KIRKLAND & ELLIS

KIRKLANDPEN
Private Equity Newsletter

April 12, 2012

JOBS Act Reforms Should Benefit Private Funds

On Thursday, April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (the JOBS Act). The JOBS Act should, in general, benefit a private fund and its portfolio companies by (a) simplifying the IPO process and public reporting requirements for "emerging growth companies," (b) reducing regulatory burdens on fundraising by a company or private fund in private placements and (c) raising the limit on the number of shareholders or limited partners permitted while remaining a private company or private fund.

JOBS Act Promises to Simplify IPO Process and Reporting Requirements for Emerging Growth Companies

PENpoints

Changes to the IPO process and reporting and governance requirements for companies with less than $1 billion in revenue may make an IPO a more attractive exit strategy for qualifying portfolio companies.

A private fund seeking liquidity for a portfolio company investment may benefit from the JOBS Act's simplified IPO process and reduced post-IPO reporting requirements for an "emerging growth company," defined as an issuer with less than $1 billion in annual gross revenues (indexed for inflation every 5 years).[1]

IPO Process Reforms

The JOBS Act simplifies and improves the IPO process for a company qualifying as an emerging growth company in several ways:

- Reduced Historical Audited Financial Information. An emerging growth company will need to include only two, rather than three, years of audited financial statements in its IPO registration statement, and will not need to include selected financial data for periods prior to the two years covered by the audited financial statements.

- Research Reports. A broker or a dealer will no longer be prohibited from publishing a research report about an emerging growth company until 40 days after its IPO, even if the broker or dealer is participating or will participate in the IPO. The JOBS Act also removes or relaxes restrictions on (a) management of an emerging growth company meeting with analysts and (b) representatives of an associated broker or dealer and arranging communications between analysts and potential investors.

- Communications with Institutional Investors. The JOBS Act permits an emerging growth company and its representatives to communicate with certain institutional investors to gauge their interest in an IPO, whether before or after the filing of an IPO registration statement.

- Confidential Review by the SEC. An emerging growth company may submit a draft IPO registration statement for confidential SEC review so long as the registration statement and amendments are publicly filed at least 21 days before the company's road show. This will allow the company to assess the viability or attractiveness of a potential IPO before making public its sensitive business information.[2]

INSIDE KIRKLANDPEN

The SEC recently published guidance and Frequently Asked Questions regarding the confidential submission process for emerging growth companies, available at http://www.sec.gov/divisions/corpfin/guidance/cfjumpstartfaq.htm.

Reduced Post-IPO Disclosure and Governance Requirements

In addition to simplifying the IPO process, the JOBS Act relieves an issuer so long as it remains an emerging growth company (generally approximately five years or until gross revenues rise to $1 billion)[3] from several of the reporting obligations of a public company under the Securities Exchange Act of 1934 (the Exchange Act), such as:

- Less historical financial and MD&A disclosure (including no required selected financial data for periods prior to those covered in the audited financial statements in its IPO registration statement).
- No auditor attestation of the company's internal control over financial reporting (although management must still provide its own report and certifications on internal control over financial reporting).
- The right to elect whether to comply with new or revised accounting standards applicable only to public reporting companies, although the company may not selectively adopt some new or revised standards and not others and may not change its election while it is an emerging growth company.
- No mandatory audit firm rotation or so-called auditor discussion and analysis.
- Reduced executive compensation disclosure.
- No "say-on-pay", "say-on-when" or "say-on-parachutes" advisory votes.

An emerging growth company may take advantage of some, all or none of these exemptions, and may change its approach to the exemptions over time (except with respect to compliance with new and revised financing accounting standards).

While these exemptions may lessen the legal and regulatory burdens on an emerging growth company, it remains to be seen whether pressure from stockholders and other constituencies will require such companies to provide the more fulsome disclosures previously customary for a public company.

What is Next?

The IPO process and reduced reporting provisions for emerging growth companies are effective immediately, although we expect the SEC to continue to issue interpretative guidance and update certain of its rules and policies in response to the JOBS Act.[4]

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1 An issuer will not qualify as an emerging growth company if it conducted an IPO before December 9, 2011.

