CARLTON FIELDS

JOBS Act Enhances Private Capital Raising Activities

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On April 5, 2012, Jumpstart Our Business Startup Act of 2012 (the "*JOBS Act*") was enacted into law. In addition to providing an "on-ramp" designed to ease the burden on emerging growth companies to engage in an IPO and phasing-in the obligations of being a public company, the JOBS Act also added provisions designed to enhance the ability of companies to raise funds through transactions that are exempt from registration under the Securities Act of 1933 (the "*Securities Act*"). In particular, the JOBS Act expanded the ability of companies to raise capital in private offerings by adding two new exemptions from registration under the Securities Act and providing for a significant modification to an existing exemption under Regulation D. **Modification to Regulation D and Rule 144A** The JOBS Act expands the ability to raise capital in offerings made pursuant to Rule 506 of Regulation D and Rule 144A by permitting the use of general advertising or general solicitation of potential investors under certain circumstances and providing an exemption from broker-dealer registration under the Securities Exchange Act of 1934 (the "*Exchange Act*") for certain intermediaries involved in Rule 506 offerings under Regulation D. **General Solicitation and Advertising Permitted** The JOBS Act requires the SEC to amend its rules within 90 days from its enactment (July 4, 2012) to eliminate the prohibition against general solicitation or general advertising in connection with private offerings made in reliance on:

- Rule 506 of Regulation D, so long as all purchasers of the securities are accredited investors as defined under Regulation D.

  Issuers will be required to take reasonable steps, using methods established by the SEC, to verify that the purchasers of the securities are accredited investors. It is unclear whether the SEC will consider the current practice of self-certification to be sufficient for these purposes.

- Rule 144A, so long as all purchasers of the securities are reasonably believed to be qualified institutional buyers ("*QIBs*") as defined under Rule 144A.

The elimination of the prohibition against general solicitation or general advertising also will

eliminate the need to establish a pre-existing relationship with a potential investor prior to offering them with a private placement offer. As a result, participants in private offerings will be able to publicly solicit investor interest through various forms of communications and media, including advertisements, e-mail, and social media. While these provisions may be directed more to privately-held companies, these revisions to Rule 506 and Rule 144A are not limited to offerings by privately-held companies and can also benefit public companies seeking private capital, including smaller public companies. However, companies will still be subject to the anti-fraud provisions of the securities laws and, as a result, will need to carefully consider the solicitation and advertising materials that they use to seek investors. **Broker-Dealer Exemption** In addition, the JOBS Act provides that, subject to certain specified requirements, registration with the SEC as a broker or dealer under the Exchange Act will not be required by a person who, in connection with the sale of securities pursuant to Rule 506:

- maintains a platform or mechanism that permits the offer, negotiation or sale of securities, or permits general solicitation (whether online or in person) (e.g., matching services), or

- provides ancillary services with respect to such securities (i.e., due diligence).

This exemption from SEC broker-dealer registration is available only if the person or its associated persons:

- do not receive compensation in connection with the purchase or sale of the offered securities;

- do not have possession of customer funds or securities in connection with the purchase and sale of the offered securities; and

- are not subject to certain statutory disqualifications (the “bad boy” provisions).

When combined with the higher thresholds for requiring Exchange Act registration and the ability of emerging growth companies to test the waters under Title I of the JOBS Act, this exemption may make it easier to develop secondary trading markets for private company securities. **Potential Implications** The ability to use general solicitation and general advertising to seek accredited investors for Rule 506 offering and QIBs for Rule 144A offerings may have the following impact:

- There may be an increased reliance on the safe harbors of Regulation D and Rule 144A to raise private capital rather than general reliance on Section 4(2) of the Securities Act (where it is uncertain whether general solicitation is permissible).

- The increased ability to access a wider pool of investors and to raise capital from private offerings, when combined with the increased thresholds also established under the JOBS Act for requiring Exchange Act registration (see our related bulletin "*The JOBS Act Eases Requirements Triggering the SEC's Exchange Act Registration Requirements*"), may permit companies to remain private longer.

