

US Securities Law Developments Under the JOBS Act



On 5 April 2012, President Barack Obama signed the Jumpstart Our Business Startups Act (the 'JOBS' Act). This new law materially changes existing federal securities laws and regulations governing raising new capital in the United States. This article briefly discusses the changes brought about by the JOBS Act, changes that may well alter the way in which public and private offerings of securities are conducted, and highlights provisions of the JOBS Act which may be of particular interest to non-US issuers.

Kenneth J Stuart

Becker, Glynn, Melamed & Muffly LLP

On 5 April 2012, President Barack Obama signed the Jumpstart Our Business Startups Act (the 'JOBS Act'). This new federal law, which materially changes existing laws and procedures involved in raising new capital in the United States, was designed to help smaller businesses have access to the capital markets, through reducing perceived impediments to capital formation and eliminating or reducing certain regulatory requirements for smaller companies going public. It was also supposed to promote job creation in the private sector. However, one former Securities and Exchange Commission (SEC) Commissioner, Roberta Karmel, has written in the *New York Law Journal*, 19 April 2012, that 'it is

unlikely that the JOBS Act will create any new jobs other than for lawyers'. She added that 'perhaps that result is not so bad'.

The following briefly discusses the major changes to existing federal securities laws and regulations brought about by the JOBS Act, changes that may well alter the way in which public and private offerings of securities are conducted. The concluding portion of this article highlights provisions of the JOBS Act which may be of particular interest to non-US issuers.

Elimination of the Current Ban on General Solicitation and Advertising in Rule 506 and Rule 144A Offerings

Issuers of securities in a private offering under Rule 506 of Regulation D adopted by the SEC under the Securities Act of 1933, as amended (the 'Securities

Act'), and in an offering which qualifies under Rule 144A adopted by the SEC under the Securities Act, can now engage in both general solicitation and advertising, so long as all purchasers are 'accredited investors' for offerings under Rule 506, and for offerings under Rule 144A the issuer has taken 'reasonable steps' to ensure that all purchasers are 'qualified institutional buyers' (QIBs). General solicitation and advertising can include, among other things, newspaper ads, television and radio broadcast pitches, outdoor billboards and use of the internet. The ability of issuers to engage in general solicitation and advertising in a private placement of securities is a very significant change from current SEC requirements.

However, since Rule 144A is not an issuer exemption but a resale exemption for underwriters, it is unclear how it will work with the issuer having to take reasonable steps to ensure that all purchasers in a Rule 144A offering are QIBs. It is equally unclear how issuers can be certain in a Rule 506 placement that all purchasers are in fact accredited investors.

These JOBS Act changes will not become effective until the SEC issues implementing Rules, which it is required to do by 5 July 2012. The SEC, through its rule making, is expected to impose additional requirements on issuers and provide interpretive guidance on what is or is not permissible in such offerings. In other words, what 'reasonable steps' must an issuer take to verify that it only sells to accredited investors or, indirectly, to QIBs.

The JOBS Act also permits establishment of 'platforms' for participants to advertise, solicit, negotiate and enter into transactions in Regulation D offerings without requiring the 'platform' to register with the SEC as a broker-dealer, provided the 'platform' does not receive transaction-based compensation or have possession of customer funds or securities in connection with transactions over the 'platform'. Any such 'platforms' can provide form documents for issuers to use in selling their securities, but they may not be involved in negotiating the documents with prospective investors on behalf of an issuer. Thus, internet platforms will be able to be used to offer and sell securities to the public without the platform having to register with the SEC.

Greater Threshold Before Having to Register Securities with the SEC Under the Securities Exchange Act of 1934, as Amended (the 'Exchange Act')

