

**BUSINESS LAW**  
**CLIENT E-ALERT**  
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**ON YOUR MARK, GET SET, JUMPSTART:  
THE NEW JOBS ACT AIMS TO OPEN DOORS  
FOR SMALL COMPANIES**

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**INTRODUCTION**

On April 6, 2012, President Obama signed into law the Jumpstart Our Business Startups (JOBS) Act, which is intended to facilitate job growth by increasing access to private and public capital. The JOBS Act can be broken into five principal subparts:

- ▶ [Easing Emerging Growth Companies' Entry Into Public Markets;](#)
- ▶ [Allowing General Solicitation Under Regulations D and 144A;](#)
- ▶ [Creating a New Exemption for Crowdfunding;](#)
- ▶ [Enhancing Exemptions for Smaller Public Offerings;](#) and
- ▶ [Increasing the Permitted Number of Shareholders for Private Companies.](#)

**▶ EASING EMERGING GROWTH COMPANIES' ENTRY INTO PUBLIC MARKETS**

An IPO Task Force assembled by the U.S. Treasury Department to research the IPO landscape found that companies were deferring public offerings because the regulatory burdens outweighed the benefits of tapping the public investment market. As a result, the JOBS Act amends the federal securities laws to create a new category of securities issuer known as emerging growth companies (EGCs). The JOBS Act gives EGCs an IPO on-ramp that phases in certain disclosure requirements and other regulatory burdens.

An EGC is an issuer with total annual gross revenues of less than \$1 billion. EGCs will continue to hold this status until the earlier of five years following an IPO or when specified thresholds are met. The JOBS Act benefits EGCs by (i) permitting certain pre-registration communications with investors, (ii) allowing confidential treatment of initial, pre-IPO registration statement filings made with the Securities and Exchange Commission (SEC), and (iii) deferring certain reporting and other obligations that apply to public companies.

For ECGs, these changes should reduce the cost of conducting an IPO and operating as a public company. In addition, the changes may alleviate concerns about making premature public disclosure of financial statements and other material non-public information prior to a company gaining a more full assessment of the receptivity of the public markets to its proposed IPO. In our opinion, these are real, substantive changes that should tend to increase the volume of IPOs.

## ▶ ALLOWING GENERAL SOLICITATION UNDER REGULATIONS D AND 144A

The JOBS Act removes the prohibition against general solicitation and general advertising in private offerings under Rule 506 of Regulation D, provided the issuer verifies that all purchasers of the securities are accredited investors, as defined in the securities laws. The SEC will adopt rules to outline the steps necessary for verification. General solicitation and general advertising will also be permitted in secondary sales under Rule 144A for qualified institutional buyers, as defined in the securities laws. The JOBS Act directs the SEC to adopt rules implementing these changes within 90 days of enactment. Until such time, companies should proceed in accordance with the existing prohibitions against general solicitation and general advertising.

The JOBS Act also clarifies that persons who maintain online or other platforms to conduct Rule 506 offerings that use general advertising or general solicitation will not, by virtue of this activity, be required to register as a broker or dealer under the Exchange Act. This exemption applies provided that the matching services do not: (i) receive transaction-based compensation; (ii) take possession of customer funds or securities; or (iii) participate in documentation.

As a result of these changes, issuers may market Rule 506 and 144A offerings through advertisements in newspapers and online, marking a change in the way companies solicit capital. These changes will likely result in the creation and expansion of platforms for matching emerging companies with potential investors. We view such platforms as an important step in the evolution of capital formation. Issuers and intermediaries may need to revise screening procedures and materials used in relevant private offerings depending on the SEC's rulemaking with respect to the reasonable steps required to ensure that purchasers are accredited investors or, with respect to Rule 144A offerings, qualified institutional buyers.

## ▶ CREATING A NEW EXEMPTION FOR CROWDFUNDING

Crowdfunding (also referred to as crowd financing or crowd-sourced capital) is an increasingly popular method of raising capital for start-ups and other projects, such as charities and films. It entails pooling relatively small investments from a large number of people, typically via the Internet or social media. Because crowdfunding does not fit neatly into existing registration exemptions, the JOBS Act adds a new exemption under Section 4(6) of the Securities Act. This exemption gives start-ups greater access to capital by facilitating the access of non-accredited investors to early financing rounds. To balance the concerns for fraudulent investment practices, the JOBS Act imposes restrictions and reporting requirements on crowdfunding issuers, which, although potentially expensive and time consuming, are intended to be less intrusive than other financing alternatives. The reporting obligations will include requiring the issuer to file with the SEC, and for the broker or funding portal to make available to potential investors, a description of the issuer's business and financial condition, as well as information about the offering, such as the use of proceeds and the method for determining the offering price. Crowdfunding issuers will also need to file financial information with the SEC on an ongoing basis and make such information available to investors.

