

## Securities Alert

APRIL 5, 2012

# JOBS Act to Ease Capital Formation for Public and Private Companies and Reduce Regulatory Burdens on Emerging Growth Companies

## Alert 2 of 2: Focus on Easing Capital Formation for Private Companies

On April 5, 2012, after overwhelming bi-partisan support in Congress but criticism from regulators and investor protection groups, President Obama signed into law the Jumpstart Our Business Startups Act (the JOBS Act). The JOBS Act significantly amends the federal securities laws to:

- reduce regulatory burdens on smaller “emerging growth companies” and the investment banking community that serves them,
- expand access by start-ups and other small companies to private and public sources of financing in the United States, and
- increase the thresholds under which private companies are required to register with the Securities and Exchange Commission (the SEC) and begin filing periodic public reports.

This alert focuses on the portions of the JOBS Act that are intended to spur additional private financing and provide regulatory relief from periodic public reporting. We have also prepared a separate alert that focuses on the portions of the JOBS Act that impact smaller public companies and public financing.

Congress enacted the JOBS Act for the express purpose of “increas[ing] American job creation and economic growth by improving access to the public capital markets for emerging growth companies.” The number of initial public offerings in the United States has fallen dramatically since 2000, in part because of increased costs of regulatory compliance as a result of the Sarbanes-Oxley Act of 2002 and other burdens, according to the IPO Task Force of the National Venture Capital Association, which has championed the JOBS Act’s reforms through the legislative process over the past year.

Although the JOBS Act will result in significant changes to the federal securities laws, many of the changes are not self-effectuating and require rulemaking by the SEC, which in some cases could take up to a year or longer to complete. Moreover, given that the SEC has expressed concerns about the JOBS Act’s loosening of existing regulations, the SEC could, in exercising its rulemaking authority, require changes that are more restrictive than what Congress has proposed if the SEC believes these changes are necessary for the protection of investors. We will monitor the rulemaking process and continue to provide further updates on these matters as they develop.

## Title II of the JOBS Act: Expansion of Marketing in Certain Private Offerings

Rule 506 of Regulation D provides an exemption from the registration requirements of the Securities

Act of 1933 (the Securities Act) that companies often utilize when raising capital through the private placement of securities. Similarly, Rule 144A provides an exemption from these registration requirements for certain private resales of previously issued securities.

Under Title II – Access to Capital for Job Creators – of the JOBS Act, the SEC has 90 days after the enactment of the JOBS Act to amend (1) Regulation D to allow general solicitations and general advertising in private placements conducted under Rule 506 if all purchasers in the offering are accredited investors and the company takes reasonable steps to verify that such purchasers are accredited investors using methods that the SEC will determine, and (2) Rule 144A to allow general solicitations and general advertising in private offerings conducted under Rule 144A if all purchasers in the offering are reasonably believed to be qualified institutional buyers (QIBs).

Title II of the JOBS Act also will exempt certain market participants in private placements conducted under Rule 506 from registering as a broker-dealer solely because (1) the person maintains a platform or mechanism that permits the offer, sale, purchase or negotiation of or with respect to securities or permits general solicitations, general advertisements or similar related activities by issuers, whether online, in person, or through other means, (2) any person associated with that person co-invests in the securities, or (3) any person associated with that person provides ancillary services with respect to the securities, provided, that in each case (a) such person and associated persons receive no compensation in connection with the purchase and sale of such security, (b) such person and associated persons do not have possession of customer funds, and (c) such person or any associated person is not subject to a statutory disqualification.

### Title III of the JOBS Act: Expansion of Alternatives: Crowdfunding – a New Exemption

Title III – Crowdfunding - of the JOBS Act will amend the Securities Act to provide a new exemption from securities registration for private companies raising capital in a “crowdfunding” – a private financing comprised of the pooled investments of many small investors. Companies will be allowed to raise up to \$1,000,000 within a 12-month period without registering the securities offered with the SEC, subject to certain restrictions. Companies raising between \$100,000 and \$500,000 will have to engage an auditor to “review” their financial statements, and companies raising over \$500,000 will need to provide investors with audited financials. For more information on this new offering exemption see our Venture Capital and Emerging Companies Alert, [Crowdfunding: One Step Closer to Reality](#).

