The JOBS Act in 2014 – With Rulemaking Update

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Introduction

President Obama signed the Jumpstart Our Business Startups Act (the "***JOBS Act***") into law on April 4, 2012 after Congress passed it with bipartisan support. The JOBS Act increases entrepreneurs', start-ups' and small businesses' access to capital and investor access to alternative investments. The JOBS Act also materially updates public and private securities offering processes and removes some periodic reporting obligations for new public company issuers with less than $1 billion in annual revenue.

The JOBS Act was a reaction to cost-prohibitive regulatory burdens imposed on smaller companies and antiquated legal requirements created long before the Internet and modern technologies.

In 2002 Congress passed the Sarbanes-Oxley Act which greatly increased the cost burden of being a public company. One such cost burden was the required auditor certification of internal controls under Section 404(b) of the Sarbanes-Oxley Act. A SEC survey released in 2009 found that annual costs for SOX 404(b) compliance alone had a mean of over $2.3 million and a median of over $1 million.[2] For smaller companies the benefits of these requirements was unclear. Indeed, the Dodd-Frank Wall Street Reform and Consumer Protection Act, passed in July 2010, provided an exemption from Sarbanes-Oxley Section 404(b) requirements for companies with less than $75 million in market capitalization[3] and ordered the SEC and GAO to study exempting companies with market capitalizations of less than $250 million and small companies in general.[4]

These regulatory burdens had considerable impact. Congress heard testimony that between 1995 and 2010 listings on U.S. securities exchanges shrank from 8,000 to 5,000 while

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[2] *Study of the Sarbanes-Oxley Act of 2002 Section 404 Internal Control over Financial Reporting Requirements*, U.S. Securities and Exchange Commission Office of Economic Analysis, September 2009, found at http://www.sec.gov/news/studies/2009/sox-404_study.pdf .

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act Section 989G (adding Section 404(c) to Sarbanes-Oxley Act).

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act Sections 989H and 989I.

listings on non-U.S. exchanges grew from 23,000 to 40,000.[5] In the early 1990s, before the Internet bubble, the U.S. averaged 398 IPOs per year.[6] Following the 2002 regulatory changes the U.S. IPO average was 117 per year.[7] With the rise of private equity investors, entrepreneurs became more likely to sell out than to go public at lower valuations than available in the public markets.[8] Indeed, in 1991 approximately 90% of venture investor exits occurred through IPO and 10% through mergers and acquisitions.[9] But, in 2010 approximately 80% of venture investor exits were through mergers and acquisitions and 20% through IPO.[10] Moreover, Congress also heard testimony that companies create 90% of their new jobs after going public[11] and that mergers and acquisitions do not generally produce the same rapid job growth as IPOs.[12] So, these regulatory burdens on IPOs hindered job creation.

Congress also considered whether stale statutes needed updating. Many of the provisions of the Securities Act of 1933 and Securities Exchange Act of 1934 date back to the 1930s, including the securities offering exemption for "transactions by an issuer not involving any public offering" in Section 4(2) of the Securities Act of 1933 and the shareholder "held of record" standards in Section 12(g) of the Securities Exchange Act of 1934.

As for "transactions not involving any public offering" the SEC was limited by the language of Section 4(2) in addressing the advent of the Internet. Since 1982 the SEC has provided a safe harbor for Section 4(2) offerings under SEC Rule 506 relating to offerings to primarily accredited investors that included general solicitation and advertising prohibitions.[13] The SEC has also routinely deemed the use of the Internet to seek investors to be a public offering and pursued securities registration cases.[14]

Consequently, the distribution power of the Internet has never effectively been harnessed to enable small companies or ventures to raise money from accredited investors. Congress perceived that these more than 75 year old restrictions were the product of a different era and different technology and ordered the SEC to issue rule amendments allowing general solicitation of Rule 506 offerings, not only on the Internet, but through all other means as well. Congress also provided for the use of Internet to solicit funds for small offerings of less than $1 million per 12 month period through "Crowdfunding."

Section 12(g) of the Securities and Exchange Act provided that securities issuers must commence public filing when they had $10 million in assets and 500 shareholders "held of

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[5] Testimony of Edward S. Knight, General Counsel and Executive Vice-President, NASDAQ OMX Group before the Senate Committee on Banking, Housing and Urban Affairs (December 1, 2011).
[6] Knight testimony, id.
[7] Knight testimony, id.
[8] Knight testimony, id.
[9] Testimony of Scott Cutler, Executive Vice-President, NYSE Euronext, before the Senate Committee on Banking, Housing and Urban Affairs (December 1, 2011).
[10] Cutler testimony, id.
[11] Knight testimony, id.
[12] Cutler testimony, id.
[13] Adopted in SEC Release No. 33-6389 (Fed. Sec. L. Rep. ¶83,106), effective April 15, 1982, 42 F. R. 11251; and amended in SEC Release No. 33-6825 (Fed. Sec. L. Rep. ¶84,404), effective April 19, 1989, 54 F. R. 11369.
[14] *See e.g. In the Matter of PriorityAccess, Inc., Endpoint Technologies, Inc. and Roger Shearer*, SEC Release No. 33-8021 (October 3, 2001), found at http://www.sec.gov/litigation/admin/33-8021.htm.

record." For many decades "held of record" was an effective means of determining how many shareholders there actually were. Up until the 1970s trades were settled on Wall Street by couriers carrying bags of stock certificates between brokerages.

But, in recent decades "held of record" on a Company's transfer agent books has become divorced from the actual shareholder base. The vast majority of shares of public companies are now held in the name "Cede & Co." which is a nominee of the Depository Trust Corporation ("*DTC*"). Once the share certificate is reissued to "Cede & Co." all trade settlements involving those shares are settled through a ledger transfer between brokerages on the books of DTC or internally by the broker-dealer. The record name of the shareholder on the Company's transfer agent books never changes. The shareholder number for the purposes of Section 12(g) of the Exchange Act also varies little as it is determined by the number of record holders plus the number of DTC participants holding shares[15] – not by the number of beneficial owners.

Further, growing companies who did not need capital and chose to motivate employees with equity participations had issues with bumping up against the 500 shareholder limit. Congress heard testimony from the Chief Financial Officer of Wawa, Inc. which has been in the retail business for 47 years and has 18,000 employees.[16] He complained that this shareholder limit hindered Wawa Inc.'s ability to offer its employees an ESOP and noted the large number of shareholders of a family company that can derive from multiple generations of descent. [17] He said that the 500 shareholder limit would soon require incurring the costs of being a public company or having a costly corporate restructuring, solely because of the shareholder limit.[18]

The "held of record" definition also created an inconsistency between private issuers, who must count each shareholder, and public issuers, who may have thousands of shareholders counted merely by the number of DTC participants who hold issuer shares.

Consequently, Congress ordered the SEC in the JOBS Act to conduct a rulemaking process to increase the number of shareholders allowed for private companies and banks and to redefine "held of record."

In sum, the six titles of the JOBS Act provide for the following:

- Title I—eases the IPO process and ongoing public disclosure of new public companies. No rulemaking was required.
- Title II—allows general solicitation and advertising in offerings under Rule 506 of Regulation D. The SEC's final rules were effective September 23, 2013.
- Title III—creates a new registration exemption for "crowdfunding." The SEC issued a rule proposal with comments due February 4, 2014.
- Title IV—creates a new exemption for public offerings of $50 million or less. The SEC issued a rule proposal with comments due March 24, 2014.
- Titles V & VI—increases the shareholder threshold for reporting under the Exchange Act.

[15] SEC Rule 12g5-1 (17 CFR 240.12g5-1).

[16] Testimony of Christopher T. Ghesens, Executive Vice-President – Chief Financial and Administrative Officer for Wawa, Inc. before the Senate Committee on Banking, Housing and Urban Affairs (December 1, 2011).

[17] Ghesens testimony, id.

[18] Ghesens testimony, id.

