respect to any potential investors; and

• prohibit its directors, officers, or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services.

The JOBS Act amends Section 3 of the Exchange Act by providing that, through (yet to be adopted) SEC rules, registered funding portals will be exempt from broker-dealer registration requirements under the Exchange Act, provided that the funding portal is (and remains):

• subject to the examination, enforcement and other rulemaking authority of the SEC;

• a member of a national securities association registered under Section 15A of the Exchange Act (currently, only the Financial Industry Regulatory Authority (FINRA) qualifies); and

• subject to any other requirements the SEC may determine appropriate under its rules.

Title I also authorizes FINRA to enforce rules that are written specifically for registered funding portals.

In addition, according to new Section 3(a)(80) of the Exchange Act, a funding portal may not:

• offer investment advice or recommendations;

• solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal;

• compensate employees, agents or others for such solicitation or based on the sale of securities displayed or referenced on its website or portal;

• hold, manage, possess, or otherwise handle investor funds or securities; or

• engage in such other activities as the SEC may determine appropriate.

The JOBS Act addresses liability for misstatements and omissions in crowdfunding offerings. Investor remedies in such cases include rescission, if they still own securities, or seeking damages if they do not. For purposes of the antifraud provisions of the crowdfunding exemption, "issuer" is defined unusually broadly to include the issuing company's offers, directors and partners. Thus, if the issuer made a misstatement in a crowdfunding offering, angry investors could sue management. State antifraud rules remain applicable to such offerings.

Confidential Filings: Logistics and Guidance

The SEC's Division of Corporation Finance has issued a series of frequently asked questions (FAQs) and other guidance on the confidential filing process.

Making a Confidential Submission. An issuer should submit its draft registration statement (and all correspondence with regard to the draft registration statement between the SEC staff and the issuer) for confidential review using the SEC's secure e-mail system. (The SEC intends to replace this secure e-mail system with an EDGAR-based system for confidential and non-public submission of draft registration statements in the near future.) An issuer must qualify as an EGC at the time it submits a confidential draft registration statement and also at the time it submits each amendment.

All draft submissions should:

Continued page 14

JOBS Act, *continued from page 13*

• include a letter of transmittal identifying the issuer and the type of submission;

• confirm the issuer's EGC status in the transmittal letter and by disclosing its EGC status on the cover page of its prospectus submitted confidentially (and when filing on EDGAR); and

• be submitted in text searchable PDF format.

The draft registration statement must be substantially complete at the time of initial submission, including a signed audit report and exhibits. (The staff will defer its review of any draft registration statement that is materially deficient.) However, the draft is not required to be signed or to include the consent of auditors or other experts. Similarly, an EGC does not have to pay its Securities Act registration filing fee until it makes its first public filing via EDGAR.

The confidential submission process is not available for Exchange Act registration statements.

Making the First Public Filing. Since EDGAR does not currently provide for the filing of registration statements in draft form, when an EGC makes its first filing via EDGAR, for now, the initial confidential submission and all amendments thereto should be filed as exhibits, with each confidential submission filed as a separate Exhibit 99.

Test-the-waters communications conducted in reliance on the new provisions of Title I of the JOBS Act (new Section 5(d) of the Securities Act) need not be treated as a road show that triggers the 21-day deadline. However, if an EGC's pre-filing investor communications are broader than the test-the-waters communications permitted under the JOBS Act (for example, if they include investors that are not QIBs or accredited investors), then those communications should be treated as a road show for purposes of the 21-day deadline. If an EGC does not conduct a traditional road show and does not engage in any investor communications outside of permitted test-the-waters communications, it must publicly file its registration statement no later than 21 days before the anticipated date of effectiveness of its registration statement.

A confidential submission does not count as the filing of a registration statement for purposes of Section 5(c) of the Securities Act, which prohibits pre-filing offers. When an issuer files its registration statement for purposes of Section 5(c) as an EGC, the EGC rules continue to apply through effectiveness of the registration statement even if EGC status is lost. The Rule 134 safe harbor for communications about an offering is not available until the first public filing via EDGAR.

Public Disclosures for EGCs

The JOBS Act reduces financial reporting and other disclosure requirements in connection with IPOs by EGCs.

