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Supreme Court Issues Four Decisions Favorable to Employers

By E. Fredrick Preis, Jr., Joseph R. Hugg and Rachael Jeanfreau

The U.S. Supreme Court issued four decisions in 2013 involving important questions of employment law that are being widely praised by corporate attorneys for their "pro-employer" rulings. Companies should be aware of these decisions so that they can take advantage of the potential defenses they offer. However, these decisions do not change the fundamental rules of employment law or the importance of maintaining an effective employee relations program. Companies must remain vigilant to ensure that their interests are protected.

Every company that has defended itself against a harassment claim under employment discrimination laws understands that dealing with harassment allegations is time-consuming, expensive, and, at a minimum, unpleasant for all employees involved. Further, a company sued for harassment also may be exposed to bad press and an expensive settlement or a large court judgment. Fortunately, a recent Supreme Court decision has made it a little easier to defend your company against harassment allegations under federal employment discrimination laws.

One of the most important issues in any harassment case is whether an alleged harasser is a "supervisor." This is because the legal standards are different if the alleged harassment is committed by a supervisor or a co-employee. Pursuant to well-established Supreme Court precedent, it is much easier for an employee to obtain a judgment against a company if he or she was harassed by a supervisor because a company is "vicariously liable" (*i.e.*, directly liable) for harassment committed by a supervisor. By contrast, when a non-supervisory co-employee is responsible for the alleged harassment, the company cannot be directly liable and can avoid exposure by asserting the so-called *Faragher/Ellerth* defense by showing that it exercised reasonable care to prevent and correct any harassment — usually by implementing and following a well-drafted anti-harassment policy.

On June 24, the Supreme Court issued a decision in the *Vance v. Ball State University* case that clarified and narrowed the definition of "supervisor" for

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The JOBS Act

What You Need to Know

By Jonathan Friedland and Vanessa J. Schoenthaler

You might recall that when the Jumpstart Our Business Startups Act (JOBS Act) was first signed into law in April, 2012, there was a great deal of fanfare from both its supporters (generally entrepreneurs and angel and venture investor groups) and detractors (generally securities regulators and consumer and investor advocacy groups) and certainly no shortage of related media coverage.

Yet as time has passed, much of the original enthusiasm seems to have faded. This is likely only a temporary abatement, however, as the JOBS Act is just now beginning to have a widespread functional impact. If you are an in-house counsel and have not been studying the JOBS Act, this article is for you. If nothing else, once reading it, you will be able to hold your own when the CEO or CFO brings up the JOBS Act at the next board strategy session or company cocktail party.

Is the JOBS Act Effective Yet?

The answer is, "somewhat." Many of the JOBS Act's provisions were self-executing and took effect immediately upon its enactment. Examples include Title I, which relates to the new category of "emerging growth companies" and much of Titles V and VI, which relate to the asset and shareholder thresholds

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for registration under the Securities Exchange Act of 1934 (Exchange Act).

More than half of the JOBS Act's provisions, however, require the SEC to undertake rulemaking before they can be implemented. Included among these are:

- Title II, which eliminates the long-standing prohibition on general solicitation and general advertising in certain private offerings (both of which we will refer to as "general solicitation") and which was the subject of the SEC's most recent rulemaking;
- Title III, which relates to crowdfunding;
- Title IV, often referred to as Regulation A+ because it is similar to existing Regulation A but allows for relatively larger offerings; and
- Those provisions of Titles V and VI that were not self-executing.

Important Aspects

What is the most important aspect of the JOBS Act? The as-yet proposed crowdfunding rules are the most widely editorialized provisions of the JOBS Act. However, far more universal in application and of greater benefit to capital formation, at least from the perspective of corporate counsel, are the rule amendments, adopted on July 10 and effective on Sept. 23, which eliminate the prohibition on general solicitation in certain private offerings made in reliance on Rule 506 of Regulation D promulgated under the Securities Act of 1933 (Securities Act) (as well as in resales made in reliance on Rule 144A, but that's a discussion for another day).