Title I—IPO-On-Ramp—Reopening American Capital Markets to Emerging Growth Companies

Title I of the JOBS Act focuses on "Emerging Growth Companies" ("*EGCs*") and eases their entry to the public securities markets. EGCs are newly-public companies with less than $1 billion in gross revenue, less than $700 million in public float and less than $1 billion in non-convertible debt who completed their IPOs after December 8, 2011 and chose to be designated EGCs.[19]

Under Title 1 of the JOBS Act, EGCs have several important exemptions from standard public company SEC disclosure requirements:

(1) No Sarbanes-Oxley Act Section 404(b) internal control certification by auditor;[20]

(2) Registration statements require 2 years of audited financial statements instead of 3 years;[21]

(3) No required pay-for-performance executive compensation analysis[22] - Section 14(i) of the Securities Exchange Act of 1934, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, requires issuers to present information that shows the relationship between the executive compensation actually paid and the financial performance of the issuer;[23]

(4) No required say-on-pay votes or say-on-pay voting frequency votes[24] - Section 14A(a) of the Securities Exchange Act of 1934, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, requires that proxy statements include a periodic shareholder advisory vote on executive compensation each 1, 2 or 3 years and a periodic shareholder vote on the frequency of the shareholder advisory vote on executive compensation;[25]

(5) No requirement for shareholder approval of golden parachute compensation.[26] Section 14A(b) of the Securities Exchange Act of 1934, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, requires that executive compensation contingent upon an acquisition, merger, consolidation or sale or other disposition of all or substantially all of the issuer's assets be presented to shareholders in the proxy statement for the transaction's shareholder approval and that this executive compensation be specifically approved by shareholders.[27]

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[19] Securities Act of 1933 §2(a)(19) (15 U.S.C. §77b(a)(19)); Securities Exchange Act of 1934 §3(a)(80) (15 U.S.C. § 78b(a)(80)).
[20] Jumpstart our Business Startups Act §103; Sarbanes-Oxley Act of 2002 §404(b) (15 U.S.C. 7262(b)).
[21] Securities Act of 1933 §7(a)(2)(A) (15 U.S.C. §77g(a)(2)(A)).
[22] Securities Exchange Act of 1934 §14(i) (15 U.S.C. §78n(i)).
[23] Securities Exchange Act of 1934 §14(i) (15 U.S.C. §78n(i)).
[24] Securities Exchange Act of 1934 §14A(e)(2) (15 U.S.C. §78n-1(e)(2)).
[25] Securities Exchange Act of 1934 §14A(a) (15 U.S.C. §78n-1(a)); SEC Rule 14a-21 (17 CFR § 240.14a-21).
[26] Securities Exchange Act of 1934 §14A(e)(2) (15 U.S.C. §78n-1(e)(2)).
[27] Securities Exchange Act of 1934 §14A(b) (15 U.S.C. §78n-1(b)); SEC Rule 14a-21 (17 CFR § 240.14a-21).

(6) No requirement to present the ratio of the CEO's total compensation to the median employee total compensation or disclose the median employee total compensation. The Dodd-Frank Wall Street Reform and Consumer Protection Act ordered the SEC to issue rules requiring public companies disclose: (a) the median of annual total compensation of all employees except for the chief executive officer; (b) the chief executive officer's total compensation; and (c) the ratio between the median annual total employee compensation and the chief executive officer's compensation.[28]

(7) EGCs may use the "Smaller Reporting Company" standard for the Management Discussion and Analysis Section (MD & A) of the registration statements and annual reports;[29]

(8) No need to comply with new accounting standards that are applicable only to public companies until such time as these accounting standards also apply to private companies;[30]

(9) In registration statements, EGCs do not need to present the "Selected Financial Data" (the period-to-period comparison tables in Regulation S-K Item 301) for the periods before which the EGCs have audited financial statements;[31]

(10) EGCs may suspend mandatory auditor rotation requirements;[32]

(11) EGCs and persons authorized to act for EGCs may engage in pre-IPO oral and written communications *("test the waters"*) with "Qualified Institutional Buyers" and institutional "Accredited Investors" without violating the securities registration requirements or the pre-IPO "quiet period."[33] Qualified Institutional Buyers are institutional investors that have discretionary authority over at least $100 million in securities holdings.[34] Institutional accredited investors generally are required to have total assets in excess of $5 million;[35]

(12) Provides for greater use of underwriter analyst research reports in IPOs by saying that such reports do not constitute an offer to sell a security;[36]

(13) Gives investors greater access to analysts employed by the underwriters pre-IPO;[37]

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[28] Jumpstart our Business Startups Act §102(a)(3); Dodd-Frank Wall Street Reform and Consumer Protection Act §953(b).
[29] Jumpstart our Business Startups Act §102(c).
[30] Securities Act of 1933 §7(a)(2)(B) (15 U.S.C. §77g(a)(2)(B)); Securities Exchange Act of 1934 §13(a) (15 U.S.C. 77g(a)).
[31] Securities Act of 1933 §7(a)(2)(A) (15 U.S.C. §77g(a)(2)(A)); Securities Exchange Act of 1934 §13(a) (15 U.S.C. 77g(a)).
[32] Jumpstart our Business Startups Act §104; Sarbanes-Oxley Act of 2002 §103(a)(3) (15 U.S.C. 7213(a)(3)).
[33] Securities Act of 1933 §5(d) (15 U.S.C. §77e(d)).
[34] SEC Rule 144A (17 CFR §230.144A).
[35] SEC Rule 501(a) (17 CFR §230.501(a)).
[36] Securities Act of 1933 §2(a)(3) (15 U.S.C. §77b(a)(3)).
[37] Securities Exchange Act of 1934 §15D(c) (15 U.S.C. §78*o*-4(c)).

(14) Provides that the SEC and securities exchanges may not proscribe brokers and dealers from publishing or distributing research reports or making a public appearance within any prescribed time period after the IPO or within any prescribed time period before the expiration of any agreement between the broker or dealer and the EGC or its shareholders that restricts or prohibits the sales of securities by the EGC or its shareholders (post-IPO lockup period);[38]

(15) Allows for the confidential submission of pre-IPO registration statements, provided that these registration statements become public 21 days before the first road show;[39] and

(16) Provides that confidentially submitted registration statements are not subject to Freedom of Information Act requests.[40]

Several quirky issues have arisen under the IPO On-Ramp. The SEC has issued several FAQs which may be found on the SEC website and the SEC has published 41 FAQs in response. Among other items, the SEC's Division of Corporation Finance has stated that:

(1) Reverse merger companies do not qualify for EGC status;[41]

(2) Asset-backed securities issuers do not qualify for EGC status;[42]

(3) Investment companies do not qualify for EGC Status;[43]

(4) Business development companies may qualify for EGC status;[44]

(5) Foreign issuers may qualify for EGC status;[45]

(6) Companies which have issued debt, but not equity, pursuant to an effective registration statement before December 8, 2011 may qualify for EGC status.[46]

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[38] Jumpstart our Business Startups Act §105(d).
[39] Securities Act of 1933 §6(e)(1) (15 U.S.C. §77f(e)(1)).
[40] Securities Act of 1933 §6(e)(2) (15 U.S.C. §77f(e)(2)).
[41] FAQ #24 - Jumpstart Our Business Startups Act Frequently Asked Questions - Generally Applicable Questions on Title I of the JOBS Act, found at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm
[42] FAQ #19 - Jumpstart Our Business Startups Act Frequently Asked Questions - Generally Applicable Questions on Title I of the JOBS Act, found at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm
[43] FAQ #20 - Jumpstart Our Business Startups Act Frequently Asked Questions - Generally Applicable Questions on Title I of the JOBS Act, found at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm
[44] FAQ #21 - Jumpstart Our Business Startups Act Frequently Asked Questions - Generally Applicable Questions on Title I of the JOBS Act, found at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm
[45] FAQs ## 9 and 10 - Jumpstart Our Business Startups Act Frequently Asked Questions - Generally Applicable Questions on Title I of the JOBS Act, found at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm

Further, the SEC's Division of Trading and Markets has stated that:

(1) The "test the waters" issuer communication provision will be limited when the communication is performed by brokers and dealers due to SEC Rule 15c2-8(e) which makes it a deceptive act or practice for a broker or dealer to communicate regarding the distribution of securities with respect to a registration statement filed under the Securities Act unless the broker or dealer takes reasonable steps to make available a copy of the preliminary prospectus and all amended preliminary prospectuses for the securities to each of its associated persons who are expected to participate in soliciting customer orders prior to the effective date of the registration statement. Obtaining indications of interest that do not ask the customer to purchase the securities would not be soliciting a customer. Further, confidential draft registration statements are not filed with the SEC and are not subject to SEC Rule 15c2-8(e).[47]

(2) The "Global Settlement" reached in enforcement actions with 12 broker-dealers in 2003 and 2004 relating to research conflicts of interests was not amended or modified in any way by the JOBS Act. Broker-dealers subject to the Global Settlement remain subject to the restrictions on research relating to underwritten offerings as stated in the Global Settlement.[48]

(3) The JOBS Act affects certain parts of NASD Rule 2711 and NYSE Rule 472 relating to research analysts and leaves other parts of these rules, such as compensation, supervision, inducements with favorable research etc., unchanged.[49]