Relief from Financial Reporting Requirements. The JOBS Act scaled-back financial reporting requirements require two years rather than three years of audited financial statements to be included in the registration statements, with corresponding limits on the scope of management discussion and analysis (MD&A) and selected financial information. Similarly, EGCs are not required to provide, in any later registration statement or periodic report, selected financial data for any period before the earliest audited period presented in their IPO registration statements. EGCs are also not required to comply with any Public Company Accounting Oversight Board (PCAOB) rules regarding mandatory audit firm rotation or an expanded auditor report, and any other PCAOB rules adopted after the date of enactment unless the SEC determines otherwise.

In addition, EGCs may elect to defer compliance with new or revised accounting standards until such time as those standards are applicable to private companies. However, an EGC must make its irrevocable election when filing its first registration statement or Exchange Act report and may not choose to defer compliance with some new or revised accountings standards but not others. Otherwise, with respect to all other relaxed disclosures set forth below, an EGC may decide to comply with any of the stricter disclosure standards applicable to non-EGCs at any time.

Other Disclosure Relief. The JOBS Act amends applicable federal securities laws to exempt EGCs from the requirement to provide certain executive compensation and MD&A disclosures. Instead, an EGC may comply only with the provisions of Item 402 applicable to smaller reporting companies. This means an EGC may:

• provide compensation disclosure for only three (rather than five) named executive officers (NEOs), including the principal executive officer, but not necessarily the principal financial officer;

• omit a compensation discussion and analysis (CD&A) section;

• provide only two (rather than six) executive compensation tables (in addition to the directors' compensation table) – note that an EGC must provide the summary compensation table and the table of outstanding equity awards at fiscal year-end, but that those tables need only present executive compensation information for the NEOs covering the two (rather than three) most recent fiscal years;

• omit quantification of payments due to the NEOs on termination or severance; and

• omit disclosure regarding how its compensation policies and practices for all employees relate to risk-taking incentives and risk management practices.

Similarly, EGCs are not required to comply with Section 14A(a) and (b) of the Exchange Act, implemented by Section 951 of Dodd-Frank, which require companies to hold shareholder advisory votes on executive compensation and golden parachute compensation. Once an issuer loses its EGC status, it must begin to hold say-on-pay votes no later than (i) three years after losing EGC status (if a com-

pany was an EGC for less than two years after completing its IPO) or (ii) one year after losing EGC status (for all other EGC issuers).

In addition, EGCs need not comply with Section 404(b) of SOX, which requires auditor attestation of a company's internal controls and procedures. However, EGCs are required to present management's assessment and conclusions regarding the effectiveness of internal controls and procedures.

Lastly, EGCs will not be required to comply with Section 14(i) of the Exchange Act and Section 953(b)(1) of Dodd-Frank (neither of which have been implemented yet), which require companies to disclose: the relationship between executive compensation actually paid and the financial performance of the company and the ratio between the annual total compensation of the CEO and the median of the annual total compensation of all employees of the companies, respectively.

Additional EGC Disclosures. As the first wave of EGCs to conduct their IPOs under the JOBS Act become available, we are beginning to see what type of JOBS Act-related disclosure may be included in an EGC IPO prospectus. EGC IPO prospectuses have included JOBS Act-related disclosure on the front cover (as required by SEC guidance), in the summary section, in risk factors and in MD&A (in particular in the "Critical Accounting Policies" and "Recent Accounting Pronouncements" subsections). The scope of disclosure varies to some degree (routine disclosure should become more settled over time), but the primary focus is on risks and MD&A. Topics covered generally include:

- a company's decision to take advantage of the reduced disclosure requirements and other accommodations available to it as an EGC may make its shares less attractive to investors, which could have a negative impact on the trading volume and price of its shares and make it difficult for the company to raise capital in the future;

- a company's election to delay the adoption of new or revised accounting standards may make it difficult to compare its financial statements to those of other public companies; and

- the risk that a material weakness in internal controls may remain undetected for a longer period because of the company's extended exemption from the auditor attestation requirements under Section 404(b) of SOX. •

Jones practices with Smith, Anderson, Blount, Dorsett, Mitchell & Jernigan, L.L.P. She regularly represents clients in public equity and debt offerings, private placements, public company securities compliance and corporate formation and governance. Ms. Jones teaches a practical skills course for law students considering a corporate law career as an adjunct professor at Campbell Law School in downtown Raleigh.

Many thanks to Heyward Armstrong, Andrew Fisher, Amanda Keister, Jason Martinez, Miranda Miller, Justin Truesdale, Patty Gibson and Alex Bowling for their invaluable help preparing this article.

