

**A User Friendly Primer on the JOBS Act
For the Business Person and the Capital Raiser**

The JOBS Act (Jumpstart Our Business Startups Act), signed into law on April 5, 2012, has several parts.

- It will help companies with annual sales under \$1,000,000,000 go public and file periodic reports with the SEC for up to five years after they go public.
- It will help a company making a private placement.
- It creates a crowd funding source for raising capital. Offerings under this part do not have to be registered with the Securities and Exchange Commission (SEC) or any state, but they are subject to a maximum of \$1,000,000 in any 12 months.
- It raises the limits for the small offering registration requirements under Regulation A of the Securities Act of 1933 (Securities Act) to \$50,000,000, and such offering is exempted from state registration requirements.
- The standard for when a company has to register a class of its securities under the Securities Exchange Act of 1934 (Securities Exchange Act) has been raised.

Companies with less than \$1,000,000,000 in Annual Sales

A company with less than \$1,000,000,000 in annual sales that has not previously sold securities to the public (defined in the Act as an “emerging growth company”) will have an easier way to go public. Audited financials for two years will be required, as opposed to the current requirement of three (3) years of audited financial statements. It may file its registration statement on a confidential basis—i.e. it is not publicly available, and get SEC comments. It would have to file its publicly available registration statement at least 21 days in advance of its first road show for prospective investors. In addition, the company can have “testing the water” meetings with qualified institutional buyers (entities with assets under management of \$100,000,000) and institutions that are accredited investors to determine if they have an interest in a proposed offering before or after a publicly available registration statement is filed with the SEC.

Additional provisions that do not apply for up to five years after the initial public offering are:

- Changes to GAAP do not apply to it until they apply to a company that is not publicly held;
- It does not have to have a “say on pay” shareholder vote;
- The required management discussion and analysis does not have to cover executive compensation;
- If the PCAOB adopts mandatory rotation of accountants, this will not apply to these companies; and
- The required auditor attestation as to internal controls does not apply.

The SEC and the Financial Regulatory Authority (FINRA) are required to amend the investment analyst rules to increase when analysts may communicate with issuers and investors.

Easing the Private Placement Process

The Act requires the SEC to amend Rule 506 of Regulation D to allow advertising of proposed placements if sales are made only to accredited investors.¹ In addition, Rule 144A is to be amended to allow general solicitation of sales under this rule.²

The Act provides that an entity that operates a platform for sales under Rule 506 would not have to register with the SEC as a broker-dealer because it makes offers and sales, general solicitations, advertising, of offers and sales under Rule 506, co-investing in the offering, and providing ancillary services, for a fee, regarding such securities if it meets the following conditions:

- it could not be compensated for the sale of the securities—i.e. no success fees;
- it can be paid for conducting due diligence and providing standardized documents for the issuers and investors (but not negotiating the terms of the offering or requiring the parties to use its standardized documents); and
- it cannot hold customer funds or securities in connection with the offering.

Crowd Funding

The JOBS Act permits sales of securities without having to register the sales under the Securities Act if (a) the aggregate amount sold by an issuing company in any 12 months is not more than \$1,000,000, and (b) the aggregate amount sold to any investor in 12 months is the lesser of (i) \$2,000 or 5% of the investor’s annual salary or net worth if

¹ Until such an amendment is adopted the current rule applies—sales to an unlimited number of accredited and up to 35 non-accredited investors, unlimited amount to be sold, no general solicitation and file Form D with the SEC and every state where a sale is made.

² Rule 144A allows resales of securities to qualified institutional buyers-- generally entities with at least \$100 million in assets under management, without having to register the offering under the Securities Act of 1933. However, it is not available for sales by issuers.

both are less than \$100,000, or (ii) \$100,000 or 10% of the investor's annual income or net worth when either is equal to or more than \$100,000.

To qualify for this exemption the intermediary has the following obligations:

- it must either be an SEC registered broker and a member of FINRA or register with the SEC as a crowd-funder and join an SEC registered self-regulatory organization;³
- it must provide prospective investors with investor educational materials as prescribed by the SEC and materials regarding the risks of such investments;
- ensure that the investors review the investor educational material and understand the risks of such investments, including the risks of investing in start-ups, emerging businesses and small issuers, the lack of liquidity of such investments, and the possible loss of their investment;
- check on the background of the company's principals and 20% or more shareholders;
- make available to the SEC and prospective investors at least 21 days before the first sale the information required from the company (see below);
- assure that if the target amount or a greater amount is raised that all the offering proceeds are given to the company;
- assure that no investor invests more in all securities offered under this exemption in a 12 month period than is allowed;
- can not compensate any promoters, finders or lead generators for finding potential investors;
- its officers, directors, partners can not have a financial interest in the companies using its services; and
- such other requirements as the SEC prescribes.

A company that wants to take advantage of this exemption must be a domestic entity—i.e. no foreign companies, and does not file periodic reports with the SEC under the Securities Exchange Act of 1934. The company must make the following disclosures, file them with the SEC and give them to investors and the sales intermediary:

1. its name and physical and web site addresses;
2. names of its officers, directors and shareholders with more than 20% of its shares;
3. describes its business and anticipated business plan;
4. describes its financial condition and any offerings in the prior 12 months, and financial information—(a) if the offering is for \$100,000 or less—its most recent income tax return and a financial statement certified as true and correct in all material respects by the issuer's principal executive officer; (b) for offerings between \$100,000 and \$500,000—financial statements reviewed by an independent public accountant; and (c) over \$500,000 audited financial statements;

³ There is no self-regulatory organization currently organized or registered with the SEC for crowd-funders. The existing self-regulatory organizations are the national securities exchanges, FINRA, the clearing agencies and the Municipal Securities Rulemaking board.