(4) The JOBS Act does not affect Regulation AC. Regulation AC requires that brokers, dealers, and certain persons associated with a broker or dealer include in research reports certifications by the analyst that the views expressed in the report accurately reflect his or her personal views, and disclose whether or not the analyst received compensation or other payments in connection with his or her specific recommendations or views.[50]

EGCs will cease being EGCs and lose the above-described exemptions on the last day of the fiscal year following the date of the fifth anniversary of the EGC's first sale of common equity securities under an effective registration statement or a fiscal year in which the EGC has $1 billion in gross revenues.[51] EGC status will also immediately cease if the market value of the issuer's common equity held by non-affiliates exceeds $700 million at the end of the fiscal year

[46] FAQ # 29 - Jumpstart Our Business Startups Act Frequently Asked Questions - Generally Applicable Questions on Title I of the JOBS Act, found at http://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm

[47] FAQ # 1 - Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters, found at http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm

[48] FAQs ## 2 and 4 - Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters, found at http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm

[49] FAQs ## 5, 6, 7, 8 and 9 - Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters, found at http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm

[50] FAQ # 10 - Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters, found at http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm

[51] Securities Exchange Act of 1934 §3(a)(80) (15 U.S.C. §78b(a)(80)).

or upon the EGC issuing $1 billion or more in non-convertible debt in a three year period.[52] Finally, EGCs may choose to opt-out of the emerging growth company status at any time.[53] If an EGC opts out of emerging growth company status it may not opt back in.

Appendix A provides practice tips for EMG registration statements under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Title II—Regulation D—Access to Capital for Job Creators

Summary

Title II of the JOBS Act and SEC Rules 506(c)[54] and 144A[55] issued under it allows issuers to use general solicitation and general advertising for unregistered offerings under Rule 506 of Regulation D and Rule 144A, provided that all purchasers in Rule 506 offerings are accredited investors (and other Regulation D conditions met) and all purchasers in Rule 144A offerings are qualified institutional buyers ("QIB"). These rules also require that the issuer take "reasonable steps to verify" the accredited investor status and the securities seller "reasonably believe" the QIB status. Compliance with Rule 506(c) pre-empts state securities registration requirements.

Title II of the JOBS Act changes the unregistered securities offering paradigm for Rule 506 and 144A offerings. Previously, the qualification for the exemption was to be determined by who the securities were offered to, regardless of whether an investment was made. Now there are no limits as to who can be approached as long as the appropriate type of investor is determined during the offering process.

Rule 506 Reasonable Steps to Verify Accredited Investor Status.

The SEC provided a list of non-exclusive and non-mandatory methods for taking reasonable steps to verify the accredited investor status. The accredited investor reasonable steps may include verification by an attorney, broker-dealer, investment adviser or CPA. It also may include the issuer receiving documentation in the form of tax returns, brokerage statements, certificates of deposit, tax assessments, appraisal reports by independent third party appraisers or other documentation that can be used to verify the investor's status. The SEC also suggested that investors provide issuers with consumer credit reports showing liabilities.

SEC Rule 506(c) and the changes to Rule 144A became effective on September 23, 2013.[56] Anecdotally Rule 506(c) appears to have not been widely used. First experienced issuers and their service providers understand that investors do not want to turn over their tax returns, brokerage account records and consumer credit reports to development stage issuers.

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[52] Securities Exchange Act of 1934 §3(a)(80) (15 U.S.C. §78b(a)(80)); SEC Rule 12b-2(2) (17 CFR §240.12b-2(2))
[53] Jumpstart our Business Startups Act §107(a).
[54] 17 CFR 230.506(c).
[55] 17 CFR 230.144A.
[56] 17 CFR 144A and 230.506(c); SEC Release No. 33-9415; No. 34-69959; No. IA-3624; File No. S7-07-12 (July 10, 2013).

Second, attorneys, CPAs broker-dealers and investment advisers have not made a business out of investor status certifications. The assumptions allowable in preparing a certification have not been defined. Moreover, the potential liability for issuing such certifications has also not been defined. If the certification is erroneous, has that service provider aided or abetted a securities registration violation under federal or state law? The fact-based inquiry required for such certifications is sure to make them expensive. Indeed, securities practitioners should anticipate that attorneys and CPAs would only provide such certifications to long-time tax clients as a service ancillary to preparing the clients' tax returns.

Third, a large percentage of hedge funds must treat their funds as commodity pools and the Commodity Futures Trading Commission has not issued a parallel rule allowing advertising or general solicitation for unregistered commodity pools.

One hassle for issuers in Rule 506(c)[57] is that the investor's documents or certification must date within three months of the investment. So, for example, if an issuer takes reasonable verification steps in April by obtaining the investor's tax returns for the previous two years, it must obtain the same exact tax records again if the investor seeks to make a new investment in August. The same is true for brokerage records and consumer credit reports.

Subscription documents for Rule 506(c)[58] offerings likely should include covenants to produce such records required for reasonable steps to verify process and an acknowledgement that the same documents may need to be provided again if another investment is made more than three months later.

Reasonable belief that purchaser is a QIB under Rule 144A.

Rule 144A[59] provides that securities sellers can meet the burden of reasonably believing that the purchaser is a QIB by relying on the following non-exclusive list of documents, (provided those documents are dated within 16 months preceding the date of securities sale for a US QIB and within 18 months preceding the date of securities sale for a non-US QIB):

1) The purchaser's most recent publicly available financial statements;

2) The purchaser's most recent publicly available information in documents filed by the QIB with the SEC or another federal, state or local governmental agency or self-regulatory organization; and

3) The purchaser's most recent publicly available information appearing in a recognized securities manual.

[57] 17 CFR 230.506(c).

[58] 17 CFR 230.506(c).

[59] 17 CFR 230.144A.

Broker Dealer Exemption

Finally, Title II of the JOBS Act creates a limited exemption from the broker-dealer registration provisions of Section 15(a) of the Securities Exchange Act of 1934. It exempts persons involved in Rule 506 offerings who may be brokers or dealers "solely because:

(A) That person maintains a platform or mechanism that permits the offer, sale, purchase or negotiation of or with respect to securities, or permits general solicitations, general advertisements, or similar or related activities by issuers of securities, whether online, in person or through any other means;

(B) That person or any person associated with that person co-invests in such securities; or

(C) That person or any person associated with that person provides ancillary services with respect to such securities."[60]

"Ancillary Services" means that the service provider receives no transaction-based compensation and is a provider of due diligence services or standardized documents.[61] The ancillary services definition does not cover service providers who separately provide investment advice or recommendations for compensation or who negotiate the offering terms.[62]

The broker-dealer exemption is not available to those who or are associated with those who receive compensation or have possession of customer funds or securities.[63] It is also unavailable to those having a statutory disqualification under the Exchange Act.[64]

Proposed Amendments to Regulation D

The SEC has also issued a rule proposal (by a 3-2 vote) to amend Rule 506,[65] partly in response to general solicitation of Rule 506 offerings. The proposed rule proposes several new requirements for Rule 506 offerings:

1) Issuers engaged in a Rule 506(c) must file an "Advance Form D" at least 15 days before engaging in advertising or general solicitation, as a condition of the exemption safe harbor;

2) Issuers engaged in Rule 506 offerings must file a closing Form D amendment within 30 days of the termination of the offering, as a condition of the exemption safe harbor;

3) Issuers engaged in Rules 504, 505 or 506 offerings must file a Form D within 15 days of first sale, as a condition of the exemption safe harbor;

[60] 15 USC §77d(b)(1).

[61] 15 USC §77d(b)(3).

[62] 15 USC §77d(b)(3).

[63] 15 USC §77d(b)(2).

[64] 15 USC §77d(b)(2).

[65] SEC Release No. 33-9416, 34-69960, IC-30595; File No. S7-06-13 (July 10, 2013).

4) The rule proposal adds substantial new information disclosure requirements for the Form D in Rule 506 offerings;

5) New proposed Rule 509 would require issuers to include prescribed legends in all advertising and solicitation materials. Private investment companies must include additional prescribed legend language with additional legends to accompany statements relating to fund performance. Issuers who are subject to an order, judgment or decree for violations of the Rule 509 legend requirements would be subject to a permanent disqualification from using SEC Rule 506.

6) Under a proposed amendment to Rule 507, Issuers would be disqualified from relying on the Rule 506 exemption safe harbor for one year of future offerings in the issuer, or any predecessor or affiliate of the issuer, did not comply, within the last five years, with all of the Form D filing requirements for a Rule 506 offering.