2 A foreign private issuer qualifying as an emerging growth company is also eligible for confidential review of its IPO registration statement to the same extent as a U.S. company.

3 More specifically, an issuer remains an emerging growth company until the earliest of (a) the last day of the fiscal year in which its annual gross revenues are $1 billion or more; (b) the last day of the fiscal year following the fifth anniversary of its IPO of common equity securities; (c) the date on which it has issued more than $1 billion in non-convertible debt during the previous three-year period; and (d) the date on which it is deemed to be a "large accelerated filer" under the Exchange Act, which includes at least $700 million of public float and filing periodic reports under the Exchange Act for at least one year.

4 The JOBS Act also requires the SEC to comprehensively analyze the registration requirements of Regulation S-K of the Exchange Act, determine how such requirements can be modernized and simplified for emerging growth companies and report its findings to Congress by October 2, 2012.

If you have any questions about the matters addressed in this *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

Dennis M. Myers, P.C.
http://www.kirkland.com/dmyers
+1 312-862-2232

Bradley C. Reed
http://www.kirkland.com/breed
+1 312-862-7351

Wayne E. Williams
http://www.kirkland.com/wwilliams
+1 312-862-7135

JOBS Act Reforms Reduce Regulatory Burdens on Private Offerings by Companies and Private Funds

PENpoints

The JOBS Act reduces regulatory burdens on private placements by a company or private fund and raises the limit on the number of equity owners a company or private fund may have before it must become public.

Elimination of General Advertising and Solicitation Restrictions in Certain Private Offerings

The SEC's rules governing the sale of securities by a private company — including a private fund and a "newco" formed to purchase or invest in a target — have for many years prohibited the company/issuer from engaging in general solicitation of investors or advertising for the offering. The JOBS Act requires the SEC to issue by July 4, 2012 regulations eliminating these longstanding restrictions, which should reduce regulatory burdens on the private placement process, including fundraising by a private fund.[1]

Historically, the SEC's Rule 506 (which is part of Regulation D) allowed an issuer, including a private fund, to sell securities without any dollar limitation to an unlimited number of accredited investors (subject to applicable limitations in the Investment Company Act and the Exchange Act), but only so long as the issuer did not engage in any general advertising or general solicitation of investors.

The SEC interpreted this general advertising or solicitation ban in private placements to (a) prohibit any publication, broadcasting or use of other mass media methods to solicit investors and (b) require the issuer (or its sponsor) to have a pre-existing substantive relationship with each potential investor solicited (i.e., a relationship that allows the issuer to reasonably conclude the persons being solicited are accredited investors or financially sophisticated).

As a result, the issuer was required to restrict public statements on websites, in the general media and in public presentations by its (or the sponsor's) employees. In addition, the SEC's pre-existing substantive relationship test prohibited cold-call solicitations, even to institutional investors generally known to be accredited investors. This led some private funds to retain placement agents because the SEC allowed an issuer to market to a placement agent's pre-existing substantive relationships even if the issuer had no such direct relationship.

The JOBS Act requires the SEC to remove the general advertising/solicitation ban under Rule 506,[2] so long as an issuer takes reasonable steps to verify that purchasers of securities are accredited investors under methods specified by the SEC. These relaxed rules should allow a private fund manager to:

- refer, in appropriate situations, to its fundraising in public media outlets such as newspapers, industry periodicals, interviews, press releases, fund databases, websites and social media, and/or

- market its new fund to investors with which it has no pre-existing relationship, so long as it takes the "reasonable steps" required by the SEC to verify that each purchaser is an accredited investor.[3]

Despite this new flexibility, each issuer (a) must still be mindful of securities law prohibitions against making misleading statements or failing to disclose material information to investors and (b) should consider adopting a marketing policy addressing these and related issues. A private fund manager registered as an investment adviser will also need to consider advertising restrictions that apply to fund offering materials under the Investment Advisers Act and other regulations applicable to private fund managers may also apply.[4]

Rule 144A Resale Provisions

SEC rules (Rule 144A of the Securities Act) governing resale by a holder of restricted securities to "qualified institutional buyers" (e.g., an institution that manages at least $100 million in assets, or a broker-dealer owning and investing at least $10 million of securities for non-affiliates, commonly called a QIB) effectively prohibit general advertising or solicitation activities. The JOBS Act also relaxes these restrictions by requiring the SEC to issue revised rules allowing a holder of restricted securities to offer by general advertising and solicitation, so long as the securities are ultimately sold only to QIBs.