5. describes the purpose and intended use of the proceeds;
6. states the targeted amount, deadline to reach it and provides periodic updates of progress in meeting these goals;
7. price to the public of the security offered;
8. description of the ownership and capital structure of the company, including the terms of the securities being offered and the differences between these securities and any other class of the company's securities as well as how these rights can be changed;
9. identify each holder of 20% or more of any class of securities and their holdings;
10. how the offered securities were valued and how they may be valued in the future by the company;
11. the risks to the purchasers of a minority interest in the company; and
12. such other information as the SEC may prescribe.

The issuing company can not advertise the offering other than to direct investors to the funding portal. Finally, the issuer can not compensate anyone to promote the offering, such as through a broker or a crowd-funding portal except pursuant to SEC rules requiring disclosure of such compensation.

A company that has sold securities in reliance on this exemption is required to file at least annually with the SEC and furnish investors the results of its operations and financial statements, as the SEC may prescribe by rule. The SEC is authorized to adopt such additional rules as it deems necessary for the protection of investors and in the public interest.

An investor buying securities under this exemption can not transfer the security for the first year other than to the issuing company, an accredited investor, as part of a public offering registered with the SEC, or to a family member in connection with death or divorce.

Crowd-funding portals need not register with the SEC as a broker-dealer, but are subject to SEC rulemaking and the rules of the national securities association to which they must belong that are specifically applicable to registered funding portals. Crowd-funding portals cannot:

- a) offer investment advice or recommendations;
- b) solicit orders for securities displayed on its web site;
- c) compensate others for making solicitations based on the sale of securities displayed; or
- d) do such other things as the SEC proscribes.

Sales under this exemption are excluded from state blue sky registration requirements, but not the state anti-fraud and unlawful broker-dealer conduct laws. Further, states can not require the payment of any fees for the sale of these securities except the state of the issuing company's principal place of business and any state in which 50% or more of the purchasers of the security reside. Crowd-funding portals may only be examined and enforcement action taken by the state in which it has its principal place of business, and is

subject to that state's laws and rules but only to the extent these laws are not in addition to or different from the requirements for funding portals registered with the SEC.

Small Offering Exemptions

The SEC is required to amend its rules under Securities Act of 1933 section 3(b) to allow a company to make public offerings of up to \$50,000,000 in any 12 month period.⁴ Securities sold under section 3(b) will not be restricted as to their resale, and the issuer will not be required to file periodic reports with the SEC under the Securities Exchange Act. Companies will be allowed to solicit interests, on such terms as the SEC prescribes, prior to filing any offering statement. Companies relying on this exemption have to file with the SEC annual audited financial statements. The SEC is to adopt rules requiring these companies to file electronically with the SEC and distribute to prospective investors an offering statement and related documents as the SEC prescribes including audited financial statements, describing the company's business operations, financial condition, corporate governance principals, use of proceeds, and other appropriate matters. To use this exemption the company's officers, directors, affiliates, underwriters and other related persons can not have been previously sanctioned by a state or federal governmental agency. Further, the securities offered must be equity or debt securities, including debt securities convertible into or exchangeable for equity securities.

The SEC is authorized to require companies relying on this exemption to file and make available to investors periodic reports regarding the issuer, its business operations, its financial condition, its corporate governance principles, and use of investor funds. Securities offered and sold in reliance on this exemption are not exempt from state blue sky law registration/qualification requirements.

SEC Company Registration

Companies that as of the end of their fiscal year (i) have more than \$10,000,000 in assets, and (ii) have a class of securities with either 2,000 or less holders of record or 500 or less holders of record who are not accredited investors, as the SEC may define, do not have to register their securities with the SEC under the Securities Exchange Act of 1934, and be subject to the periodic reporting, proxy, and officers, directors and 10% shareholder reporting requirements. Securities held of record by persons who received the securities in transactions pursuant to an employee compensation plan exempted from the Securities Act registration requirements and persons who purchased in a crowd-funding transaction are not counted for this purpose.

Analysis

The relief for the emerging growth companies will become very useful once these provisions are implemented by SEC rulemaking and interpretations. The platform for sales under the expanded private placement exemption is not likely to be attractive unless

⁴ The current limit is \$5,000,000.

the SEC allows it to be compensated for its successful sales efforts—e.g. collect a commission from the investors. Crowd-funding is subject to the same disadvantage—no success fees to the crowd-funding source, unless it is allowed to collect a fee from investors. The SEC could solve these problems if it adopted the American Bar Association’s Special Study recommendation of a form of broker-dealer-light registration for private placement agents. Once the SEC adopts the rules to implement the Act’s provisions for Regulation A offerings there could be a substantial increase in their use, assuming companies are comfortable with the required annual audit requirement and with the periodic reporting requirements of the Act. In addition, offerings under Regulation A would likely not be an initial public offering precluding the company from using the emerging growth company provisions, and would not subject to the company to the periodic reporting obligations under the Securities Exchange Act that apply to a company making a public offering. Whether companies eligible to do so will take advantage of the requirement not to register a class of its securities under the Securities Exchange Act is a question of whether there are satisfactory alternative trading markets for their securities. Companies with no securities registered under the Securities Exchange Act can not have their securities traded on a stock exchange.

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