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# The Jumpstart Our Business Startups (JOBS) Act

Louis R. Dienes

## Introduction

On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act (JOBS Act) (Pub L 112–106, 126 Stat 306). The JOBS Act's stated purpose is to increase job creation and economic growth by improving access to public capital markets for emerging growth companies. The JOBS Act relaxes the disclosure requirements for certain companies going public, provides alternative ways for private companies to raise capital, and allows some companies to stay private longer.

## Immediate and Significant Reduction in Regulatory Burden for Emerging Growth Companies: IPO Process and Exchange Act Reporting

The JOBS Act relaxes the initial public offering (IPO) procedural process for "emerging growth companies" (EGCs), as defined below, and provides them with a phase-in period for compliance with certain Securities and Exchange Commission (SEC) requirements. In addition, EGCs may capitalize on scaled-back disclosure requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) (Pub L 111–203, 124 Stat 1376). The provisions related to EGCs in the Act are effective immediately.

An EGC is a company that (15 USC §78c(a)(80)):

- Completed an IPO after December 8, 2011; and
- Had less than $1 billion in total revenue (subject to an adjustment for inflation every 5 years) in its most recently completed fiscal year.

A company will cease to qualify as an EGC upon the earlier of (15 USC §78c(a)(80)(A)–(D)):

- The last day of the fiscal year when the company has annual gross revenues in excess of $1 billion;
- The last day of the fiscal year following the fifth anniversary of the company's IPO;
- The date on which the company issues more than $1 billion in nonconvertible debt during the previous 3-year period; or
- The date the company qualifies as a "large accelerated filer" under the Securities Exchange Act of 1934 (Exchange Act) (15 USC §§78a–78pp) (*i.e.,* the company has a public float of at least $700 million).

Prospective EGCs may submit a draft of their IPO filings to the SEC for confidential review by its staff, provided the submissions and all amendments are filed publicly at least 21 days before the EGC begins its road show. 15 USC §77f(e).

EGCs are afforded relief from certain regulatory burdens currently borne by public companies. For example (15 USC §77g(a)(2)):

- EGCs need only include 2 years of audited financials in their IPO registration statements instead of 3 (and 2 years of management discussion and analysis and selected financial information). Future periodic reports and registration statements may exclude any financial data from any period earlier than that covered by the IPO registration statement.
- EGCs are not required to hire an auditor to attest to management's assessment of internal controls over financial reporting required under the Sarbanes-Oxley Act of 2002.

EGCs are also exempt from certain accounting requirements, including the mandatory audit firm rotation rules and the rules that require a supplement to the auditor's report, and they are not required to comply with new or revised audit standards until these standards are also applicable to private companies. 15 USC §7213(a)(3)(C).

EGCs are also temporarily exempt from soliciting "say-on-pay," "say-on-frequency," and "say-on-golden parachute" advisory shareholder votes on executive compensation. 15 USC §78n–1(e)(2)(A). These issuers will be required to solicit such shareholder votes within 3 years after the IPO (for issuers that

qualified as an EGC for less than 2 years) and within 1 year of having lost EGC status (for other issuers). 15 USC §78n–1(a)(1), (e)(2)(B). EGCs are also exempt from the "CEO pay versus financial performance ratio" and "CEO compensation to median employee ratio" compensation disclosure rules mandated by §953(b)(1) of the Dodd-Frank Act, although these provisions have not yet been adopted by the SEC. See Pub L 112–106, §102, 126 Stat 306.

EGCs have the option of complying with the scaled-back disclosure requirements for smaller reporting companies regarding executive compensation. This election will, among other things, reduce the number of executive officers for whom compensation disclosure is required to three (instead of five) and exempt an EGC from the requirement to provide a compensation discussion and analysis.

The JOBS Act also reduces or eliminates many restrictions that would otherwise apply to securities offerings by EGCs:

- EGCs may "test the waters" by communicating orally or in writing with potential investors that are qualified institutional buyers and institutions that are accredited investors before and after the filing of a registration statement for the offering. 15 USC §78o–6(d).
- Brokers and dealers are permitted to publish and distribute research reports about an EGC that is the subject of a public offering, even if the broker or dealer is underwriting the EGC's public offering. 15 USC §77b(a)(3).
- The conflict-of-interest rules generally applicable to the marketing of IPOs and communication between research analysts, investment banking personnel, and management do not apply to EGCs. 15 USC §78o–6(c).
- Research reports relating to EGCs may be published and distributed during any post-IPO quiet or lock-up periods. See Pub L 112–106, §105(d), 126 Stat 306.

