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Client Alert

Financial Industry Group

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The JOBS Act of 2012: Benefits for Foreign Issuers Accessing the U.S. Capital Markets

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the "JOBS Act") containing important changes to U.S. federal securities laws that should make the U.S. capital markets more appealing for foreign private issuers. The most significant changes of interest to foreign companies are the removal of restrictions on general solicitation or general advertising, and the establishment of a new category of registrant known as an emerging growth company ("EGC") that does not exclude non-U.S. companies and provides a number of advantages for companies considering an initial public offering of common stock ("IPO").

This note focuses on the advantages to non-U.S. companies considering accessing the U.S. capital markets either as part of an SEC registered IPO or a Rule 144A private placement transaction. The JOBS Act contains a number of further revisions to U.S. federal securities laws of less importance to foreign issuers, such as establishing the concept of "crowdfunding" for small U.S. domestic issuers, increasing the potential size of the small issues exemption and increasing the registration thresholds for public companies based upon the number of U.S. record holders.

Accessing the New U.S. "Public" Private Placement Market

- *Removal of Prohibition on General Solicitation and General Advertising* The JOBS Acts directs the SEC within 90 days of enactment to adopt rules to eliminate the prohibition on general solicitation or general advertising contained in Rule 506 of Regulation D and also to permit securities sold pursuant to Rule 144A to be offered to persons other than Qualified Institutional Buyers ("QIBs").

  In the case of Rule 506, the SEC is directed to permit general solicitation or general advertising so long as the securities are only sold (as opposed to "offered") to accredited investors and the issuer takes reasonable steps to ensure all holders are accredited investors. A similar direction is given to the SEC to amend Rule 144A to permit securities to be offered to person other than QIBs provided that only QIBs or persons the seller reasonably believes to be QIBs are permitted to purchase the securities.

If the U.S. market is targeted and not another non-U.S. jurisdiction, then a new "public" private placement market may develop, with the potential use of print, television, internet and other media to "offer" the securities. This may lead to significant changes in the manner of conducting private placements in the United States although uncertainties regarding combined Rule 144A and Regulation S offering and continued federal anti-fraud liabilities may reduce the immediate impact of the JOBS Act.

The SEC is due to implement regulations on or prior to July 4, 2012 in order to effect the removal of the prohibition on general solicitation and general advertising. It is uncertain whether the SEC will be able to meet this statutory deadline given the high volume of regulations being implemented in connection with the Dodd-Frank Wall Street Reform and Consumer Protection Act that are designed to address the recent turmoil in the financial markets.

- *Federal Anti-Fraud Liabilities* The use of general solicitation or general advertising to conduct a "public" private placement may be limited in practice by the continued application of the anti-fraud provisions of the federal securities laws and, in particular, Section 10(b) of the Securities Act of 1933 (the "Securities Act") and Rule 10b-5 thereunder.

  Any potential underwriters will likely be wary of the content of any general solicitation or general advertising concerning the offer. This may lead to them seeking to maintain significant restrictions on the type and content of any general solicitation or general advertising while at the same time enjoying the benefit that any inadvertent offers will not run afoul of SEC registration requirements.

- *Dual Rule 144A and Regulation S Offerings* While the JOBS Act removed the prohibition on general solicitation or general advertising in the context of a U.S. private placement, it did not direct the SEC to alter the non-U.S. offering rules contained in Regulation S under the Securities Act that prohibit "directed selling efforts" in the United States. Historically, directed selling efforts have been interpreted to be the functional equivalent to the prohibition on general solicitation or general advertising contained in Rule 506.

  In a combined Rule 144A placement in the U.S. together with an offering in accordance with Regulation S outside the United States, the prohibition against directed selling efforts will likely be violated by any general solicitation or general advertisement in connection with the U.S. placement. It remains to be seen how the SEC, in adopting rules under the JOBS Act, will address this apparent oversight. Until then, combined offerings are unlikely to include any form of general solicitation or general advertising in the United States.

Advantages for Foreign EGCs Conducting an IPO

- *Which Companies Qualify as EGCs?* Foreign companies are not excluded from the definition of an EGC and can thus benefit from the numerous potential advantages created by the JOBS Act designed to provide easier and less burdensome access to the U.S. retail market for an IPO of common stock. The definition of EGC includes companies that have annual gross revenues of less than $1 billion for their last financial year (or the equivalent in their reporting currency based on the exchange rate on the last day of such year) and have

not raised more than $1 billion of debt over the past three years from the date of issue. In addition, a company must not have conducted an SEC registered public offering of its common stock on or prior to December 8, 2011.