7) Private investment companies will be subject to the disclosure requirements for their sales literature that apply to public investment companies in SEC Rule 156.

The rule proposal is controversial. Commissioners Gallagher and Paredes voted against it. Many commentators have been critical. Commentator statements include:

1) The 15 day Advance Form D waiting period is not authorized by the JOBS Act or any other statute and is an unconstitutional prior restraint on legal commercial advertising. Its costs outweigh benefits. Also, no private commentator requested this proposal. Instead it was requested by NASAA and the securities administrators of Massachusetts, Nevada, Ohio, South Carolina and Virginia as an apparent attempt to pare back the pre-emption of state securities registration intended by Congress when it adopted the JOBS Act and retain the "gotcha" jurisdiction that states would have over inadvertent public solicitations.

2) The SEC Division of Economic and Risk Analysis stated that 66% of Rule 506 Form D filers report revenue of less than $1 million and that the median offering size by non-financial issuers was less than $2 million. Moreover, 50% of Regulation D offerings are below $1 million. Thus, Rule 506 issuers are typically too small to have a robust internal compliance and legal regime. These small issuers should not be subject to punitive automatic disqualifications based on a complex notice filing regime without a generous opportunity for notice and cure. Such disqualifications over technical defects in getting notice forms filed will lead to disastrous financial impact for trivial filing errors. The SEC's rule proposal appears to assume that these small issuers have internal legal and compliance functions, which is untrue.

3) An exemption disqualification and its attendant recording of a current contingent liability should not be based on the filing of a notice form that is rarely provided to investors.

4) The five year look back/one year disqualification provision puts onerous and expensive due diligence requirements on compliant issuers because the look back would need to be done for each offering.

5) The lengthy proposed legends will not fit on many advertising platforms (e.g. Twitter, mobile devices, banner ads, etc.)

6) Private funds are already subject to advertising standards under the anti-fraud provisions of the Exchange Act and the Investment Advisers Act.

The comment period closed in November 2013, but comments can still be filed.

Title III—Crowdfunding

Title III of the JOBS Act adopts a new Securities Act registration exemption for "Crowdfunding," which involves small investors investing small amounts in small offerings.

While Crowdfunding has received substantial publicity, it might not have a material impact on raising funds for small businesses. First, the Crowdfunding exemption has a $1 million maximum in a 12-month period. This will be insufficient for many businesses. Second, Crowdfunding requires reviewed financial statements for offerings of more than $100,000 and audited financial statements for offerings of more than $500,000, both of which may prove to be cost-prohibitive for a small startup. The SEC issued its 585 page Crowdfunding rule proposal with 284 requests for comments on October 23, 2013. The comment period officially closed on February 4, 2014, but comments can still be filed.

Only a narrow spectrum of issuers will find uses for Crowdfunding due to the capital and accounting limitations. Crowdfunding may be useful for ventures focused on providing services while having low capital requirements. Such issuers may be able to parallel their costs to the revenues as they grow because such a large percentage of their costs will be labor costs. If they have greater demand, they can hire more employees and pay from cash flow. For example, Crowdfunding might be useful for neighborhood restaurants, small software companies and other labor-intensive businesses. It will not be appropriate for capital intensive industries such as real estate, oil and gas or manufacturing.

The Crowdfunding Offering Exemption

The new crowdfunding exemption allows certain non-reporting, domestic issuers to sell unregistered securities to the public through a broker or funding portal[66] that complies with the requirements of the exemption:

- The total amount sold to all investors by the issuer, including amounts sold in reliance on the crowdfunding exemption during the prior 12-month period, may not exceed $1 million;[67]

- The total amount sold to any single investor by the issuer, including any amount sold in reliance on the crowdfunding exemption during the prior 12-month period, may not exceed: (i) the greater of $2,000 or 5% of the investor's annual income or net worth if either the annual income or the net worth of the investor is less than $100,000, and (ii) 10% of the

[66] Securities Act of 1933 §4(6)(C) (15 U.S.C. §77d(6)(C)).

[67] Securities Act of 1933 §4(6)(A) (15 U.S.C. §77d(6)(A)).

investor's annual income or net worth so long as the maximum aggregate amount invested by that investor is less than $100,000, if either the annual income or the net worth of the investor is $100,000 or more;[68]

- The offering is conducted through a registered broker-dealer or "funding portal;"

- The issuer files with the SEC and provide investors and the relevant funding portal or broker-dealer with the following information about the issuer:

    - Name;
    - Legal status;
    - Physical address;
    - Website address;
    - Names of directors and officers;
    - Names of 20% or more equity owners;
    - Financial condition description;
    - For offerings of $100,000 or less – 1) Income tax returns for most recent year; and 2) financial statements certified by principal executive officer to be true and complete in all material respects;
    - For offerings of $100,000 or more but less than $500,000 – financial statements reviewed by an independent public accountant using professional standards for such review or standards adopted by the SEC per rulemaking;
    - For offerings of more than $500,000 – audited financial statements;
    - A description of the stated purpose and intended use of offering proceeds for the targeted offering amount;
    - The price to the public for the securities or the method for determining the price, provided that each investor, prior to sale, shall be provided the final price and all required disclosures with reasonable opportunity to rescind the purchase commitment;
    - A description of the ownership and capital structure, including:
        - The terms of the securities being offered and the terms and ownership of other classes of securities;
        - A description of how the exercise of principal shareholder rights could negatively impact securities purchasers;
        - The name and ownership level of existing shareholders who own more than 20% of any class of securities;
        - How the securities being offered are being valued, including examples of methods for how the securities may be valued by the issuer in the future and during subsequent corporate actions;
        - The risks of minority ownership;
        - The risks of corporate actions, including the additional issuance of shares, the sale of the issuer's assets and related party transactions; and
        - Other information required by SEC rule.[69]

[68] Securities Act of 1933 §4(6)(B) (15 U.S.C. §77d(6)(B)).

[69] Securities Act of 1933 §§4(6)(D) and 4A(b)(1) (15 U.S.C. §77d(6)(D) and 77d-1(b)(1)).

- No advertising of the offering except for notices which direct investors to the broker or funding portal;[70]

- No compensation to or commitment to compensate any person to promote the offering through communication channels provided by the broker without taking such steps as the Commission shall require by rule to ensure that such person clearly discloses the past or prospective receipt of compensation for these communications;[71]

- Issuers are required to file with the SEC and provide to investors, no less than annually, the issuer's reports of the results of operations and financial statements as prescribed by the SEC pursuant to rule;[72]

- The issuer may not being affiliated with any person who has a material securities disciplinary history (a "bad boy" disqualification) as stated in a forthcoming SEC Crowdfunding rule. The disqualifications will include provisions similar to SEC Rule 262 and final orders of state securities administrators barring a person from association with an entity regulated by the state securities administrators or engaging in the business of securities, insurance, banking, a savings association or a credit union within the last ten years;[73]

- The issuer must be a domestic business entity organized under the laws of a state or territory of the United States or the District of Columbia;[74]

- The issuer must not be a SEC-reporting company or an investment company;[75] and

- Complying with other requirements required by SEC rulemaking.[76]

If the issuer complies with **all** these conditions, it will have a Crowdfunding securities registration exemption for the transaction. Further, the Crowdfunding exemption will pre-empt state law securities registration requirements.[77] Finally, states may not impose any filing or fee requirements on Crowdfunding offerings.[78]

Importantly, note that it is a condition of the securities registration exemption in the statute and in the rule proposal to fulfill all these conditions. Theoretically the issuer could lose its securities registration exemption by not providing one of the technical disclosures or not timely providing an annual financial statement even after the offering is completed. Further, once the Crowdfunding exemption is lost, the state securities registration pre-emption is also lost.

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[70] Securities Act of 1933 §§4(6)(D) and 4A(b)(2) (15 U.S.C. §77d(6)(D) and 77d-1(b)(2)).

[71] Securities Act of 1933 §§4(6)(D) and 4A(b)(3) (15 U.S.C. §77d(6)(D) and 77d-1(b)(3)).

[72] Securities Act of 1933 §§4(6)(D) and 4A(b)(4) (15 U.S.C. §77d(6)(D) and 77d-1(b)(4)).

[73] Securities Act of 1933 §4A(d) (15 U.S.C. §77d-1(d)).

[74] Securities Act of 1933 §4A(f)(1) (15 U.S.C. §77d-1(f)(1)).

[75] Securities Act of 1933 §4A(f)(2) and (3) (15 U.S.C. §77d-1(f)(2) and (3)).