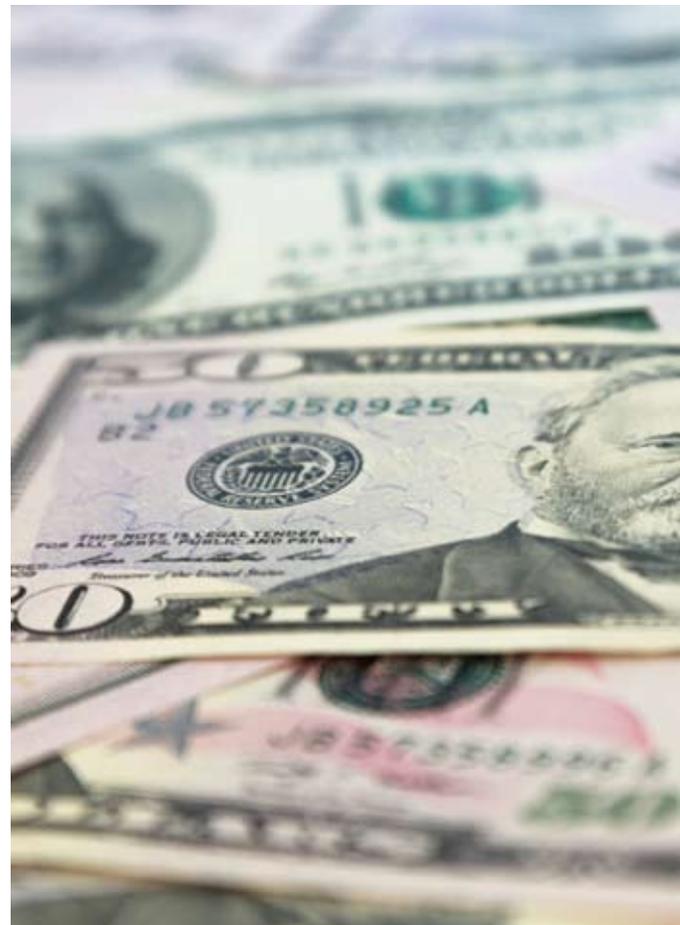
The JOBS Act substantially increases the number of securities holders of record threshold previously in effect which required an issuer to register its equity securities with the SEC under the Exchange

Act from 500 record holders to 2000 record holders, provided not more than 499 record holders are non-accredited investors, not including in this number any employee receiving issuer securities under equity compensation plans, and also not including persons purchasing securities under the new 'crowdfunding' provisions of the JOBS Act to be discussed later in this article. These amendments to ss 12(g) and 15(d) of the Exchange Act, which will enable companies to raise capital privately from a much greater pool of investors before having to register its shares under the Exchange Act and become a SEC reporting company, became effective upon enactment of the JOBS Act on 5 April 2012.

Emerging Growth Companies

The JOBS Act has significantly reduced, or made less onerous, the traditional registration and initial public offering (IPO) process, and the subsequent SEC reporting and regulatory burden, for so-called Emerging Growth Companies (EGCs).

An EGC is defined in the JOBS Act as any company that had total annual gross revenues of less than US\$1 billion in its most recently completed fiscal year, excluding an issuer whose IPO occurred on or before 8 December 2011. An EGC remains such until the earliest to occur of:



(i) the last day of the fiscal year in which its gross revenues exceed US\$1 billion; (ii) the last day of the fiscal year following the 5th anniversary of its IPO; (iii) the date on which it becomes a large accelerated filer (having a public float of over US\$700 million) with the SEC; and (iv) the date on which it has, during the previous three-year period, issued more than US\$1 billion in non-convertible debt securities.

EGCs are: (a) permitted to file registration statements with the SEC for an IPO on a non-public or confidential basis, so long as the public filing is made at least 21 days before the road show for the IPO; (b) permitted to ‘test the waters’ by holding meetings with institutional accredited investors and QIBs to evaluate interest in an upcoming IPO without being subject to current limitations on pre-offering communications; (c) required to present only two years (instead of three years) of audited financial statements and selected financial information in an IPO registration statement; (d) exempt from Sarbanes-Oxley s 404(b) requiring auditor attestation of internal controls over financial reporting; (e) exempt from shareholder advisory votes on executive compensation (‘Say or Pay’), and from certain proxy disclosure requirements relating to executive compensation, and can otherwise

comply only with the compensation disclosure requirements applicable to ‘smaller reporting companies’; (f) exempt from compliance with new US GAAP accounting pronouncements applicable to Exchange Act reporting companies until such pronouncements also become applicable to private companies; and (g) exempt from any future Public Company Accounting Oversight Board rules mandating auditor rotation or making modifications to the auditor report.

Regulation A-Type Offerings Expanded

The JOBS Act increased the maximum amount of proceeds that can be raised pursuant to a Regulation A offering under the Securities Act from US\$5 million to US\$50 million in any 12-month period by adding a new s 3(b)(2) to the Securities Act. Securities sold in a s 3(b)(2) offering will not be restricted and may be publicly resold. The SEC is required to adopt rules under the new s 3(b)(2) of the Securities Act to implement this change.

Issuers relying on this exemption will be required to file electronically with the SEC and distribute to prospective investors an offering statement with audited financial statements and such other appropriate information as the SEC may require, likely to include a description of the company’s business and operations, risk factors, use of proceeds and corporate governance principles. However, the issuer will not be required to file periodic reports with the SEC pursuant to the Exchange Act. Nevertheless, the SEC is authorized to adopt rules that require any such issuer to file and make available to its investors periodic reports regarding the issuer’s business operations, financial condition, use of proceeds and corporate governance principles.