And so, the prohibition on general solicitation will soon be no more, at least with regard to a new category of Rule 506 offerings (Rule 506(c) offerings). This change by itself has the capacity to transform the private capital markets and open up additional avenues of capital formation for issuers of all types.

Tapping the Private Capital Markets

Is tapping the private capital markets really a significantly more viable alternative today because of the JOBS Act? Yes. Recall that the original version of Rule 506 (which will be retained in subsection (b) of the amended Rule 506 and which we'll refer to hereafter as Rule 506(b)) allows an issuer to offer and sell an unlimited amount of securities to an unlimited number of accredited investors and up to 35 non-accredited investors who either alone or with a purchaser representative meet certain sophistication requirements. There are of course a number of other conditions associated with Rule 506 offerings, but the most relevant for our purposes is that neither the issuer, nor anyone acting on its behalf, may offer or sell securities through any form of general solicitation.

Under the newly adopted subsection (c) of Rule 506, an issuer can still offer and sell an unlimited amount of securities, but, notably, it can use general solicitation to do so, subject to the requirement that all purchasers are accredited investors and reasonable steps are taken to verify all purchasers are accredited investors.

In essence, Title II of the JOBS Act gives us a very public market for otherwise private offerings: a safe harbor for the offer and sale of unregistered securities by means of general solicitation. Through Rule 506(c), the private capital markets have the potential to become a viable alternative to a registered public offering.

Verifying an Investor

How do you verify that an investor is accredited? There are two basic means by which an issuer may satisfy its obligation to verify that an investor falls into one of the eight categories of accredited investors enumerated in Rule 501(a) of Regulation D: by engaging in a principles-based method of verification, or by complying with one of four non-exclusive methods of verification.

Under the principles-based method of verification, whether the steps taken to verify accredited investor status are sufficient will be an objective determination, made in the context of the facts and circumstances of each purchaser and transaction. Among the factors an issuer should consider are: 1) the nature of the purchaser and type of accredited investor they claim to be; 2) the amount and type of information the issuer has about the purchaser; and 3) the nature and terms of the offering, such as the manner in which the purchaser was solicited and the minimum investment amount.

The more likely it appears that a purchaser qualifies as an accredited investor after considering the facts and circumstances, the fewer steps necessary to verify accredited investor status; similarly, the less likely, the more steps necessary. One thing is clear: Simply having a purchaser check a box in an investor questionnaire or execute a form stating that the purchaser is an accredited investor will not itself constitute reasonable steps.

Under the non-exclusive method of verification, the steps taken to verify that a natural person is an accredited investor will be deemed sufficient if one of the following methods is employed:

1. The income method. Reviewing copies of any IRS form that reports income, along with obtaining a written representation from such purchaser that she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year.

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Jonathan Friedland is a partner with Chicago-based law firm Levenfeld Pearlstein, LLC. He is also the founder and chairman of DailyDAC, LLC, which owns and operates Accredited Investor Markets (www.aimkts.com), a website providing information to accredited investors. **Vanessa J. Schoenthaler** practices corporate and securities law in New York at Qashu & Schoenthaler LLP. She also serves as outside general counsel of DailyDAC, LLC. The authors may be reached at jfriedland@lplegal.com and vschoenthaler@qsllp.com, respectively.

2. The net worth method. Reviewing one or more of certain types of documentation related to net worth, such as bank statements and brokerage statements, in each case dated within the prior three months, along with obtaining a written representation from the purchaser that all liabilities necessary to make a determination of net worth have been disclosed.

3. The written confirmation method. Obtaining written confirmation from certain third parties (*i.e.*, a registered broker-dealer, SEC-registered investment adviser, licensed attorney or CPA, etc.).

4. The existing accredited investor method. With respect to any natural person who had invested in an issuer's Rule 506(b) offering as an accredited investor prior to Rule 506(c)'s effective date and who remains an investor of that issuer, by obtaining a certification at the time of sale that such person qualifies as an accredited investor.