[76] Securities Act of 1933 §§4(6)(D) and 4A(b)(5) (15 U.S.C. §77d(6)(D) and 77d-1(b)(5)).

[77] Securities Act of 1933 §18(b)(4)(c) (15 U.S.C. §77r(b)(4)(c)).

[78] Securities Act of 1933 §18(c)(2)(f) (15 U.S.C. §77r(c)(2)(f)).

Congressional testimony from the North American Securities Administrators Association ("NASAA") claimed that the Crowdfunding exemption "is far too broad."[79] NASAA is the trade association for state securities administrators. Consequently, Crowdfunding issuers should anticipate that states will seek to assure themselves that the Issuer has strictly complied with all the myriad of technical requirements to fulfill the Crowdfunding exemption.

Moreover, every other securities registration exemption focuses on the conditions at the time of the transaction to determine whether the conditions necessary for the exemption have been fulfilled. The Crowdfunding registration exemption as included in the rule proposal, instead, imposes conditions for the securities registration exemption that includes providing annual financial statements for years after the close of the transaction.

This means that there is no way to make a determination with certainty at the time of the close of a transaction that the transaction has fulfilled the Crowdfunding exemption obligation. There are continuing obligations. This issue will bring considerable risk to funding portals, broker-dealers and securities attorneys who participate in Crowdfunding and could find themselves at risk for aiding and abetting securities registration violations under state and federal law for failure to ensure that the issuer provided annual financial statements subsequent to the offering.

The future condition requirement for qualifying for the exemption also causes accounting issues. The future condition may cause the crowdfunded capital to be subject to a loss contingency assessment under GAAP.[80] At the very least, the loss contingency is likely to be required to be disclosed in a note to the financial statements.

This future condition for fulfilling the securities registration exemption can also cause issues with the Crowdfunding issuer's bank. How will banks and banking regulators treat Crowdfunding securities if there is an unfulfilled future condition for the offering exemption in connection with standard financial ratio covenants in credit facilities?

Imposing such complicated conditions on very small securities issuers in order to obtain a securities registration exemption is unrealistic given their limited compliance personnel capacity. Indeed, issuers will be almost completely dependent on funding portals and broker-dealers to try to comply with this complicated small offering regime. Given the far simpler alternatives, such as the general solicitation of accredited investors under Rule 506, small issuers have easier options to obtain a securities registration exemption.

Crowdfunding Intermediaries

Crowdfunded offerings must be sold through licensed intermediaries, either a registered broker-dealer or a "funding portal." Issuers cannot directly sell Crowdfunding offerings.

Funding portals are defined by the JOBS Act to be an entity licensed with the SEC that does NOT:

[79] Testimony of Jack E. Herstein, President of the North American Securities Administrators Association, Inc. Before the Senate Committee on Banking, Housing and Urban Affairs (December 1, 2011)

[80] FASB Accounting Standards Codification Subtopic 450-20, Contingencies – Loss Contingencies (ASC 450-20)

- Offer investment advice or recommendations;[81]

- Solicit purchases or sales or offers to purchase or sell securities;[82]

- Compensate employees, agents or other persons for soliciting securities or based on the sale of securities through the funding portal;[83] or

- Hold, manage, possess or otherwise handle investor funds or securities.[84]

The JOBS Act requires that a Crowdfunding intermediary, whether a broker-dealer or funding portal, to:

- Provide prospective investors disclosures required by the SEC;[85]

- "Ensure that each investor:"

    - Reviews investor education information required by the SEC;
    - "Positively affirms that the investor understands that the investor is risking the loss of the entire investment and that the investor can bear such a loss; and
    - "Answer questions demonstrating (i) an understanding of the level of risk generally applicable to investments in startups, emerging business and small issuers; (ii) an understanding of the risk of illiquidity; and (iii) an understanding of such other matters as the Commission deems appropriate, by rule;"[86]

- Take measures to reduce risk of fraud as required by the SEC, including obtaining background and securities regulatory history check on each officer, director and person holding 20% or more of the equity;[87]

- Make available to the SEC and prospective investors all the information required of Crowdfunding issuers not later than 21 days before the first sales date;[88]

- Ensure that offering proceeds are only provided to the issuer when the minimum offering amount has been met;[89]

- Make appropriate efforts, as determined by SEC rule, to ensure that no investor exceeds the Crowdfunding investing limits in a 12-month period;[90]

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[81] Securities Exchange Act of 1934 §3(a)(80)(A) (15 U.S.C. §78c(a)(80)(A)).

[82] Securities Exchange Act of 1934 §3(a)(80)(B) (15 U.S.C. §78c(a)(80)(B)).

[83] Securities Exchange Act of 1934 §3(a)(80)(C) (15 U.S.C. §78c(a)(80)(C)).

[84] Securities Exchange Act of 1934 §3(a)(80)(D) (15 U.S.C. §78c(a)(80)(D)).

[85] Securities Act of 1933 §4A(a)(3) (15 U.S.C. § 77d-1(a)(3)).

[86] Securities Act of 1933 §4A(a)(4) (15 U.S.C. § 77d-1(a)(4)).

[87] Securities Act of 1933 §4A(a)(5) (15 U.S.C. §77d-1(a)(5)).

[88] Securities Act of 1933 §4A(a)(6) (15 U.S.C. §77d-1(a)(6)).

[89] Securities Act of 1933 §4A(a)(7) (15 U.S.C. §77d-1(a)(7)).

- Protect investor privacy[91] (broker-dealers already required to follow Regulation S-P);

- Not compensate promoters, finders and lead generators for providing the broker or funding portal with the personal identifying information of any potential investor;[92]

- Prohibit the broker-dealer's or funding portal's directors, officers or partners from having a financial interest in the Crowdfunding issuer;[93] and

- Meet other requirements imposed by the SEC.[94]

Funding portals shall not be subject to state regulation by any state other than the portal's home state.[95]

Limitations on Resales

Investors who purchase Crowdfunding securities are limited as to how they can resell these securities beyond the requirements of SEC Rule 144[96] which provides a safe harbor from being deemed to be an underwriter of securities.

The JOBS Act provides that securities issued in a Crowdfunding Transaction may not be "transferred" during the first year from the date of purchase except transfers to (1) the issuer of the Crowdfunding securities;[97] (2) accredited investors;[98] (3) pursuant to an effective registration statement;[99] or (4) to a family member or equivalent in connection with a death or divorce of the purchaser.[100]

It is unclear whether the JOBS Act was intended to limit or override other secondary transfer exemptions such as Rule 144 which provides for a six month holding period if the issuer has been a reporting company for 90 days.[101] This provision also does not address other circumstances that may lead to the transfer of securities such as the distribution of the securities held by a business entity to its beneficial owners via dividend, distributions or dissolution.

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[90] Securities Act of 1933 §4A(a)(8) (15 U.S.C. §77d-1(a)(8)).

[91] Securities Act of 1933 §4A(a)(9) (15 U.S.C. §77d-1(a)(9)).

[92] Securities Act of 1933 §4A(a)(10) (15 U.S.C. §77d-1(a)(10)).

[93] Securities Act of 1933 §4A(a)(11) (15 U.S.C. §77d-1(a)(11)).

[94] Securities Act of 1933 §4A(a)(12) (15 U.S.C. §77d-1(a)(12)).

[95] Securities Exchange Act of 1934 §15(i) (15 U.S.C. §78*o*(i).

[96] SEC Rule 144 (17 CFR §230.144).

[97] Securities Act of 1933 §4A(e)(1)(A) (15 U.S.C. §7d-1(e)(1)(A)).

[98] Securities Act of 1933 §4A(e)(1)(B) (15 U.S.C. §77d-1(e)(1)(B)).

[99] Securities Act of 1933 §4A(e)(1)(C) (15 U.S.C. §77d-1(e)(1)(C)).

[100] Securities Act of 1933 §4A(e)(1)(D) (15 U.S.C. §77d-1(e)(1)(D)).

[101] SEC Rule 144(d)(1)(i) (17 CFR §230.144(d)(1)(i)).

