

PUBLICATION

Impact of the JOBS Act on Public Companies (No. 2) [Ober|Kaler]

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A periodic bulletin keeping small businesses informed about current developments in securities law and related matters.

President Obama signed the Jumpstart Our Business Startups Act (Act) into law on April 5, 2012. This Bulletin discusses the new law's impact on private companies (i.e. companies that are not required to file reports with the Securities and Exchange Commission (SEC)). For a discussion of the provisions of the Act impacting public (SEC reporting) companies, please see our [April 2012 Bulletin, "Impact of the JOBS Act on Public Companies."](#)

Threshold Triggering SEC Registration and Reporting

Companies that publicly offer and sell securities pursuant to a registration statement under the Securities Act of 1933 are required to file reports with the SEC under the Securities Exchange Act of 1934, including annual, quarterly and current reports and annual proxy statements, among other things. Even companies that have never publicly offered and sold their securities, however, are required to register their securities under the Exchange Act if they have \$10 million in assets and, prior to the Act, a class of securities held by record of 500 or more persons, and file reports with the SEC under the Exchange Act subsequent to such registration. The Act increases the holders of record threshold for mandatory Exchange Act registration to 2,000 holders of record for banks and bank holding companies and, for all other companies, to 2,000 holders of record or 500 holders of record who are not accredited investors as defined by the SEC (in general, accredited investors include natural persons with income of \$200,000 or \$300,000 with their spouse or a net worth (excluding their primary residence) exceeding \$1 million and certain institutions). In addition, persons receiving securities under an employee compensation plan exempt from the registration requirements of the Securities Act, and persons holding securities acquired under the "crowdfunding" exemption discussed below, will not count towards the holders of record registration threshold.

In general, SEC reporting companies may terminate their Exchange Act registration and suspend their reporting obligations if the number of holders of record of the applicable class of their security (often common stock) falls below 300. For bank and bank holding companies only, the Act increases the deregistration threshold to 1,200 holders of record. For all other companies, the deregistration threshold remains at 300 holders of record.

"Crowdfunding"

As our readers know, any offer or sale of securities must be registered or exempt from registration under both the Securities Act and any applicable state securities laws. The Act creates a new exemption from registration (to be implemented by SEC rule within 270 days of the Act's passage) for offers and sales of up to \$1 million within any 12-month period, provided that the amount raised from any single investor cannot exceed (i) the greater of \$2,000 or 5% of the annual income or net worth of the investor, if the investor's income or net worth is less than \$100,000, or (ii) 10% of the investor's annual income or net worth (maximum \$100,000) if the investor's annual income or net worth is \$100,000 or more (these amounts will be subject to adjustment for

inflation). This new exemption will only be available to companies that are not required to file reports with the SEC under the Exchange Act and is not available to investment companies. "Crowdfunding" offerings will be exempt from the registration provisions of state securities laws, and the securities sold in such offerings will be restricted from transfer for one year, except for transfers (i) to the issuer, (ii) to an accredited investor, (iii) as part of an offering registered with the SEC, or (iv) to a family member or in connection with the death or divorce of the purchaser.

Companies that wish to use this new exemption may conduct offers and sales only through a registered broker or a registered "funding portal" that complies with the requirements set forth in the Act, and must file with the SEC and provide to potential investors (and the funding portal) certain required information as set forth in the Act, including general information about the company, a description of its business and financial condition, financial statements (which must be audited if the offering exceeds \$500,000), the stated purpose and use of proceeds of the offering as well as the target offering amount, the price and a description of the securities being offered, the names of its officers, directors and persons who own more than 20% of its shares, certain risks with respect to such investment, and "such other information as the [SEC] may, by rule, prescribe for the protection of investors and in the public interest." Companies will not be permitted to advertise the offering other than notices directing investors to the funding portal or broker through which the offering is conducted. Companies who use this exemption will also be required to file with the SEC and provide to investors annual reports of the results of its operations and its financial statements, subject to such exemptions and termination dates as the SEC determines, and comply with any other requirements the SEC imposes with respect to such exemption.