Regardless of the steps taken, the burden remains on the issuer to demonstrate that it is entitled to the Rule 506(c) exemption.

Crowdfunding

Should your company consider raising money through the Crowdfunding provisions of Title III? In a word: no. Leaving aside for a moment the fact that rules to implement the crowdfunding provisions have not yet even been proposed, based on the statutory provisions alone, crowdfunding is not likely to be a viable means of capital raising for anyone other than the smallest of issuers.

For starters, crowdfunding will not be available to issuers organized outside of the United States or those that are already Exchange Act reporting, investment companies, or private funds. Those issuers who do qualify (private operating companies) will be limited to raising a maximum of $1 million in any 12-month period (and not just from crowdfunded offerings, but all exempt offerings). In addition, issuers will be limited in the amount they can raise from any single investor. For investors with either an annual income or net worth of less than $100,000, investment amounts will be limited to the greater of $2,000 or 5% of such their annual income or net worth. For investors with either an annual income or net worth of at least $100,000, investment amounts will be limited to 10% of their annual income or net worth, but not to exceed $100,000.

As a consequence, in some cases raising $1 million could require that an issuer take on 500 or more new shareholders. That's quite a large shareholder base for a private company to manage.

If you're not convinced of the impracticality of a crowdfunded offering by the limitations on offering size and individual investment amounts, consider that crowdfunded offerings will also have to be conducted through a qualifying broker or funding portal and issuers will have to meet a number of specific disclosure requirements, all of which will add to the expense of conducting an offering (and thereby reduce the net offering proceeds).

Finally, small- and early-stage issuers, really the only ones who should consider raising funds through a crowdfunded offering, need to also carefully consider how crowdfunding fits into the context of their overall financing strategy, and particularly how a crowdfunded offering might affect their ability to raise future funds by more traditional means, such as through a venture capital fund.

A crowdfunded offering that results in a large number of relatively unsophisticated investors may have the consequence of discouraging sophisticated investors from later considering an issuer as a credible investment candidate.

Crowdfunding may seem like a good idea on paper and may even be an excellent source of capital for your favorite mom and pop coffee shop or one-off entrepreneur who will never seek outside capital again, but it is otherwise not likely to offer much in the way of a financing strategy.

Angel Investors

Should your company consider raising money from AIs through Title II platforms? Yes. Once the amendments to Rule 506 take effect on Sept. 23, another self-executing provision in Title II of the JOBS Act will also come into effect. It creates an exemption from the broker-dealer registration requirements for the operation of certain platforms or mechanisms that permit issuers to offer and sell securities by means of general solicitation or other related activities. These Title II platforms will even be able to provide issuers with ancillary services, subject to certain limitations, that will serve to facilitate the investment process, for example, due diligence services or the provision of standardized transaction documents.

Take care, however, not to confuse a Title III crowdfunding portal, which will be openly available to all investors (accredited and non-accredited alike), with a Title II platform, which will use general solicitation (so may appear to be openly available to all investors) but will offer securities reliance on Rule 506(c), so participation will be limited exclusively to accredited investors who have been reasonably verified as such (as discussed above).

Private Companies

If you are a private company that wants to stay private, how does the JOBS Act help you? You probably remember the old rule related to Exchange Act registration: Once you accumulated total assets in excess of $10 million and a class of equity securities held of record by 500 or more shareholders, you were required to register that class of securities under the Exchange Act and begin filing periodic reports.

The JOBS Act increased the registration threshold from 500 shareholders of record to either 2,000 persons or 500 persons who are not accredited investors, excluding persons who receive securities pursuant to an employee compensation plan in a transaction exempt from registration under the Securities Act. In the case of a bank

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holding company, the JOBS Act increased the registration threshold from 500 shareholders of record to 2,000 persons.