Special Liability Provision

The JOBS Act created a special private cause of action against the only the issuer. It does not create a new cause of action against broker-dealers or funding portals. The JOBS Act provides that issuers can be liable in courts of competent jurisdiction for damages or rescission if the issuer sold the securities:

> by any means of any written or oral communication . . . (that) makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make such statements, in light of the circumstances under which they were made, not misleading, provided that the purchaser did not know of the untruth or omission."[102]

Crowdfunding investor plaintiffs will be required to prove lost causation[103] and have a three-year statute of limitations from purchase date.[104] Finally, the JOBS Act provides a no knowledge/due diligence defense.[105]

The JOBS Act Crowdfunding liability provision tracks the language of Section 17(a)(2) of the Securities Act of 1933.[106] In *Aaron v. SEC*, the Supreme Court examined the language of Section 17(a)(2) and determined that no culpable mental state was required for liability.[107] Likewise, it is likely that Crowdfunding investors will not be required to prove culpable mental states to hold issuers liable under the special Crowdfunding issuer cause of action in the JOBS Act.

Crowdfunding Investors Excluded from Shareholder Cap

Section 12(g) of the Securities Exchange Act of 1934, as amended by the JOBS Act, limits issuers to 2,000 shareholders held of record, provided that no more than 500 of these shareholders may be unaccredited investors.[108] The Crowdfunding provisions of the JOBS Act state that Crowdfunding investors will not be counted against this cap.[109] Consequently, Crowdfunding issuers can sell to hundreds or thousands of small investors, but such sales will not cause the issuers to become a public company.

Rulemaking

The SEC issued its 585 page Crowdfunding rule proposal with 284 requests for comments on October 23, 2013 with a comment period closing on February 4, 2014.[110] In

[102] Securities Act of 1933 §4A(c)(2)(A) (15 U.S.C. §77d-1(c)(2)(A)).

[103] Securities Act of 1933 §§4A(c)(2)(B) and 12(b) (15 U.S.C. §§77d-1(c)(2)(B) and 77*l*(b)).

[104] Securities Act of 1933 §§4A(c)(2)(B) and 13) (15 U.S.C. §77d-1(c)(2)(B) and 77m).

[105] Securities Act of 1933 §4A(c)(2)(B) (15 U.S.C. §77d-1(c)(2)(B)).

[106] Securities Act of 1933 §17(a)(2) (15 U.S.C. §77q(a)(2).

[107] *Aaron v. SEC*, 446 U.S. 680 (1980)

[108] Securities Exchange Act of 1934 §12(g)(1)(A) (15 U.S.C. §78*l*(g)(1)(a).

[109] Securities Exchange Act of 1934 §12(g)(6) (15 U.S.C. §78*l*(g)(6).

[110] SEC Release Nos. 33-9470; 34-70741; File No. S7-09-13 (October 23, 2013).

addition to the elements required by statute stated above, the rule proposal also requires the filing a new SEC form – a Form C.

Title IV—Regulation A—Small Company Capital Formation

Regulation A provided a registration exemption pursuant to Section 3(b) of the Securities Act and was intended for securities offerings of less than $5 million. Due to state registration requirements the exemption was not widely used. Qualified Regulation A offerings have declined from a peak of 57 in 1998 to only one in 2011.[111] Title IV of the JOBS Act is designed to reverse this trend by renumbering the previous Section 3(b) with the $5 million cap as Section 3(b)(1) and adding Section 3(b)(2) with a $50 million cap. ("Regulation A Plus"). Section 3(b)(2) provides (subject to SEC rulemaking) that:

1) Regulation A Plus Issuers may raise up to 50 million in any 12 month period;

2) Regulation A Plus securities may be offered and sold "publicly," that is, through general solicitation and advertising;

3) Regulation A Plus securities will not be restricted securities under Federal securities law;

4) Regulation A Plus does not impose conditions as to the type of purchaser;

5) Regulation A Plus issuers may solicit interest before filing an offering statement with the SEC to the extent permitted by SEC rule;

6) Regulation A Plus Issuers must file audited financial statements annually with the SEC; and

7) Regulation A Plus offerings are subject to the civil prospectus liability provisions of Section 12(a)(2) of the Securities Act. [112]

On December 18, 2013 the SEC published its 387 page rule proposal for Regulation A Plus.[113] Comments are due March 24, 2014. The rule proposal creates a structure of "Tier 1" Regulation A offerings subject to Section 3(b)(1) of the Securities Act and "Tier 2" subject to Section 3(b)(2) of the Securities Act. The following table shows some of the relevant provisions:

[111] U.S. Gov't Accountability Office, GAO-12-839, Securities Regulation: Factors That May Affect Trends in Regulation A Offerings 9 (2012) [hereinafter GAO Report].

[112] Securities Act of 1933 §3(b)(2); 77 U.S.C. §3(b)(2).

[113] SEC Release Nos. 33-9497; 34-71120; 39-2493; File No. S7-11-13 (December 18, 2013).

	Regulation A (Tier 1)	**Regulation A Plus (Tier 2)**
12 Month Period Offering Limit	$5 million, including no more than $1.5 million on behalf of selling shareholders.	$50 million, including no more than $15 million on behalf of selling shareholders.
Financial Statements	• Provide balance sheets for two most recently completed fiscal year ends (or for such shorter time that they have been in existence); • Provide statements of income, cashflows and stockholders' equity for each of two fiscal years preceding the date of the most recent balance sheet, and for any interim period between the end of the most recent fiscal year and the date of the most recent balance sheet; • Financial statements of significant acquired businesses; • Pro Form information relating to significant business combinations • Provide audited financial statements to the extent that the issuer has prepared them for other purposes • US GAAP for US domiciled issuers; and • IFRS or GAAP acceptable for Canadian-domiciled issuers.	• In addition to Tier 1 requirements, provide two years audited financial statements required; • US GAAP for US domiciled issuers; and • IFRS or GAAP acceptable for Canadian-domiciled issuers.
Ongoing Reporting Requirements	• File Part I of Form 1-Z not later than 30 calendar days after termination or completion of offering.	• Annual Reports, including audited annual financial statements; • Semi-Annual Reports; • Current Reports; and • Applies to successor issuers.
State Securities Registration Requirement Pre-emption	No State securities registration requirement pre-emption.	State securities registration requirement subject to pre-emption provided issuers comply with investment limitations, audited financial statements and ongoing reporting requirements.

	Regulation A (Tier 1) and Regulation A Plus (Tier 2)
Securities Allowed	• Equity securities; • Debt securities; • Debt securities convertible or exchangeable to equity interests; and • Any guarantees of such securities.
Securities Not Allowed	• Asset-backed securities as defined by Regulation ABS.
Issuers Not Allowed	• Reporting issuers; • Investment companies; • Blank check companies; • Issuers disqualified under bad actor provisions parallel to SEC Rule 506(d); • Issuers of fractional undivided interest in oil, gas or mineral interests; • Reporting issuers; • Issuers who have not filed with the SEC the ongoing reports required by the proposed Regulation A rules during the two years immediately preceding the new offering statement; and • Issuers subject to a SEC order denying, suspending or revoking the registration of a class of securities pursuant to Section 12(j) of the Exchange Act entered within five years of the filing of the offering statement.
Bad Actor Disqualification	Bad actor disqualification proposed to be same as recently adopted in SEC Rule 506(d).
Issuer Domicile	Issuers organized and with their principal place of business being in the United States or Canada.
Issuer Size	No proposed limit on issuer size, but comments sought on limiting issuer size.
Non-Integration Safe Harbor	• Prior offers or sales of Regulation A or Regulation A Plus securities; • Subsequent offers or sales of securities that are: o Registered under the Securities Act; o Made in reliance of Rule 701 under the Securities Act (compensatory benefit plans and contracts related to compensation); o Made pursuant to an employee benefit plan; o Made in reliance of Regulation S (offshore offerings); o Made more than six months after the completion of the Regulation A offering; and o Made pursuant to a Crowdfunding offering; and • Safe harbor also provided when issuer decides to register securities after soliciting interest in a contemplated, but abandoned, Regulation A or Regulation A Plus offering.
Civil Liability	Offering participants can be liable under Section 12(a)(2) of Securities Act (Prospectuses and Communications).