The SEC must issue by July 4, 2012 new private placement and Rule 144A regulations, at which time the JOBS Act amendments become effective.

Exchange Act Registration Threshold Raised

The JOBS Act also increases the number of investors that may own a private fund or portfolio company before SEC registration is required. Previously, under Section 12(g) of the Exchange Act, an issuer was required to register with the SEC if it exceeded $10 million in assets and had 500 or more holders of record in any class of its equity securities. Such registration requires compliance with the Exchange Act's exhaustive public company reporting obligations.

The JOBS Act amends Section 12(g) by increasing the threshold number to 2,000 record holders (so long as no more than 500 of them are non-accredited investors).[5] As a result, a private fund claiming an exemption under Investment Company Act §3(c)(7) will be permitted to accept significantly more investors and a portfolio company will be able to extend its growth period before Exchange Act registration is required.[6]

Although these Section 12(g) amendments are effective immediately, the SEC may impose additional regulations applicable to private funds and private companies in connection with its general advertising/solicitation rulemaking.

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1 The JOBS Act also requires the SEC to amend Regulation A, an exemption previously available only to an issuer making an offering less than $5 million in any 12-month period, to increase the threshold to $50 million, and to exempt from state "blue sky" laws a Regulation A offering sold on national securities exchanges or exclusively to qualified investors. Regulation A may not be used by a private fund in its fundraising.

2 The public offering restriction, including through general advertising or solicitation, will remain in effect for other private placement exemptions, such as §4(2) or Rule 505 of the Securities Act.

3 Similarly, a private fund relying upon the exemptions from investment company registration under Investment Company Act §§3(c)(1) (100 or fewer beneficial owners) or 3(c)(7) (100% qualified purchaser owners) could qualify for those exemptions only if it did not engage in general advertising or solicitation, which (prior to the JOBS Act) would transform its fundraising into a public offering under the securities laws. The JOBS Act states that any general advertising or solicitation under Rule 506 is not a public offering, so a private fund should also be able to engage in general advertising or solicitations without a loss of the §§3(c)(1) or 3(c)(7) exemptions.

4 E.g., securities laws of non-U.S. jurisdictions in which securities are offered, publicly traded partnership tax rules, Investment Company Act §3(c)(1) limitations, and CFTC exemptions from commodity pool operator registration.

5 Certain holders are excluded from the 2,000 record holder threshold and the 500 non-accredited investor threshold, such as employees receiving equity securities as part of an employee compensation plan not required to be registered under the Securities Act, and persons purchasing securities under the new crowd-funding exemption (not available to private funds). Banks and bank holding companies are subject to the 2,000 holder threshold but not the 500 non-accredited investor threshold.

6 The SEC recently published guidance and Frequently Asked Questions regarding these provisions, which may be found at http://sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-12g.htm.

If you have any questions about the matters addressed in this *KirklandPEN,* please contact the following Kirkland authors or your regular Kirkland contact.

Scott A. Moehrke, P.C.
http://www.kirkland.com/smoehrke
+1 312-862-2199

Josh Westerholm
http://www.kirkland.com/jwesterholm
+1 312-862-2007

Stephanie A. Yoshida
http://www.kirkland.com/syoshida
+1 212-446-6477

PENnotes

The North Park University Breakfast Series
University Club of Chicago - Chicago, IL
April 17, 2012

The North Park University Breakfast Series unites Chicago's business community with North Park alumni, faculty, staff and students to network and hear from industry leaders.

Thomas S. Bagley, Founder and Senior Managing Director, Pfingsten Partners, LLC, will be speaking and moderating a panel discussion with Charles K. Huebner and Bruce I. Ettelson on the topic of "What is Private Equity? Is It Good or Bad For the Economy?" For more information click here.