## Private Placements: General Solicitation and General Advertising Now Permitted in Some Rule 506 and 144A Offerings

The JOBS Act removes prohibitions on general solicitation and general advertising when private companies conduct offerings under Rule 506 of Regulation D (17 CFR §230.506) and Rule 144A (17 CFR §230.144A) of the Securities Act. The SEC is required to modify Rule 506 of Regulation D and Rule 144A to eliminate the ban on general solicitation and general advertising in private offerings conducted under those rules if all purchasers of securities are accredited investors (for Rule 506 offerings) or qualified institutional buyers (for Rule 144A offerings). See Pub L 112–106, §201(a), 126 Stat 306. The modified rules will require companies to take reasonable steps to verify accredited-investor or qualified-institutional-buyer status. The verification methods companies must use will be determined by the SEC.

The JOBS Act also provides that individuals who maintain "platforms or mechanisms" that facilitate private placements under Rule 506 and engage in general solicitation or advertising, co-invest in securities, or provide certain "ancillary services" are not required (solely because they maintain a "platform or mechanism") to register as broker-dealers under the Exchange Act, subject to certain conditions. 15 USC §77d(b)(1).

## The New Crowdfunding Exemption

"Crowdfunding" is a method of raising capital in which the Internet is used by nonpublic domestic companies to publicly solicit a large number of small investments from individual investors. The JOBS Act creates a new crowdfunding exemption from registration under the Securities Act. Companies using this exemption must provide information on their financial status, business plan, risks to shareholders, and other matters. Significant requirements also are imposed on intermediaries in these offerings. Key conditions to this exemption include, among others (15 USC §77d(a)(6)):

- The aggregate amount sold to all investors, including amounts sold in reliance on the crowdfunding exemption during the preceding 12-month period, may not be more than $1 million.
- The aggregate amount sold to any investor, including amounts sold in reliance on the crowdfunding exemption during the preceding 12-month period, may not exceed (1) for an investor with either an annual income or net worth of less than $100,000, the greater of $2000 or 5 percent of the annual income or net worth of that investor; and (2) for an investor with either an annual income or net worth of at least $100,000, 10 percent of the annual income or net worth of that investor, not to exceed $100,000.

- Securities issued in a crowdfunding transaction will be "covered securities" and exempt from state blue sky registration requirements. 15 USC §77r.
- Securities issued in a crowdfunding transaction will be subject to transfer restrictions (with limited exceptions) for 1 year. 15 USC §77d–1(e).
- The issuer may not advertise the offering, although it may issue notices that direct potential investors to the issuer's designated broker or funding portal. 15 USC §77d–1(b)(2).

The SEC must adjust the dollar limitations at least once every 5 years. 15 USC §77d–1(h)(1). The company and brokers or funding portals must also comply with additional requirements that will be laid out by supplementary SEC rulemaking.

To rely on the crowdfunding exemption, issuers, 21 days in advance of sales, must file with the SEC and make available to investors and intermediaries basic information about the issuer's business, including the names of each of its directors and officers and of each individual holding more than 20 percent of its equity securities, a description of its business, anticipated business plan and financial condition, including income tax returns, and, for issuers seeking more than $500,000 in crowdfunding, audited financial statements. 15 USC §77d–1(a)–(b). An issuer must also provide to investors and the intermediary information about the transaction, including the target offering amount, the deadline to reach the target amount, regular funding progress reports related to the issuer's progress in reaching the target amount, as well as the final price of the security and a description of the intended use of the proceeds. 15 USC §77d–1(b)(1)(E)–(G). In addition, issuers must file specified reports with the SEC after the offering has completed.

A crowdfunding transaction must be conducted through an intermediary that is registered with the SEC as a broker or as a "funding portal," defined as

any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to [this exemption] that does not (15 USC §78c(a)(80)):

(A) offer investment advice or recommendations;

(B) solicit purchases, sales or offers to buy securities offered or displayed on its website or portal;

(C) compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;

(D) hold, manage, possess, or otherwise handle investor funds or securities; or

(E) engage in such other activities as the Commission, by rule, determines appropriate.

Brokers and funding portals acting as intermediaries in crowdfunding transactions must also comply with considerable disclosure requirements related to risk, investor education, and investor protection, the details of which will be determined by additional SEC rulemaking.