	Regulation A (Tier 1) and Regulation A Plus (Tier 2)
Application of Section 12(g)	Regulation A and Regulation A Plus securities count towards Section 12(g) held of record thresholds.
Offering Circular Delivery Requirement	• Access equals delivery for final offering circulars if investors have been provided preliminary offering circulars; • Notice required in preliminary offering circulars as to obligation to deliver final offering electronically; • Electronic-only delivery acceptable with prior consent of offeree; • Delivery of copy of offering circular required when sales take place within 90 calendar days after qualification; • Preliminary offering circular required to be delivered 48 hours before sale when preliminary offering circular is used during the prequalification period to offer such securities to potential investors; • 48 hour before sale provision can be met by delivery within 2 days after sale, provided that purchaser receives a copy of the final offering circular and a notice stating that the sale occurred pursuant to a qualified offering statement. Such notice is required to have URL of final offering circular.
Offering Circular	Offering Circular will have required elements based on a scaled version of Form S-1.
Electronic Filing	EDGAR and XML filing of Offering Statement required.
Confidential Filing	Confidential filing of Offering Statements will be available.
Continuous or Delayed Offerings Allowed	• Securities offered or sold by or on behalf of a person other than the issuer or its subsidiary; • Securities sold pursuant to a dividend or interest reinvestment plan; • Securities issued upon the exercise of outstanding options, warrants or rights; • Securities issued upon conversion of outstanding securities; • Securities pledged as collateral; and • Other qualified ongoing offerings.
Continuous or Delayed Offerings Information Requirements	• Use of Offering circular allowed where offering statement is not required to be amended by Regulation A and there is no fundamental change in Offering Statement disclosure. • Offering circular supplements allowed for final pricing
Offering Qualification	• By SEC order; and • Offering Circular required to be filed for 21 days before effective.
Testing the Waters	Allowed with no restriction on offeree type.

The SEC has the authority to suspend the Regulation A exemption for cause with an opportunity for hearing.

The opportunity to resell Regulation A Plus stock without restriction will provide a boon to OTC trading in Regulation A Plus securities. The required offering disclosure requirements comport with the requirements of 15c2-11 and can be used by broker-dealers to justify making market in the Regulation A Plus securities.

While the Rule Proposal generally seems reasonable, one potential problem is the requirement to file periodic reports indefinitely as a condition of the exemption. This will bring the same issues noted in connection with Crowdfunding. Qualified service providers will be hesitant to recommend or be involved with an offering in which the compliance with the securities registration exemption will not be known at or near the time of the exemption. Further, the equity capital raised may be treated as a contingent liability under FASB ASC 450-20.

Title V & VI—Shareholder Limits–-Private Company Flexibility and Growth and Capital Expansion

First, Title V of the JOBS Act increased the number of shareholders issuers can have before being required to become a periodic reporting company. Before the JOBS Act, the Exchange Act required registration of a class of an issuer's securities and periodic reporting if, as of the first day of the issuer's fiscal year, the issuer had more than $10 million in assets and the class of equity securities was "held of record" by 500 or more persons. The JOBS Act retains the $10 million threshold, but increases the 500 holders of record threshold to 2,000 holders of record or 500 or more persons who are not accredited investors. [114] As a result, private companies will need to keep track of the number of their non-accredited investors. The going-private shareholder standards have not changed.

Second, Title V of the JOBS Act directed to the SEC to issue rules excluding employees from the definition of held of record.[115] The SEC has yet to issue a rule proposal.

Third, Title V of the JOBS Act also directed the SEC to:

> adopt safe harbor provisions that issuers can follow when determining whether holders of their securities received the securities pursuant to an employee compensation plan in transactions that were exempt from the registration requirements of section 5 of the Securities Act of 1933.[116]

The SEC has yet to propose a rule regarding this required safe harbor.

Finally, Title V of the JOBS Act ordered the SEC to "examine its authority to enforce Rule 12g5-1 to determine if new enforcement tools are needed to enforce the anti-evasion

[114] Securities Exchange Act of 1934 §12(g)(1)(A); 15 U.S.C. §78a12(g)(1)(A).

[115] Jumpstart our Business Startups Act §502.

[116] Jumpstart our Business Startups Act §503.

provision contained in subsection (b)(3) of the rule."[117] This report requirement apparently stemmed from concerns over the recent use of private funds to acquire private company stock, particularly pre-IPO technology companies. SEC Rule 12g5-1(b)(3) provides that "if the issuer knows or has reason to know the form of holding securities is used primarily to circumvent the provisions of Section 12(g) or 15(d) of the act, the beneficial owners of such securities shall be deemed to be record owners thereof."[118] The SEC issued that report on October 15, 2012.[119] It concluded that the SEC Enforcement had sufficient enforcement tools.

Title VI of the JOBS Act provides that banks and bank holding companies will be subject to a Section 12(g) shareholder limit of 2,000 shareholders before they are required to file a registration statement or begin periodic reporting, provided the issuer has at least $10 million in assets.[120] Title VI also orders the SEC to issue final rules to implement Title VI.[121] The SEC has yet to propose such rules.

Conclusion

The effectiveness of much of the JOBS Act will depend on the implementation of SEC Rules. The IPO On-Ramp in Title I was not subject to SEC rulemaking and has had a significant impact on the IPO process for smaller issuers. The general solicitation provisions for Rule 506 in Title II have been of limited utility so far due to the investor verification requirements and the lack of a reliable third party verification infrastructure. The onerous rules proposed in July 2013, including Advance Form Ds, five year lookbacks for automatic disqualifications, busting an exemption for failure to file a notice form after the offering is closed, adding complexity to the Form D, requiring advertising legends and requiring the advertising be filed with the SEC may, if adopted, go even further in making the general solicitation opportunity irrelevant in helping to fulfill an issuer's capital needs. Likewise, the onerous limits and regulations placed on Crowdfunding, including the $1 million cap per 12 months, complex disclosure requirements, complex funding portal rules, requirements for audited or reviewed financial statements and the requirement to keep filing those financial statements for years as a condition of the Crowdfunding exemption likewise may result in Crowdfunding not being a reasonable path to fulfill an issuer's capital needs. When effective, Regulation A Plus may be an approach to raise significant capital for small issuers. Finally, the expansion of the "held of record" thresholds have provided flexibility to private issuers, banks and bank holding companies that wish to remain private entities.

[117] Jumpstart our Business Startups Act §504.

[118] SEC Rule 12g5-1(b)(3); 240 CFR §12g5-1(b)(3).

[119] Report on Authority to Enforce Exchange Act Rule 12g5-1 and Subsection (b)(3): As Required by Section 504 of the Jumpstart our Business Startups Act, October 15, 2012, found at http://www.sec.gov/news/studies/2012/authority-to-enforce-rule-12g5-1.pdf

[120] Jumpstart our Business Startups Act §601(a).

[121] Jumpstart our Business Startups Act §601(b).

Appendix A - IPO On-Ramp Practice Tips

The SEC's Division of Corporation Finance has provided guidance as to what it expects in EGC registration statements.

Prospectus Cover Page – The Division of Corporation Finance has been requiring mention of EGC status on prospectus cover pages in bold type. The following is a sample of expected language:

> We are an "Emerging Growth Company" under applicable Securities and Exchange Commission rules and will be subject to reduced public company reporting requirements. Investing in our common stock involves risks. See "Risk Factors" beginning on page _____.

Prospectus Summary – The Division of Corporation Finance expects a description of the impact of EGC status in the summary. The following sample language may be helpful:

Emerging Growth Company

We are an "Emerging Growth Company" under the Jumpstart our Business Startups Act (JOBS Act) which was signed into law by President Obama in April 2012. This means that we have lesser SEC-reporting company requirements than we would otherwise have. Specifically, Emerging Growth Companies are subject to the following lower reporting requirements:

- No requirement for an independent auditor attestation as to the effectiveness of our internal controls;
- No requirement to present more than two years of audited financial statements;
- No requirement to discuss our financial performance or to present supplemental financial information for periods more than two years previous;
- Any future possible periodic auditor rotation requirements will not apply to us;
- We may elect to delay compliance with new or revised financial accounting standards until such time as those standards also apply to companies that do not file periodic reports with the SEC;
- Our executive compensation disclosure will comply with the provisions applicable to smaller reporting companies, that is companies with less than $75 million in market capital, rather than other companies of comparable size to us;
- No requirement that we seek an advisory vote from shareholders as to the approval of our executive compensation (say-on-pay);

- No requirement that we seek a shareholder vote determining the frequency of shareholder advisory votes on executive compensation (say-on-pay vote frequency);

- No requirement for shareholder approval of golden parachutes for our officers and directors in mergers or change-of-control transactions;

- Research reports about us by a broker or dealer will not be part of our registration statement, even if the broker or dealer is participating in underwriting or selling our securities;

- Our management or agents may communicate orally and in writing with qualified institutional buyers or institutional accredited investors who are prospective investors in our initial public offering (IPO) before or after our registration statement becomes effective (provided such communications are supplemented with the delivery of our prospectus); and

- Brokers and dealers involved with offering and selling our securities may publish research reports relating to our company at any time after our IPO and within any restrictive period on the sale of securities by our holders after the IPO.