- Companies will be able to more easily market concurrent side-by-side private placements and public offerings (including side-by-side offerings of both debt and/or equity).

  Previously, because of the publicity associated with a public offering and the prohibition against general solicitation in connection with a private offering, it was difficult to raise capital in side-by-side offerings. The elimination of the general solicitation prohibitions removes a substantial obstacle to such offerings and should provide additional flexibility in capital raising activities.

  However, integration issues still will need to be addressed.

- The burden will be on the companies selling securities under Rule 506 or Rule 144A through general solicitations or advertising to verify that all of the purchasers are accredited investors or QIBs, as the case may be. As a result, more formalized and standardized specific procedural steps are expected to be developed in order to demonstrate compliance with anticipated SEC rules relating to the verification of the accredited investor status of purchasers of securities pursuant to an offering under Rule 506 of Regulation D.

  Furthermore, there is nothing that would prevent the SEC from adopting rules in the future that revise the definition of an accredited investor or a QIB.

- Although the SEC is required to eliminate the general advertising and general solicitation prohibitions under Rule 144A for sales to QIBs (e.g., securities sold under Rule 144A may be *offered* to persons other than QIBs so long as *sold* only to QIBs), such publicity may still not be available in connection with a concurrent Rule 144A/Regulation S offering unless the SEC also modifies the prohibition in Regulation S against "directed selling efforts" that are very similar in concept to the current prohibition against general solicitation and general advertising.

- Private funds relying on Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940 may begin to use Rule 506 offerings to raise investment funds so that they can avail themselves of the ability to use general solicitations and general advertisements in locating potential investors.

  Private funds relying on Section 3(c)(1) or 3(c)(7) of the Investment Company Act are prohibited from raising capital through a public offering. Because general solicitations and general advertising are no longer deemed to be an "offer" and Rule 506 is a safe harbor under Section 4(2) of the Securities Act, the use of such means should not constitute a public offering. However, the SEC has not yet promulgated any rules under the JOBS Act and Rule 506 does not yet permit any such general solicitations and general advertising.

- The use of the Section 4(1½) exemption for resales will need to be reconsidered in view of the ability to use general solicitation and advertising for sale of securities in connection with the Section 4(2) safe harbor provisions of Rule 506.

  This raises issues as to whether the Section 4(1½) exemption (which is not a real exemption) must be more restrictive for resales than it is for primary offerings. In other words, can such resales be made to QIBs and accredited investors though general solicitation and advertising by a selling shareholder? If so, how may this impact reliance on Rule 144?

Crowdfunding Exemption A crowdfunding exemption has been established (and the JOBS Act requires the SEC to adopt implementing rules by December 31, 2012) that will exempt from registration certain offerings commonly-referred to as "crowdfunding" offerings pursuant to which private companies may raise up to $1 million over a 12-month period through the sale of small amounts of stock to an unlimited number of investors. In order to rely on this exemption from registration, sales of the securities must be made through a U.S. registered broker or through a funding portal (an "*Intermediary*") which Intermediary will be required to satisfy certain obligations (including registration with FINRA) and limitations imposed on them with respect to the offering, and the selling company is required to satisfy certain disclosure requirements and manner of sale requirements. Offerings under the crowdfunding exemption are not subject to registration under the laws of any state or regulation relating to offering or documentation requirements. For a more detailed description of the crowdfunding exemption, please see our firm's bulletin "*The Crowdfunding Act and Its Implications for Smaller Companies*." **Small Companies Capital Formation (Section 3(b) of the Securities Act and Regulation A)** The JOBS Act also amended and expanded Section 3(b) of the Securities Act (pursuant to which Regulation A was adopted) to add a provision that exempts from registration under the Securities Act offerings of up to $50 million that satisfy certain statutory terms and conditions (referred to herein as the "*New Regulation A*"). Under certain conditions, offerings made in compliance with New Regulation A would also be exempt from state law securities registration requirements. New Regulation A provides that the SEC shall adopt rules or regulations that exempt from registration under the Securities Act, offerings made on the

following terms and conditions:

- A company may be permitted to raise up to $50,000,000 during a 12-month period through the public offer and sale of equity or debt securities (including guarantees of such securities) under the New Regulation A.