Companies who utilize this exemption will be liable for material misstatements and omissions under the anti-fraud provisions of the Exchange Act, and subject to private rights of action in this regard. As a result of this liability provision and the Act's provisions with respect to information that must be provided to potential investors, we expect that issuers using this exemption will provide rather fulsome offering documents to potential investors in a crowdfunding offering similar to those currently used in Rule 506 private placements or even Regulation A offerings.

The Act defines a new category of intermediaries, a "funding portal." As noted above a crowdfunding offering must be conducted through a registered broker or funding portal, and any intermediary that participates in such an offering must be a registered broker or funding portal. Such an intermediary must also register with any applicable self-regulatory organization, comply with any other rules the SEC adopts in this regard, and provide information to potential investors in a crowdfunding offering, including relating to risks and investor educational materials, as the SEC determines. Such intermediaries must also take certain other actions as outlined in the Act, including affirming that each investor understands it could lose its entire investment and can bear such loss, taking measures to reduce the risk of fraud, ensuring that all offering proceeds are provided to the company selling securities only when the aggregate proceeds are equal to or exceed the target amount, ensuring that no single investor exceeds the investment limits discussed above, in aggregate, with respect to all offerings by all companies using the exemption, providing the required company information to potential investors, and complying with any other requirements the SEC prescribes by rule.

Certain "bad actors," including persons and entities subject to a final order that bars them from association with a regulated entity or engaging in the business of securities, insurance or banking, subject to an order based on violation of a law or regulation prohibiting fraudulent behavior, or convicted of a felony or misdemeanor in connection with the offer or sale of a security or the making of a false filing with the SEC will not be eligible to offer securities under the new "crowdfunding" exemption or participate as an intermediary with respect thereto.

Rule 506 Private Placements

Currently, the most-often used registration exemption is Rule 506 adopted under the Securities Act, which exempts from registration (under federal and state law) offers and sales of securities made solely to "accredited investors" and up to 35 non-accredited investors who are not accredited but that "either alone or with his purchaser representative(s) has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment." The Act loosens the restrictions on general advertising and general solicitation with respect to Rule 506 offerings by providing that such restrictions will not apply to such offering where all of the purchasers are accredited investors. The SEC must amend its rules in this regard within 90 days of passage of the Act. Such amended rules must require a company relying on this exemption to take "reasonable steps" to verify that the purchasers are accredited investors; this may require companies to go beyond the current standard of solely requiring purchasers to self-certify that they qualify as accredited investors. The Act requires the SEC to similarly amend its rules with respect to the exemption for private resales to qualified institutional buyers pursuant to Rule 144A under the Securities Act.

"Regulation A+" Offerings

The Act authorizes the SEC to create a new exemption from registration for offers and sales of up to \$50 million (subject to increase for inflation) of equity securities, debt securities and convertible debt securities within any 12-month period. Such securities may be offered and sold publicly and will be freely re-salable. Like current Regulation A, which exempts offerings of up to \$5 million in any 12-month period, companies will be required to prepare, file with the SEC and distribute to potential investors an offering statement and will be permitted to "test the waters" to solicit interest in the offering prior to filing. Unlike current Regulation A, the new exemption will not be limited to non-SEC reporting companies, although such companies that take advantage of the new exemption will be subject to some periodic disclosure reporting requirement to be set forth in the SEC rule adopting the exemption. Companies that take advantage of the exemption and sell the securities on a national securities exchange (an option not available to non-SEC reporting companies) or solely to qualified purchasers, as defined by SEC rule, will be exempt from state registration/exemption requirements. Otherwise, companies will have to register the offering in the states in which they plan to offer and sell the securities, unless another exemption is available under applicable state(s) law.

Although details will be provided by the SEC pursuant to a rulemaking, once implemented, this new offering exemption should be very helpful to small- and mid-size banks and holding companies who are struggling to raise capital but do not want to go through the full-blown SEC registration process.