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Entrepreneur's Guide to the JOBS Act

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Complying with federal securities laws is no simple task. Entrepreneurs fight that battle every day when raising money for their emerging companies. That is why guys like me have a job.

Things just got a little bit easier, however, thanks to President Barack Obama signing into law one of the most significant bills in recent memory, as far as emerging companies are concerned. The Jumpstart Our Business Startups Act is designed to make it easier for emerging companies to raise private capital and also reduces some of the administrative burdens associated with ultimately taking the company public via an initial public offering.

Here is a quick cheat sheet on the key changes coming thanks to the JOBS Act, and how those changes will impact the daily lives of entrepreneurs and emerging companies:

ADVERTISE AWAY

One of the major struggles for emerging companies trying to raise money without triggering the requirement that the company file a formal registration statement is the longstanding prohibition on general solicitations. This is a particularly high hurdle to clear for companies located outside of Silicon Valley, where investment dollars are plentiful and trips up and down Sand Hill Road can result in tens of millions in the bank for promising private companies.

The JOBS Act eliminates the prohibition on general solicitation, which means companies will soon be able to advertise on their website (or anywhere else, for that matter) the fact that they are in fund-raising mode. This should make it dramatically easier to raise private capital. Don’t run out and change your website just yet. The SEC has 90 days from the date the JOBS Act was signed into law to issue rules implementing this change.

Keep in mind, though, that the “accredited” investor requirement doesn’t fall away. Thus, companies must still take reasonable steps to ensure that all investors meet the appropriate financial ability tests. Consult with your favorite Dinsmore securities attorney for more information.

THE MAGIC NUMBER JUMPS FROM 500 TO 2,000

The current federal securities laws require any company with more than 500 shareholders of record and $10 million in assets to comply with the periodic reporting requirements that publicly traded companies must follow. You know what I’m talking about – annual, quarterly and current event reports. This rule has long been the bane of hugely popular, rapidly growing startups because it forces an IPO, often long before the company actually wants to go public.

Violating the 500 shareholder rule drove the timing for both Google and Facebook, among many others, to file for their IPOs. The JOBS Act increased that number to 2,000, which gives private companies more control over the timing of their IPO, especially with semi-active trading markets for private companies, like SecondMarket andSharesPost, creating the opportunity for more and more investors to

put their cash into private companies.

Up to 499 of those 2,000 shareholders of record may be “unaccredited” investors. Moreover, shareholders acquiring their stock through employee incentive plans and anyone acquiring shares through the crowdsourcing exemption discussed below are excluded from the 499 and 2,000 calculations.

Unlike with the abolishment of the general solicitation prohibition, the SEC doesn’t have a runway to adopt implementing rules for the shareholder limit increase. This rule is effective immediately. Nonetheless, the SEC needs to adopt rules interpreting the “of record” portion of the new rule, though there is no timeline for the SEC to do so.

HELLO CROWDFUNDING

Crowdsourced content has been a great driver of technology over the last few years, so it was a natural progression for that concept to eventually make its way to raising capital. Yet, it has largely been a gimmick for emerging companies, since federal securities laws basically limited companies to raising money via donations or selling grossly overpriced products, rather than selling equity, to crowdfunding participants.

Not anymore.

The JOBS Act provides for a $1 million annual exemption for companies to raise money via crowdfunding. Investors who earn less than $100,000 per year may invest up 5% of their annual income or $2,000, whichever is greater. Investors who earn at least $100,000 per year may invest up to 10% of their annual income, subject to a $100,000 aggregate limit.

Companies seeking to take advantage of crowdfunding must do so through an intermediary that is registered with the SEC -- it seems likely that leading crowdfunding sites like Indiegogo will complete the necessary registration steps. In addition, the company must file certain information with the SEC, such as the names of directors, officers and shareholders owning more than 20% of the company’s equity, a description of the company’s business and information regarding its financial condition. These reporting requirements do not apply to companies using the Regulation D, Rule 506 exemption.

The SEC has 270 days from the date of enactment to issue implementing rules regarding crowdfunding, so companies wanting to rely on this exemption have to wait just a little bit longer.

“MINI PUBLIC OFFERING” EXEMPTION NOW $50MM

The “mini public offering” exemption, which is basically an IPO without the same level of required disclosures, is a little-used mechanism for emerging companies to raise capital from the investors without worry about “accredited” investor status. Its relative anonymity is largely due to the $5 million limit, which makes it an impractical in light of the costs associated with drafting an offering circular and other required disclosures.

The JOBS Act raised the “mini public offering” limit to $50 million. This definitely brings this rarely used tool back into the mix for companies seeking to access the public markets. Of course, the increase was not without adding a new wrinkle or two. The investor protections previously associated with a “mini public offering” have been expanded, which will increase the cost of consummating an offering, but certainly not to the point where it becomes economically unviable in light of the offering limit.

The SEC must adopt implementing rules before the new limit takes effect. Unfortunately, there is no timetable imposed upon the SEC in adopting the required rules. Stay tuned to this blog for additional guidance on the matter, but it seems likely that, once those rules are in place, a Regulation A “mini public offering” could very well turn into a viable interim step ahead of an IPO for certain companies.

MAKING IT EASIER FOR EMERGING COMPANY IPOS

When most people think of phrase “emerging growth company,” they probably think of Silicon Valley startups working in a founder’s garage. The JOBS Act means something very different. It means any company with less than $1 billion in annual revenue. Any company meeting this definition that

intends to go public in the future or has priced its IPO as recently as December 9, 2012, will now enjoy reduced administrative burdens in connection with their IPO and life as a public company.

The basic changes to the IPO process for emerging growth companies include:

- companies are now able to hold certain pre-offering meetings with accredited investors and qualified institutional buyers to “test the waters” to determine their interest in an offering without running afoul of the so-called “gun-jumping” rules;
- allow companies to file an S-1 or F-1 with two years of audited financial statements, rather than three;
- companies can now confidentially file a registration statement with the SEC for review and comment, rather than having the information available to the public from day one, provided that the issuer publicly file the initial confidential submission and all amendments at least 21 days before the road show; and
- investment banks can publish research reports about an emerging growth company prior to or during the registration period, even if the bank is participating (or will participate) in the offering.

The basic changes to life as a public company include exempting emerging growth companies from:

- “say-on-pay” votes;
- hiring an independent auditor to attest to the company’s internal financial controls;
- new or revised financial accounting standards until such date as the accounting standard becomes broadly applicable to private companies; and
- more limited executive compensation disclosure.

Emerging growth companies enjoy these reduced administrative burdens until the earlier of:

- achieving annual gross revenues exceed $1 billion;
- issuing in excess of $1 billion in non-convertible debt;
- the fifth anniversary of its IPO; or
- becoming a “large accelerated filer” (i.e., a public float of at least $700 million).

These changes are effective immediately.

This is just a brief summary of the JOBS Act.

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