



JOBS Act: Important Benefits for Startups Not on the IPO On-Ramp

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The JOBS Act is probably best-known for creating an “IPO on ramp” intended to reduce the cost and complexity of going public, but the act also contains important benefits for startups that are years away from an IPO, or never plan to go public. By loosening decades-old restrictions on private fundraising, permitting a new financing technique known as “crowdfunding,” and increasing the maximum number of stockholders a private company may have, the act should make it easier for startups to obtain financing and remain private if they so choose.

Elimination of Ban on General Solicitation

Current SEC rules prohibit general solicitation and general advertising to attract investors in private placements. The JOBS Act requires the SEC to amend its rules to permit such activities in placements conducted pursuant to Rule 506 (the SEC rule that allows companies complying with its requirements to raise unlimited amounts of capital <http://www.sec.gov/answers/rule506.htm>) as long as all purchasers qualify as “accredited” investors. (Accredited investors are high income and high-net-worth individuals and qualifying institutions.) A company must take reasonable steps to verify that purchasers are accredited investors, using methods to be determined by the SEC.

This change does not go into effect until the SEC amends its rules, which is supposed to occur by July 4, 2012 (90 days after enactment of the JOBS Act), but could be delayed.

New Crowdfunding Exemption

The JOBS Act requires the SEC to adopt rules to permit private U.S. companies, without registration, to engage in “crowdfunding” transactions, subject to the following restrictions:

- Within any 12 month period, the maximum offering size is \$1 million.
- The amount any individual investor may invest must not exceed (1) the greater of \$2,000 or 5 percent of the annual income or net worth of the investor, if either the annual income or net worth of the investor is less than \$100,000, and (2) 10 percent of the annual income or net worth of the investor, not to exceed a maximum aggregate investment of \$100,000 by the investor, if either the annual income or net worth of the investor is equal to or more than \$100,000.
- An intermediary, either a broker or “funding portal,” must be used in the transaction. The intermediary must register with the SEC and any applicable self-regulatory organization; ensure that investors understand the risks of the investment and can bear the burden of possibly losing the investment; conduct a background check on each officer, director, and 20 percent stockholder of the company; make sure that no investment limits are exceeded; and comply with any other requirements the SEC may prescribe.
- Companies have to file with the SEC, and provide to investors and potential investors, an anticipated business plan, the financial condition of the company, a description of the intended use of the proceeds, and a description of the ownership and capital structure of the company.
- Investors can bring rescission claims (claims for refunds) for material misstatements and omissions. Claims may be brought against the company, the company’s directors, and certain officers, and any person who offers or sells the security in the offering.



- Companies need to disclose a target offering amount and the deadline to reach the target offering amount. Companies must provide regular updates regarding their progress in meeting the target offering amount.
- Companies may not advertise the offering, except for notices that direct investors to the intermediary. Companies may not compensate anyone for promoting the offering through the intermediary's communication channel without taking proper steps to ensure that the promoter discloses that compensation in each promotional communication.
- Companies must file financial statements and ongoing reports with the SEC, subject to rules, exceptions, termination dates, and other requirements to be determined by the SEC.
- Investors may not resell securities for one year, beginning on the date of purchase, except to the company; to an accredited investor, as part of an SEC-registered offering; to family members; or in connection with death or divorce.
- Crowdfunding is available only to U.S. companies (and not foreign companies) that are not already an SEC reporting company.

Crowdfunding will not become available until the SEC issues rules to implement it. The rules are supposed to be adopted by December 31, 2012 (270 days after enactment of the JOBS Act), but this also could be delayed.

Higher Stockholder Threshold for Mandatory SEC Reporting

The JOBS Act increases the stockholder threshold at which a private company must register its securities and become an SEC reporting company. The former limit was 500 holders of any class of equity security; the new limit is 2,000 persons, or 500 persons who are not accredited investors.

For purposes of the new threshold, securities held by persons who received the securities pursuant to an employee compensation plan—such as a stock option plan—in transactions exempt from SEC registration are excluded. Securities issued in crowdfunding transactions will also be excluded, once the SEC adopts crowdfunding rules. The increase in the registration threshold and the exclusion from such calculations of securities issued in employee compensation and crowdfunding transactions should allow some large private companies to remain private longer, and may enable companies to avoid creating new classes of equity security as a workaround to the old 500-person limit. The change may also encourage some companies to grant equity more broadly within the company, or to stop including restrictions on grants that were intended to keep the company below the former 500 person limit.

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