LIVE PROGRAMS
Thurs.–Fri. Feb. 21–22, 2013
Pinehurst Resort • Pinehurst

BLI CLE Credit: 3.75 Hours
12:55–5:00 p.m.

BLM CLE Credit: 6.5 Hours, includes 1.0 Ethics/Professionalism and 1.0 Substance Abuse/Mental Health
8:25a.m.–4:55 p.m.

2013 Business Law Institute
2013 Business Law and International Law & Practice Joint Annual Meetings
Pinehurst Resort • 80 Carolina Vista Drive • Pinehurst
Planned by the NCBA Business Law and International Law & Practice Sections

Business Law Institute Topics
Securities Law Primer/Private Placements
Modification of Fiduciary Duties in LLCs and Corporations
Intellectual Property Considerations for Business Counsel
Best Practices in Due Diligence
Getting the GReatest for Your Money in an International Acquisition – Taking Assets, Buying Stock and More

Business Law Agenda Topics
Annual Business Law Update
JOBS Act
Securities Law and Whistleblower Program Panel Discussion
Gaming Law
The Disloyal, Departing Employee – Practical and Legal Solutions
*Ethics of Email and Social Media
Venture Capital Financings
Hot Topics in Emerging Market Transactions
Traps for the Unwary in M&A Transactions
†Mental Health/Substance Abuse

*Indicates portion providing Ethics/Professionalism credit
†Indicates portion providing Substance Abuse/Mental Health credit

Register online: *www.ncbar.org/CLE/programs113BLI.aspx*
Register online: *www.ncbar.org/CLE/programs114BLM.aspx*
Or call (919) 677-8745 or (800) 228-3402 (ask for CLE)

NORTH CAROLINA FOUNDATION BAR ASSOCIATION
CONTINUING LEGAL EDUCATION

By the Numbers
Updates from the N.C. Department of the Secretary of State

Contributed by Haley Hanes

Corporation Statistics
Number of Creation filings* in State Fiscal Year

2010-2011 = 54,619
2011-2012 = 55,823

Number of Creation filings* July - September

2011 = 12,981
2012 = 11,627 (9/18/2012)

* Creation documents in the above include: Business Corporations, L3Cs, Limited Liability Companies, Limited Liability Partnerships, Limited Partnerships, Unincorporated Nonprofit Associations, Nonprofit Community Trusts, Nonprofit Corporations, Professional Corporations, Professional LLCs, and RLLLPs.

Current Processing Times
Corporation Division time to process a document filing: Approximately 1-5 business days, presently 2 business days on average.

Statutory mandate for processing UCC-1's: 3 business days, presently 2 business days on average.

New E-Notification Tool
For the past few years the Secretary of State's Office has been utilizing the e-mail to communicate with filers by e-mailing both problem documents and filed documents when examined. This method of communicating with the filer was enthusiastically embraced. We have heard you and would like to offer more e-notification services.

• **Phase One: Automatic E-Notification to the e-mail of record for the business entity when any document is filed.**
This tool is already in production. E-mail addresses are collected from the annual report. If an entity is not required to file an annual report, a letter with an e-mail address requesting this service is accepted.

• **Phase Two: Subscription Service (no fee) for third parties to receive an automatic e-notification when a document is filed on entities of responsibility.** Phase Two is not in production at this time. More information on how to subscribe will be forthcoming as details are worked through. •

Haley Haynes is Deputy Secretary of State of the office the North Carolina Secretary of State.

NORTH CAROLINA BAR ASSOCIATION
SEEKING LIBERTY & JUSTICE

North Carolina Bar Association
P.O. Box 3688 | Cary, NC 27519-3688

Nonprofit Org.
U.S. Postage
PAID
Raleigh, N.C.
Permit #297

Thank you for joining us!

Is there something you would like to see in the next newsletter? Let us know!

CONTACT THE NCBA

Call toll-free 1.800.662.7407
Email ***newsletter@ncbar.org***
Visit us at ***ncbar.org***

SMARTER LEGAL RESEARCH.

Log in to Fastcase at *www.ncbar.org* using your NCBA member ID or password.

As a member of the North Carolina Bar Association (NCBA) you now have free access to Fastcase. Fastcase is the leading next-generation legal research service that puts a comprehensive national law library and smarter searching tool at your fingertips.

NORTH CAROLINA BAR ASSOCIATION
SEEKING LIBERTY & JUSTICE