We will lose the above-described exemptions from our reporting and shareholder approval obligations when we cease to be an Emerging Growth Company. We will cease to be an Emerging Growth Company on the last day of the fiscal year following the date of the fifth anniversary of our first sale of common equity securities under an effective registration statement or a fiscal year in which we have $1 billion in gross revenues. We will also immediately cease to be an Emerging Growth Company if the market value of our common stock held by non-affiliates exceeds $700 million or upon our issuing $1 billion or more in non-convertible debt in a three year period. Finally, we may choose to opt-out of the emerging growth company status at any time. If we opt out of emerging growth company status we may not opt back in.

Prospectus Risk Factors – The Division of Corporation Finance expect to see the "Risk Factor" section in the prospectus to reference EGC status. The following is a sample risk factor language:

We are an "emerging growth company," and we cannot be certain if the reduced reporting requirements applicable to emerging growth companies will make our common stock less attractive to investors.

We are an "emerging growth company," as defined in the Jumpstart Our Business Startups Act, or the JOBS Act. For as long as we continue to be an emerging growth company, we may take advantage of exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies, including not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements and exemptions

from the requirements of holding a nonbinding advisory vote on executive compensation and shareholder approval of any golden parachute payments not previously approved. We could be an emerging growth company for up to five years, although circumstances could cause us to lose that status earlier, including if the market value of our common stock held by non-affiliates exceeds $700 million as of the last day of the fiscal year, if we issue $1 billion or more in non-convertible debt during the previous three-year period, or if our annual gross revenues exceed $1 billion. We would cease to be an Emerging Growth Company on the last day of the fiscal year following the date of the fifth anniversary of our first sale of common equity securities under an effective registration statement or a fiscal year in which we have $1 billion in gross revenues. We also would immediately cease to be an Emerging Growth Company if the market value of the common stock held by non-affiliates exceeds $700 million as of the last day of our fiscal year or upon our issuing $1 billion or more in non-convertible debt in a three year period. Finally, at any time we may choose to opt-out of the emerging growth company reporting requirements. If we chose to opt out, we will be unable to opt back in to being an emerging growth company. We cannot predict if investors will find our common stock less attractive because we may rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

If we are unable to implement and maintain effective internal control over financial reporting in the future, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock may decline.

As a public company, we will be required to maintain internal control over financial reporting and to report any material weaknesses in such internal control. Further, we will be required to report any changes in our internal controls on a quarterly basis. In addition, beginning with our 2014 annual report on Form 10-K to be filed in 2015, we will be required to furnish a report by management on the effectiveness of our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act. We are in the process of designing, implementing, and testing the internal control over financial reporting required to comply with this obligation, which process is time consuming, costly, and complicated. In addition, our independent registered public accounting firm will be required to attest to the effectiveness of our internal control over financial reporting beginning with our annual report on Form 10-K following the date on which we are no longer an "emerging growth company," which may be up to five full years following the date of this offering. If we identify material weaknesses in our internal control over financial reporting, if we are unable to comply with the requirements of Section 404 in a timely manner or assert that our internal control over financial reporting is effective, or if our independent registered public accounting firm is unable to express an opinion as to the effectiveness of our internal control over financial reporting when required, investors may lose confidence in the accuracy and completeness of our financial reports and the market price of our common stock could be negatively affected, and we could become subject to investigations by the stock exchange on which our securities are listed, the Securities and Exchange Commission, or the SEC, or other

regulatory authorities, which could require additional financial and management resources.

As an Emerging Growth Company, our auditor is not required to attest to the effectiveness of our internal controls.

Our independent accountant is not required to attest to the effectiveness of our internal control over financial reporting while we are an emerging growth company. This means that the effectiveness of our financial operations may differ from our peer companies in that they may be required to obtain independent accountant attestations as to the effectiveness of their internal controls over financial reporting and we are not. While our management will be required to attest to internal control over financial reporting and we will be required to detail changes to our internal controls on a quarterly basis, we cannot provide assurance that the independent accountant's review process in assessing the effectiveness of our internal controls over financial reporting will not find some new material deficiency. Further, once we cease to be an emerging growth company we will be subject to independent accountant attestation regarding the effectiveness of our internal controls over financial reporting. Even if management finds such controls to be effective, our independent accountant may decline to attest to the effectiveness of such internal controls and issue a qualified report.

As an Emerging Growth Company we are presenting our audited financial statements and selected financial data for only a two-year period, which may not be comparable to those companies that provide audited financial statements and selected financial data for longer periods of time.

The JOBS Act provides that emerging growth companies need not present more than 2 years of audited financial statements in connection with this prospectus and that they need not present selected financial data as required by SEC Regulation S-K Item 301 for periods that pre-date its audited financial statements. This selected financial data includes a table showing net sales, operating revenue, income or loss from continuing operations per common share, total assets, long-term obligations (including long-term debt, capital leases and redeemable preferred stock) and cash dividends per common share. We are providing only two years of audited financial statements and selected data. But, investors should understand that, on a comparable basis, our financial statements and selected financial data do not go back as far in time as other companies.

As an Emerging Growth Company we may opt out or have an extended transition period for compliance with new or revised accounting standards which may cause our financial statements to not be comparable to those companies that timely adopt the new or revised accounting standards.

The JOBS Act provides that we may not be required to comply with any new or revised accounting standard until such date as companies that do not file periodic reports with the SEC are required to comply with the new or revised accounting standard. If we elect not to adopt a specific new or revised accounting standard as of the effective date of the standard, then our financial statements will not be comparable to those companies that

comply with these new or revised accounting standards as of the standard's effective date. This lack of comparability may lead to material differences between the way we apply accounting standards and the way our peer group applies those standards which could impact our financial statements.

Moreover, the JOBS Act effectively requires Emerging Growth Companies to elect to comply with none of the new or revised accounting standards or all of them. If we chose to comply with a new or revised accounting standard applicable to reporting companies as of the effective date of the standard, we will be required to: 1) make such election at the time it is first required to file a registration statement, periodic report or other report with the SEC and notify the SEC of this election; 2) comply with all such new and revised standards and may not elect some standards for compliance and others for non-compliance; and 3) comply with such new or revised standards to the same extent that a non-emerging growth company is required to comply with such standards for so long as we are an emerging growth company.

Consequently, if we elect not to comply with a new or revised accounting standard, it is likely that we will be electing not to comply with several such new or revised standards which would further exacerbate the lack of comparability between our financial statements and the financial statements of a peer company that complies with the new or revised accounting standards as of the effective date for reporting companies.

We cannot predict if investors will find our common stock less attractive because we may rely on these postponements of the adoption of new or revised accounting standards. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock trading price may be more volatile.

***Prospectus Management Discussion and Analysis*:** The Division of Corporation Finance has focused on opting out of new accounting standards until these standards also apply to private companies. Most issuers have opted to comply with new accounting standards for public companies. The Division of Corporation Finance requires ECGs who elect to comply with new accounting standards when they apply to public companies to state this and to state that the election is irreversible.

The following is sample M D &A language for the minority of EGCs that elect not to comply with new accounting standards that are applicable to public companies, but not yet applicable to private companies.

Delayed Adoption of New or Revised Accounting Standards under the Jumpstart our Business Startups Act (JOBS ACT)

The JOBS Act provides that we may not be required to comply with any new or revised accounting standard until such date as companies that do not file periodic reports with the SEC are required to comply with the new or revised accounting standard. If we elect not to adopt a specific new or revised accounting standard as of the effective date of the standard, then our financial statements will not be comparable to those companies that

comply with these new or revised accounting standards as of the standard's effective date. This lack of comparability may lead to material differences between the way we apply accounting standards and the way our peer group applies those standards which could impact our financial statements.

Moreover, the JOBS Act effectively requires Emerging Growth Companies to elect to comply with none of the new or revised accounting standards or all of them. If we chose to comply with a new or revised accounting standard applicable to reporting companies as of the effective date of the standard, we will be required to: 1) make such election at the time it is first required to file a registration statement, periodic report or other report with the SEC and notify the SEC of this election; 2) comply with all such new and revised standards and may not elect some standards for compliance and others for non-compliance; and 3) comply with such new or revised standard to the same extent that a non-emerging growth company is required to comply with such standard for so long as we are an emerging growth company.

Consequently, if we elect not to comply with a new or revised accounting standard, it is likely that we will be electing not to comply with several such new or revised standards which would further exacerbate the lack of comparability between our financial statements and the financial statements of a peer company that complies with the new or revised accounting standards as of the effective date for reporting companies.

We cannot predict if investors will find our common stock less attractive because we may rely on these postponements of the adoption of new or revised accounting standards. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.