ABA Section of International Law 2012 Spring Meeting
New York, NY
April 17 - 21, 2012

At the ABA Section of International Law's annual spring meeting, Kirkland associate Sergio Urias will participate in a panel discussion, "Latin American Utilities: What Big PE Wants, Big PE Gets," on Tuesday, April 17, 2012. He and his fellow panelists will discuss the ongoing boom of private equity investment in Latin American utilities and other regulated sectors, as well as private equity investment strategies, goals, trends and practical advice about transactions in Brazil, Argentina, Chile, Peru and Colombia (from diligence to post-closing compliance). For more information, click here.

32nd Annual Ray Garrett Jr. Corporate and Securities Law Institute
Chicago, IL
May 3-4, 2012

The Ray Garrett Jr. Corporate and Securities Law Institute is the pre-eminent securities law conference in the Midwest. It is the only Midwest conference that brings together senior officials from the Securities and Exchange Commission and leading securities practitioners. Kirkland partner F. Scott Falk is the Institute's Chair, and Kirkland partner Keith S. Crow is a member of the Institute's Executive Committee. Kirkland partner Mark Filip will chair a session on "Current Topics in SEC and DOJ Enforcement & Corporate Litigation." For more information, click here.

Chicago
300 North LaSalle
Chicago, IL 60654
+1 (312) 862-2000
+1 (312) 862-2200 fax

Hong Kong
26th Floor
Gloucester Tower
The Landmark
15 Queen's Road Central
Hong Kong
+852-3761-3300
+852-3761-3301 fax

London
30 St Mary Axe
London, EC3A 8AF
United Kingdom
+44 20 7469 2000
+44 20 7469 2001 fax

Los Angeles
333 South Hope Street
29th Floor
Los Angeles, CA 90071
+1 (213) 680-8400
+1 (213) 680-8500 fax

Munich
Maximilianstrasse 11
80539 Munich
Germany
+49 89 2030 6000
+49 89 2030 6100 fax

New York
601 Lexington Avenue
New York, NY 10022
+1 (212) 446-4800
+1 (212) 446-4900 fax

Palo Alto
950 Page Mill Road
Palo Alto, CA 94304
+1 (650) 859-7000
+1 (650) 859-7500 fax

San Francisco
555 California Street
San Francisco, CA 94104
+1 (415) 439-1400
+1 (415) 439-1500 fax

Shanghai
11th Floor, HSBC Building
Shanghai IFC
8 Century Avenue
Pudong New District
Shanghai 200120
P.R. China
+8621 3857 6300
+8621 3857 6301 fax

Washington, D.C.
655 Fifteenth Street, N.W.
Washington, D.C. 20005
+1 (202) 879-5000
+1 (202) 879-5200 fax

Private Equity Practice at Kirkland & Ellis

Kirkland & Ellis LLP's nearly 400 private equity attorneys handle leveraged buyouts, growth equity transactions, recapitalizations, going-private transactions and the formation of private equity, venture capital and hedge funds on behalf of more than 200 private equity firms around the world.

Kirkland has been widely recognized for its preeminent private equity practice. The Firm was named Best M&A Firm in the United States at World Finance's 2011 Legal Awards and was honored as the "Private Equity Team of the Year" at the 2011 IFLR Americas Awards. Kirkland was also recognized as "Law Firm of the Year" in *Buyouts* magazine's "2010 Deal of the Year Yearbook." Kirkland was ranked in the first tier among law firms for both Private Equity Buyouts and Private Equity Funds by *The Legal 500 U.S. 2010*. Additionally, *Pitchbook* named Kirkland as one of the most active law firms representing private equity firms in its 2010 "Private Equity Breakdown."

The Lawyer magazine recognized Kirkland as one of the "The Transatlantic Elite" in 2008, 2009, 2010 and 2011, noting that the firm is "leading the transatlantic market for the provision of top-end transactional services ... on the basis of a stellar client base, regular roles on top deals, market-leading finances and the cream of the legal market talent."

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EDITORS
Jack S. Levin, P.C.
Margaret A. Gibson, P.C.
Norbert B. Knapke II

SUBSCRIPTIONS
To subscribe to *KirklandPEN*, please e-mail
kirklandpen@kirkland.com
+1 (312) 862-2894