The Comptroller General is required by the JOBS Act to report back to Congress within three months of enactment on any necessary amendments to state blue sky laws regarding Regulation A. Currently, only Rule 506 offerings are exempt from state regulation and control of investor suitability issues and permissibility within the particular state of the offering, raising a question of possible state blue sky regulation of the expanded Regulation A offerings.

Crowdfunding

Crowdfunding is basically the term applied to raising money for a common cause or venture through relatively small contributions from a large number of people. This form of capital raising has generally been used by start-ups and hopeful entrepreneurs. More recently, crowdfunding moneys are being raised through social networking sites like Facebook, Twitter or LinkedIn, or through funding portals such as Kiva (www.kiva.org)



or Kickstarter (www.kickstarter.com). Those providing moneys through crowdfunding have not typically been traditional investors, since they did not receive a profit participation in the businesses they funded, and thus did not trigger securities law issues. Typically, they were customers of the issuer, friends, family and others solicited on the social networking sites.

More recently, however, crowdfunding has been offering those who contribute a return on investment capital, and thus such 'offerings' would require Securities Act registration or an exemption from registration – which was not available – and the 'portals' (intermediaries) who provided the platform for raising funds through crowdfunding would have to register with the SEC as broker-dealers. The JOBS Act adds a new s 4(6) to the Securities Act which permits non-SEC reporting issuers to raise capital from non-accredited investors without registering the securities being sold, provided no more than US\$1 million can be raised in any 12-month period using this and all other exemptions. Additionally, the aggregate amount that can be raised from any one investor in any 12-month period and cannot exceed the greater of: (i) US\$2000 or 5% of the annual income or net worth of the investor (if either is less than US\$100,000); or (ii) 10% of the annual income or net worth of the investor, not to exceed a maximum amount sold to such investor of US\$100,000 if either annual income or net worth is US\$100,000 or more.

Under the JOBS Act, for crowdfunding to qualify for the new s 4(6) exemption, the funds being raised must involve a SEC registered broker-dealer or a 'funding portal' that complies with requirements to be promulgated by the SEC. Moreover, companies raising more than US\$500,000 under s 4(6) in any 12-month period are required to file with the SEC and provide investors and the broker or 'funding portal' used to raise the funds with audited financial statements. Companies raising between US\$100,000 and US\$500,000 will need to provide financial statements that have been reviewed, but not audited, by an independent public accountant. Those companies raising less than US\$100,000 will need to provide income tax returns for its most recent year and financial statements certified by the issuer to be true and complete in all

material respects. In addition, the filings with the SEC and information provided to investors and the relevant broker-dealer or funding portal must include, among other things, disclosure regarding the company's business, plan of operations, capital structure, officers, directors and principal shareholders, risk factors, intended use of proceeds and targeted offering amount.

The SEC is required by the JOBS Act to adopt within 270 days of enactment such rules as it may deem appropriate to carry out the new ss 4(6) and 4A of the Securities Act, which covers broker-dealers and funding portals acting as intermediaries in crowdfunding offers and sales of securities.

Provisions of the JOBS Act of Particular Interest to Non-US Issuers

The JOBS Act does not distinguish between US and non-US issuers with respect to EGCs. Thus, a non-US issuer which qualifies as an EGC can take advantage of a more expeditious and possibly less onerous IPO process, with fewer disclosure requirements both during registration and in its subsequent SEC reporting obligations.

Also, as previously described, a non-US issuer offering and selling its securities in a Rule 506 or in a Rule 144A offering will, after adoption of the mandated rules by the SEC, be able to engage in general solicitation and advertising with respect to its offering, provided all of the purchasers in the Rule 506 offering are accredited investors and that all purchasers in the Rule 144A offering are reasonably believed by the issuer to be QIBs.

Similarly, non-US issuers are eligible to take advantage of the increase to US\$50 million of securities permitted to be sold without formal SEC registration within a 12-month period under Regulation A. While a Regulation A offering is generally a shorter and simpler process than full registration, it is not yet clear how the SEC will implement the expanded Regulation A availability.

Finally, non-US issuers are not eligible to raise capital in the US under the new crowdfunding exemption in s 4(b) of the Securities Act. Further, as noted previously, crowdfunding must be conducted through a broker-dealer or funding portal that is registered with the SEC and the applicable self-regulatory organization, thereby excluding non-US broker-dealers and funding portals from participating in crowdfunding offerings in the US.