The crowdfunding transaction must be conducted through a broker or funding portal complying with the requirements of Section 4A(a) of the Securities Act. Issuers may not advertise the terms of the crowdfunding offerings, except by directing investors to the funding portal or broker. Funding portals will not be subject to registration as a broker-dealer, but will be subject to an alternative regulatory regime, to be determined by the SEC or a Self Regulatory Organization authority. Section 4A(a) requires brokers or funding portals to facilitate the disclosure process and take measures to reduce the risk of fraud. The JOBS Act also adds the term “funding portal” to the defined terms in Section 3(a) of the Exchange Act, which limits the scope of permissible activities in which a funding portal may engage.

Importantly, crowdfunding securities will be covered securities, exempting them from state blue sky registration requirements. Nonetheless, securities issued under the crowdfunding exemption will be deemed “restricted securities” and may not be transferred during the one-year period from the date of the purchase, except in limited circumstances. In addition, the state securities law exemption will not limit states’ jurisdiction to take enforcement action against funding portals, brokers or issuers for fraud or other unlawful conduct. The exemption restricts the amount a company relying on this exemption may raise in any 12-month period to \$1 million and the amount of money any single investor may invest, based on annual income or net worth with a cap of \$100,000. The exemption will not be available to: (i) non-U.S. issuers; (ii) reporting companies; (iii) investment companies; or (iv) companies excluded from the definition of “investment company” under certain sections of the Investment Company Act of 1940. The SEC has 270 days to issue rules governing the crowdfunding exemption. Until such time, the crowdfunding exemption is not available.

The crowdfunding provisions are intended to help entrepreneurs and early-stage companies that generally cannot access traditional capital markets and venture capital financing by promoting investment from a broader group of investors through the Internet and social media. Given the restrictions and reporting requirements, issuers must weigh the costs of compliance against the benefits of reaching a broader pool of investors.

## ► ENHANCING EXEMPTIONS FOR SMALLER PUBLIC OFFERINGS

The JOBS Act directs the SEC to amend Regulation A, or to adopt a new regulation, to exempt securities offerings of up to \$50 million. The existing Regulation A has not been widely utilized, in part because offerings are limited to \$5 million and state securities laws apply. Accordingly, the JOBS Act is intended to provide for a modernized and more useful version of the existing Regulation A.

The JOBS Act requires the SEC’s enhanced exemption to provide that:

- The aggregate amount of securities issued under Regulation A may not exceed \$50 million in any 12-month period;
- Issuers must file audited financial statements annually with the SEC;
- The securities may be offered or sold publicly, including through solicitations of interest before a written offering document is prepared, in accordance with the SEC rules;
- The securities will not be considered restricted securities, meaning there will not be a holding period on resales; and

- The securities will be considered covered securities such that state securities laws are preempted, as long as the securities are either offered or sold on a national securities exchange or sold only to qualified purchasers (to be defined by the SEC).

Issuers may increasingly rely on this enhanced exemption as an alternative to a registered initial public offering or a Regulation D private placement. There is no timeline for the SEC's rulemaking, so the impacts and burdens of this exemption remain to be seen. We anticipate the enhanced exemption will include requirements for a detailed issuer offering circular.

## ► INCREASING THE PERMITTED NUMBER OF SHAREHOLDERS FOR PRIVATE COMPANIES

The JOBS Act increases the number of shareholders a company may have before it must register and comply with the reporting requirements under the Exchange Act. This amendment is effective immediately and does not require further SEC rulemaking.

Changes have also been made to the "held of record" definition. Securities held by recipients under an employee compensation plan in a transaction exempt from registration are not considered held of record for purposes of the record holder calculations. Securities issued under the new crowdfunding exemption are also excluded from the calculations. The SEC must issue rules implementing the changes, but, despite the required rulemaking, issuers may immediately begin to exclude these holders from record holder calculations. These changes may lead to an increase in the number of private company shareholders and to more secondary market trading of private securities.

## CONCLUSION

The JOBS Act is intended to facilitate investment by creating and amending a number of private offering exemptions under the federal securities laws. It also eases the burden on companies conducting an IPO by decreasing regulation and disclosure requirements before and after the offering. Companies seeking private capital, as well as those contemplating a public offering, should consider these changes to the securities laws and how the JOBS Act may affect their fundraising and growth plans.

If you have questions about this Business Law Alert, please contact [Andrew D. Myers, Esq.](#) in our [Business Law Practice Area](#). [Michael V. Serra, Esq.](#), an associate at the firm, contributed to this article.

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