- The securities issued under the New Regulation A may be offered to an unlimited number of non-affiliated investors and such shares sold under New Regulation A will continue to be freely tradable.

- The issuer may "test the waters" for investor interest prior to making any filing with the SEC.

- The SEC is granted the authority to determine the terms, conditions, or other requirements of the exemption as it deems appropriate, which may include the filing and distribution of an offering statement and related documents.

  The SEC is authorized to determine the content of any offering statement, and the JOBS Act clarifies that such content may include, among other things, audited financial statements, a description of the company's business, its financial condition, its corporate governance principles, and its uses of funds raised in the offering.

- The SEC also is authorized to prohibit issuers, insiders and certain other related parties that are subject to the "bad boy" provisions of rules to be adopted by the SEC under Section 926 of the Dodd-Frank Act from using any new Regulation A exemption.

A company that sells shares under New Regulation A (a "*New Regulation A Issuer*") will be subject to civil liability under Section 12(a)(2) of the Securities Act (the provisions that provide for prospectus liability) for misstatements or omissions made orally or in written materials in the course of the offer and sale of such securities. Under the JOBS Act, New Regulation A Issuers:

- will be required to file audited financial statements annually with the SEC.

- to the extent required by rules promulgated by the SEC, may be required to file with the SEC and distribute to investors periodic reports related to, among other things, its business operation, its financial condition, its corporate governance principles, and its uses of funds raised in the offering.

The SEC also is authorized to provide for the suspension and termination of any such periodic disclosure requirements (similar to its authority to permit deregistration of public companies under the Exchange Act). Securities sold pursuant to the requirements of New Regulation A will not be

subject to state securities and blue sky laws if such securities are either:

- offered or sold on a national securities exchange; or

- offered or sold to a "qualified purchaser" as such term is to be determined by the SEC.

New Regulation A may be viewed as an attractive bridge between private company status and being a public company subject to full compliance under the Exchange Act, such as later stage private companies. Because of the disclosure requirements and processes likely to be required for using New Regulation A (with respect to both the offering and the post-offering disclosure requirements), later stage companies could use the experience to establish the infrastructure necessary for a future public offering (as an emerging growth company or otherwise) while raising significant capital from both accredited and non-accredited investors. The shares sold under New Regulation A are not restricted securities (because they are publicly offered) and, as a result, will be freely transferable. This may prove attractive for institutional and other investors because they will not be saddled with any holding period prior to reselling such securities, and it may encourage the formation of secondary trading markets for the securities (unless the company seeks contractual trading restrictions). Although it is difficult to assess the potential impact of any New Regulation A until the SEC proposes and adopts implementing rules, it has the potential of creating a logical nexus for a measured transition from being a privately-held company to becoming a public company (including an emerging growth company which has its own phase-in prior to becoming subject to the full reporting requirements under the Exchange Act). **Effective Dates** As indicated above, the SEC is directed to revise Rule 506 and Rule 144A to eliminate the prohibition against general solicitation and general advertising by July 4, 2012 and to adopt rules implementing the Crowdfunding exemption by December 31, 2012. There is no established time frame for adopting implementing rules with respect to New Regulation A. Prior to the adoption of SEC rules implementing these changes (including any delay resulting in the failure to meet the deadlines established under the JOBS Act), market participants should continue to adhere to the currently existing safe harbor provisions under Rule 506 and Rule 144A (including Rules 135c, 152, and 155, as well as SEC interpretations regarding the integration of private and public offerings). The Crowdfunding exemption *may not* be utilized under any circumstances until the SEC promulgates implementing rules.

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