### Title IV of the JOBS Act: Expansion of Regulation A under the Securities Act

Regulation A has provided private companies for many years with a streamlined process in which to sell securities by allowing scaled SEC disclosure requirements as compared to the traditional public offering and registration process. Additionally, a company does not become subject to the periodic reporting requirements under the Securities Exchange Act of 1934 (the Exchange Act), including the obligation to file Forms 10-K, 10-Q, and 8-K, solely by conducting an offering under Regulation A. However, Regulation A has not often been used by companies since it only allows the sale of up to \$5,000,000, including up to \$1,500,000 by certain selling shareholders, of securities in any 12-month period. Also, an offering under Regulation A is subject to state “blue sky” laws.

Title IV – Small Company Capital Formation – of the JOBS Act will require the SEC (although the Title does not set a timeframe for SEC action) to expand Regulation A or create a new similar exemption under which a company may sell in public or private offerings up to \$50,000,000, without a maximum for selling shareholders, of equity securities, debt securities, and debt securities convertible into equity in any 12-month period. However, the expanded rule will, among other things, subject a company to the civil liability provisions of Section 12(a)(2) of the Securities Act and require the filing with the SEC of annual audited financial statements. Through rulemaking, the SEC may also require that the company file with the SEC and distribute to potential investors an offering statement and may require the company to file additional periodic disclosures. If the securities are offered and sold on a national

securities exchange or to a qualified purchaser, the offer and sale will be exempt from state “blue sky” laws. In addition, within three months of the enactment of the JOBS Act a study must be completed assessing the impact of state “blue sky” laws on offerings made under Regulation A.

## Titles V and VI of the JOBS Act: Expansion of Shareholder Thresholds for Exchange Act Registration

The Exchange Act and the rules and regulations promulgated thereunder currently require a company to register under the Exchange Act and file periodic public reports if on the last day of its fiscal year the company had total assets exceeding \$10,000,000 and a class of equity securities held of record by 500 or more persons, excluding beneficial holders of shares held in “street name.”

Under Title V – Private Company Flexibility and Growth – and Title VI – Capital Expansion – of the JOBS Act, the thresholds for the number of shareholders of record a company may have before it must register under the Exchange Act will be increased significantly. Under the new thresholds in Title V, a company must register under the Exchange Act and become subject to its periodic disclosure requirements if on the last day of its fiscal year it had total assets exceeding \$10,000,000 and a class of equity securities held of record by 2,000 or more persons or by 500 or more persons who are not accredited investors.<sup>1</sup> Shareholders that received their securities pursuant to an employee compensation plan in a transaction exempt from registration under Section 5 of the Securities Act or through an offering conducted under the “crowdfunding” exemption in the JOBS Act (discussed above) will not count towards the holders of record thresholds. Although Title V mandates the SEC to make amendments to its rules and regulations to implement these changes, no time frame to do so is included in the statutory mandate.

In addition, within 120 days of the enactment of the JOBS Act, the SEC must make a recommendation to Congress as to whether it believes the current manner in which shareholders of record are determined for purposes of the thresholds discussed above should be altered (for example, whether beneficial holders of securities should be deemed holders of record).

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As noted above, the SEC is now charged with issuing rules to implement various sections of the JOBS Act. In many cases, the JOBS Act calls for these changes to take effect within 90 days or one year from the date on which the JOBS Act became law. Mintz Levin will continue to update its clients and friends on these rules and the effects of the multiple changes in this area as they develop.

If you have any questions regarding the matters discussed in this alert, please contact one of the attorneys listed below or your regular contact at Mintz Levin.

[Megan N. Gates](#)

[Pamela B. Greene](#)

[Daniel T. Kajunski](#)

[Brian P. Keane](#)

[Jonathan L. Kravetz](#)

[Scott A. Samuels](#)

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***[Click here to view Mintz Levin's Securities attorneys.](#)***

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### Endnotes

1. Under Title VI, the threshold will be increased to 2,000 or more persons for a bank or bank holding company and the number of shareholders of record a bank or bank holding company may have to deregister under Section 12(g) of the Exchange Act and suspend its reporting obligations under Section 15(d) of the Exchange Act will be increased from 300 (500 in certain circumstances) to 1,200. The JOBS Act did not change the 300 (500 in certain circumstances)

shareholder of record thresholds to deregister and suspend reporting obligations for companies that are not banks or bank holding companies. The SEC is mandated within one year of the enactment of the JOBS Act to make amendments to its rules and regulations to implement these changes with respect to banks and bank holding companies.

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