A company that qualifies as an EGC enjoys the benefits of its status under the JOBS Act until the last day of the financial year falling five years after its IPO unless it achieved annual gross revenues in excess of $1 billion, raises more than $1 billion of debt during any three year period or qualifies as a "large accelerated filer" under applicable SEC rules.

- *Use of Research Reports* The JOBS Act contains provisions designed to remove limitations on the use of research reports regarding EGCs before, during and after an IPO. Research reports prepared by a broker or dealer about an EGC do not constitute an offer for sale under the applicable provisions of the Securities Act irrespective of whether a registration statement has been filed or whether the particular broker or dealer will participate in the public offering of common stock. Prior to the JOBS Act, any such research that was not permitted by Rule 139 under the Securities Act could be potentially classified as "gun jumping" in violation of Section 5(c) of the Securities Act if conducted prior to the filing of an SEC registration statement.

  Research reports frequently include projections and other information not included in the prospectus and are thus not subject to the indemnity provisions contained in a standard underwriting contract. Similar to the removal of the general solicitation and general advertising prohibition, issuers and underwriters may nonetheless be reluctant to rely on the JOBS Act provisions to distribute research in connection with an IPO given the potential application of the anti-fraud provision of the federal securities laws to information contained in research reports.

- *"Testing-the-Waters" with QIBs and Institutional Accredited Investors* The JOBS Act permits an EGC or a person acting on its behalf to communicate with QIBs and institutional Accredited Investors only in order gauge the interest in a potential IPO prior to the filing of a registration statement with the SEC. In the past, any such communications prior to the filing of the registration statement could also be deemed to be "gun jumping". This provides a significant advantage to EGCs as the ability to "test the waters" in this fashion can avoid the substantial costs of preparing and filing an SEC registration statement for a proposed offering that is unlikely to be completed.
- *Confidential SEC Review of Draft Registration Statements* An EGC is expressly permitted to file a draft registration statement for an IPO for confidential review by the SEC. In the context of an IPO, this provides a significant benefit to a company that does not wish to publicly disclose sensitive information to its competitors until such time as it has received feedback from the SEC and is reasonably confident that the IPO is likely to proceed. An EGC is, however, required to publicly file the registration statement at least 21 days prior to beginning any road show with potential investors. The SEC staff has made clear in its published responses to FAQs regarding the JOBS Act that "testing-the-waters" and non-public presentations permitted by the JOBS Act do not constitute a road show for purposes of the public filing requirement.

- *Relaxation of Disclosure and Other Requirements* An EGC has the benefit of a number of relaxed disclosure requirements as compared to other SEC registrants. The main benefit from a financial statements perspective is that an EGC is only required to produce two years of audited financial statements instead of three in its registration statement and may omit selected financial data for any period prior to the earliest audited financial statements included in its IPO registration statement.

  The JOBS Act also entitled an EGC to limit disclosure in the MD&A to the period covered by the audited financial statements and reduces disclosure requirements regarding executive compensation. In addition, an EGC is exempt from the requirement to hold shareholder advisory votes regarding executive compensation.

  The SEC staff has confirmed in its responses to FAQs that a foreign private issuer filing annual reports on Form 20-F will also benefit from the scaled down disclosure requirements even though the JOBS Act does not specifically address the issue.

- *Relaxing Auditor and Accounting Requirements* The JOBS Act contains a number of provisions designed to reduce the burden on EGCs that would normally be imposed on new SEC registrants in connection with an IPO related to auditors and accounting requirements. In addition to the relaxed disclosure regime regarding financial statements noted above, the JOBS Act exempts an EGC from the Section 404(b) requirement of the Sarbanes-Oxley Act of 2002 to undergo an independent audit of its assessment of internal control procedures over financial reporting.

  An EGC also benefits from an exemption from certain potentially costly rules to be implemented by the Public Company Accounting Oversight Board, including, among other matters, a requirement to rotate an SEC registrant's audit firm. Finally, EGCs will not be required to implement changes to U.S. GAAP accounting requirements until such time as companies that are not subject to SEC reporting requirements are also required to comply.

Conclusion

The JOBS Act provides a number of potential benefits to foreign issuers both for those that qualify as EGCs and for those conducting private placements in the U.S. market. Foreign companies that qualify as EGCs will benefit from substantial reductions in the regulatory burden and cost of conducting an IPO in the United States. It remains to be seen whether foreign companies that qualify as EGCs will take advantage of the new more relaxed IPO requirements or continue the common practice of conducting offering in their home jurisdiction with a Rule 144A tranche offered into the U.S. In either scenario, the JOBS Act provides foreign companies with a number of benefits designed to make it easier to access the U.S. capital markets.

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