The increased shareholder thresholds took effect immediately upon the JOBS Act's enactment. As a consequence, private companies may now raise several rounds of capital while at the same time using equity incentives to compensate management and employees, all without having to worry about triggering the Exchange Act registration requirements or being compelled to go public prematurely, as was the case with companies like Google and more recently, Facebook.

Going Public

If you are a private company that wants to go public how does the JOBS Act help you? The JOBS Act introduced a new category of filer into the federal securities laws: the "emerging growth company." An emerging growth company is a company with total annual gross revenues of less than $1 billion as of its most recently completed fiscal year, excluding any company that held an initial public offering on or before Dec. 8, 2011.

The JOBS Act confers a number of benefits on emerging growth companies, beginning with the IPO process itself: if a private company falls within the definition of an emerging growth company it has the ability to submit a confidential registration statement to the SEC for nonpublic review and comment. The registration statement (and all amendments thereto) only becomes public 20 days in advance of the company's roadshow. This allows an emerging growth company to file to go public but still retain the option to not go through with the offering, without having to disclose information that would not otherwise be made available by a private company (such as financial data and strategic plans). This confidential registration process serves to shield an emerging growth company from public scrutiny until it is more fully prepared to be public, giving a company much greater control over the entire process.

Once public, an emerging growth company may also elect to take advantage of a number of scaled down corporate governance and financial disclosure requirements. These include: 1) providing only two (rather than three) years of audited financial statements; 2) less historical financial data and corresponding management's discussion and analysis; and 3) scaled down executive compensation disclosures.

Generally once a company is an emerging growth company it will remain one until the earlier of: 1) the last day of the fiscal year in which it has total annual revenue of $1 billion or more; 2) the last day of the fiscal year following the fifth anniversary of the its IPO; 3) the date on which it has, during the previous three-year period, issued more than $1 billion in non-convertible debt; or 4) the date on which it becomes a large accelerated filer (a company with a worldwide non-affiliate market capitalization of $700 million or more, measured as of the last business day of its second fiscal quarter).

Another advantage of being an emerging growth company is the ability to "test the waters" or engage in oral or written communications with certain potential investors (qualified institutional buyers and institutional accredited investors) following the filing of a registration statement and prior to its effective date (*i.e.*, during the "quiet period"). What's more, emerging growth companies have the ability to test the waters in connection with any registered offering, not just when conducting an IPO. The JOBS Act goes even further and liberalizes many of the rules regarding analyst communications and research reports published and distributed about emerging growth companies.

On the whole, for a private company contemplating an IPO, emerging growth company status offers greater flexibility and more control over the process, thereby easing the transition to public company status.

Conclusion

The JOBS Act embodies some of the most significant changes to private capital formation since the federal securities laws themselves were first enacted, and no doubt will make a lasting impact. That said, many of the JOBS Act's provisions are just coming online or still remain subject to SEC rulemaking, so it will be several years before we can truly assess its efficacy.

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her with no remaining interest in the suit. Because no other employee had joined the collective action as a plaintiff, the lawsuit was no longer justifiable. The Third Circuit Court of Appeals reversed the decision because it would "frustrate the goals of [FLSA] collective actions," although it agreed with the effect of a settlement offer on the nurse's claim.

In a decision issued on April 16, the Supreme Court reversed the Third Circuit and held the suit had been appropriately dismissed. The Court reasoned that the plaintiff's individual action could no longer proceed since the intervening settlement offer effectively "deprive[d] the plaintiff of a 'personal stake in the outcome of the lawsuit.'" The Court then examined whether the lawsuit could remain based on the collective-action allegations in her complaint, and it decided the action must be dismissed since no other employees opted in and "the mere presence of collective-action allegations in the complaint cannot save the suit" after a settlement offer satisfies the individual plaintiff's claim.

Based on the Court's decision in *Genesis Healthcare*, companies now have a choice when they are served with an FLSA collective-action lawsuit filed by a single plaintiff — or potentially a small number of plaintiffs. Rather than defend the lawsuit as it would any other, which may increase the chances that the plaintiff will convince his or her coworkers to join the lawsuit as

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