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Legal Update

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JOBS Act Eases Restrictions on Advertising for Private Securities Offerings

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The newly-enacted Jumpstart Our Business Startups Act (JOBS Act), which President Obama signed into law last month, is intended primarily to "increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies." Much of the attention surrounding the JOBS Act has focused on the mandated amendments to the US securities laws that will permit smaller companies to raise capital through so-called "crowdfunding" via the internet and simplify the IPO process for "emerging growth companies." Another significant change will allow companies issuing securities through offerings that are exempt from registration with the Securities Exchange Commission (SEC) to more freely advertise to and solicit investors.

The existing safe-harbor regulations under the federal securities laws (Regulation D) prohibit companies from engaging in general solicitations and/or advertising to raise capital through private securities offerings. The JOBS Act directs the SEC to adopt amendments to the safe harbor rules to allow companies to market their sales of securities through both online and traditional print and broadcast advertising channels. These amendments are due from the SEC by the beginning of July. The impact for startups and early-stage companies could be significant, allowing companies to connect with a much wider audience of interested potential investors, including through postings on their own and others' websites.

Specifically, the anticipated rule change will permit general advertising and solicitation in connection with exempt private offerings so long as ***all*** of the ultimate purchasers are "accredited investors". "Accredited Investors" include various qualifying entities and institutions as well as individuals (and couples) whose net worth exceeds $1 million at the time of the purchase (excluding the value of their primary residence), and individuals whose income has exceeded $200,000 (or joint income with a spouse has exceeded $300,000) during the two years before the purchase with a reasonable expectation of a similar income in the year of the purchase.

Critics of the JOBS Act warn that looser regulation of private securities offerings will invite fraud and wider proliferation of internet scams. To address these concerns, the SEC is expected to include enhanced responsibilities for issuing companies to ensure that ultimate purchasers of their securities (but not all of those who merely access the advertisements) are indeed accredited investors.

In a related change, the JOBS Act will eliminate broker-dealer registration requirements for those who maintain a platform or mechanism permitting, among other things, advertising activities by sellers of securities in exempt transactions, provided they do not receive compensation for the sale of securities or hold customer funds. This change could pave the way for social media sites and applications aimed at matching investors with financial firms, which have generally been reluctant to embrace social media due to regulatory uncertainty.

Of course, any marketing of securities will be subject to existing laws against fraud and abuse. Companies seeking to advertise their private offerings under these new rules should (1) wait until the SEC finalizes the regulations mandated by the JOBS Act, and (2) consult with legal counsel.

The JOBS Act also includes several other significant changes affecting both public and private companies. For example:

- Similar to the changes discussed above, the SEC will amend Rule 144A to allow general advertising and solicitation in connection with certain re-sales of restricted securities to Qualified Institutional Buyers.

- The JOBS Act will allow certain private companies to raise up to $1 million per year via "crowdfunding" without registering the sales of securities with the SEC. Crowdfunding will permit pooling of small investments from larger groups of investors regardless of whether the investors are accredited or sophisticated. The SEC will adopt regulations implementing new crowdfunding rules in the coming months. We will publish a further newsletter on this topic after the crowdfunding regulations are announced.

- The JOBS Act simplifies IPOs by Emerging Growth Companies (EGCs) by, among other things, permitting them to (1) file limited initial disclosures and subsequent reports, (2) provide fewer and less detailed audited financial statements, and (3) reduce disclosures regarding executive compensation. Companies will cease to qualify as EGCs after either five years have elapsed since their IPOs, or they reach $1 billion in annual revenues.

- The JOBS Act expands the use of Regulation A, as an alternative to a registered IPO, by increasing from $5 million to $50 million the amount of capital that companies can raise under that exemption.

- The JOBS Act increases from 500 to 2,000 the number of stockholders of record a company may have before it must register and file quarterly and annual reports with the SEC (provided that no more than 500 of these stockholders are unaccredited investors).

This Legal Update only briefly summarizes some of the many significant provisions of the JOBS Act. Companies that may be affected by the Act should consult with counsel so that they are prepared to take advantage of the changes once the new regulations are finalized.

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