A broker or funding portal conducting a crowdfunding transaction must also, among other things (15 USC §77d–1(a)(3)–(8)):

- Provide such disclosures, including investor-education materials, as the SEC determines appropriate;
- Ensure that each investor (a) reviews the investor-education information, (b) positively affirms that the investor understands the risks of the investment, and (c) answers questions that demonstrate an understanding of the level of risk generally applicable to investments in startups and small issuers and the risk of illiquidity of such investments;
- Take measures to reduce the risk of fraud (which will be specified by future SEC rulemaking), including obtaining background checks on directors, officers, and any person holding more than 20 percent of the company's equity securities;
- Make available to the SEC and to potential investors any information provided by the issuer to investors and the intermediary, no later than 21 days before the first day securities are sold to any investor;
- Ensure that all offering proceeds are provided to the issuer only after the aggregate capital raised from all investors is equal to or greater than the target offering amount and allow all investors to cancel their commitments to invest; and
- Take steps, as the SEC determines appropriate, to ensure that no investor in a 12-month period has purchased securities pursuant to the crowdfunding rule in aggregate from all issuers that exceed the investment limits of the rule.

Registered funding portals are subject to limited regulation in the state in which their principal place of business is located. Other states are prohibited from regulating registered funding portals "with respect to its business as such." 15 USC §78o(i)(2).

The SEC must issue rules to carry out the various measures contained in this exemption within 270 days after the date of enactment of the JOBS Act. See Pub L 112–106, §302(c), 126 Stat 306.

### Increased Regulation A Threshold for "Mini-Public Offerings" From $5 Million to $50 Million

Regulation A (17 CFR §§230.251–230.263) provides an exemption from registration under §3(b) of the Securities Act (15 USC §77c(b)) for "mini-public offerings" of up to $5 million that meet certain conditions set forth in Regulation A. However, Regulation A is not available to reporting companies under the Exchange Act.

The SEC must amend Regulation A or create a new exemption from registration that has the following features (15 USC §77c(b)):

- Securities offerings of up to an aggregate of $50 million during any 12-month period will be exempt (instead of the previous $5 million cap). The $50 million limit is subject to review and increase by the SEC every 2 years.
- Issuers that rely on amended Regulation A or the new exemption must file audited financial statements with the SEC annually.
- The SEC may also require an issuer relying on amended Regulation A or the new exemption to file with the SEC and make available to investors periodic disclosures regarding business operations, financial condition, and corporate governance structure.

The JOBS Act clarifies that Regulation A securities are not "restricted securities" subject to restrictions on resale. However, unlike crowdfunding offerings, unless the securities offered under this exemption are offered or sold on a national securities exchange or to qualified purchasers, offerings under the new exemption or amended Regulation A will be subject to state blue sky laws.

### Increased Shareholder Threshold for Public Reporting

Previously, companies were required to register under the Exchange Act once their assets at year-end exceeded $10 million and their shares were held of record by more than 500 persons. The JOBS Act increased the threshold for shares held of record to 2000 persons in total or 500 persons who do not qualify as accredited investors. 15 USC §78*l*(g)(1)(A). However, under the JOBS Act, shareholders who obtained securities in a crowdfunding transaction and shareholders who acquire securities pursuant to the company's employee compensation plans in an exempt transaction are not counted against the shareholder threshold. 15 USC §78*l*(g)(5).

The JOBS Act further requires the SEC to examine whether new tools are necessary to enforce the anti-evasion provisions contained in the rules implementing the shareholder threshold. Pub L 112–106, §504, 126 Stat 306. These provisions allow beneficial owners of securities to be deemed the record owners for the purpose of counting against the shareholder threshold in situations where the issuer knows or has reason to know that the structure of holding securities of record is used primarily to circumvent the shareholder threshold (for example, securities held by special purpose vehicles). The SEC is required to give its recommendations to Congress within 120 days.

The JOBS Act also increased the shareholder threshold for banks and bank holding companies from 500 shareholders to 2000 shareholders. 15 USC §78*l*(g)(1)(A). Banks and bank holding companies may terminate or suspend registration and reporting requirements if the number of shareholders of record is reduced to fewer than 1200. 15 USC §78*l*(g)(4). As with private companies, persons who received shares pursuant to crowdfunding transactions and exempt transactions under the company's employee compensation plan do not count toward the 2000-shareholder threshold. 15 USC §78*l*(g)(5).

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