2013 JOBS ACT REVIEW & ANALYSIS OF EMERGING GROWTH COMPANY IPOs

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I. INTRODUCTION

In April 2012, the U.S. Congress passed the Jumpstart Our Business Startups Act (the "JOBS Act") with the goals of expanding access to capital markets and increasing flexibility in capital formation.[1] In short, the JOBS Act eases restrictions imposed by federal securities laws.[2] These laws—primarily the Securities Act of 1933, as amended (the "Securities Act"),[3] the Securities Exchange Act of 1934, as amended (the "Exchange Act"),[4] the Sarbanes-Oxley Act of 2002,[5] as amended (the "Sarbanes-Oxley Act"), and the Dodd-Frank Wall Street Reform and Consumer Protection Act,[6] as amended (the "Dodd-Frank Act")—are intended to protect both investors and markets.

This article is comprised of five Parts. Part II provides an overview of the JOBS Act, and Part III reviews JOBS Act-related rulemaking activity in 2013. While several JOBS Act provisions became effective upon enactment, other provisions have required rulemaking by the Securities and Exchange Commission ("SEC"). Part IV examines the extent to which the JOBS Act has impacted initial public offering ("IPO") activity in 2013. In particular, Part IV explores the extent to which companies have utilized the emerging growth company provisions of

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1 Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (hereinafter, "JOBS Act").

2 *President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, THE WHITE HOUSE (Apr. 5, 2012), http://www.whitehouse.gov/the-press-office/2012/04/05/president-obama-sign-jumpstart-our-business-startups-jobs-act.

3 Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (2013).

4 Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78pp (2013).

5 Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

6 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

the JOBS Act. In the past year, IPOs have made a resurgence.[7] This article posits that the JOBS Act may have been too broad and that companies that have recently gone public do not exhibit the attributes of an issuer as contemplated by Title I of the JOBS Act. Finally, Part V provides a brief conclusion.

II. OVERVIEW OF THE JOBS ACT

The JOBS Act included a range of provisions related to capital formation and securities regulation.[8] Specifically, the IPO process and disclosure requirements for certain companies changed, offering exemptions and related rules were revised or newly created, and certain Exchange Act registration thresholds were increased.[9] To provide context and foundation for the rest of the paper, this Part summarizes the main provisions of the JOBS Act.[10]

A. The IPO On-Ramp

The JOBS Act created special rules with respect to IPOs for a new category of issuers called "emerging growth companies" ("EGCs").[11] To facilitate going public for young companies,[12] Title I of the JOBS Act reduced disclosure obligations, eliminated auditor attestation of internal controls under Section 404(b) of the Sarbanes-Oxley Act and Dodd-Frank executive compensation vote requirements, expanded permissible communications with analysts and publication of research reports, provided for confidential draft registration statements, and allowed EGCs to "test the waters" before the securities offering.[13] Collectively, the provisions are referred to as the "IPO On-Ramp"[14] and provide up to a five-year transition period for EGCs.[15] These changes became effective upon enactment of the JOBS Act.[16]

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[7] *See, e.g.*, *IPO Market Momentum Breaks Full Year 2012 Totals, According to PwC's Q3 IPO Watch*, PRICEWATERHOUSECOOPERS LLP (Oct. 2, 2013), *available at* http://www.pwc.com/us/en/press-releases/2013/q3-2013-ipo-watch-press-release.jhtml.

[8] *See infra* notes 9-221 and accompanying text.

[9] *Id.*

[10] For a more exhaustive description of the JOBS Act, *see* James E. Bitter & Todd B. Skelton, *Reforms for Hire: The JOBS Act Legislation*, 14 TENN. J. BUS. L. 13 (2012).

[11] JOBS Act § 101(a).

[12] *President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, *supra* note 2.

[13] JOBS Act §§ 102-106.

[14] *President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, *supra* note 2.

[15] JOBS Act § 101(a).

To qualify as an EGC, the company must have "total annual gross revenues of less than $1,000,000,000 . . . during its most recently completed fiscal year."[17] An issuer may not qualify as an EGC if it conducted an IPO on or before December 8, 2011.[18] An issuer may retain its status as an EGC until the earliest of: (i) the last day of the fiscal year in which the issuer surpasses the revenue threshold, (ii) the last date of the fiscal year following the fifth anniversary of the first sale of common equity securities under the JOBS Act, (iii) the date on which the company has issued more than $1,000,000,000 non-convertible debt during a three-year period, or (iv) the date on which the issuer becomes a "large accelerated filer."[19] The "on-ramp" exemptions are not mandatory for all issuers that qualify as an EGC, as such issuers may opt in to compliance with the standards for non-EGCs.[20] EGCs may not, however, pick and choose exemptions with respect to applying new accounting standards.[21]

1. Confidential Draft Registration Statements

One of the most significant changes of the JOBS Act was permitting EGCs to submit confidential draft registration statements to the SEC.[22] Section 5 of the Securities Act requires companies to register any offer or sale of securities, unless the securities or transaction qualifies for an exemption.[23] To satisfy this requirement, a company must file a registration statement with the SEC.[24]

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16 *See* JOBS Act §§ 101-107.

17 JOBS Act § 101(a). This amount is indexed for inflation every five years. *Id.*

18 JOBS Act § 101(d). Thus, issuers that sold common equity securities for the first time after December 8, 2011, but before enactment of the JOBS Act on April 5, 2012, may qualify as an EGC and take advantage of applicable provisions.

19 JOBS Act § 101(a). Under the Exchange Act, an issuer becomes a "large accelerated filer" when: (i) the market value of its common equity is greater than $700,000,000, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) the issuer has been subject to the periodic reporting requirements of the Exchange Act for a period of at least twelve calendar months; (iii) the issuer has filed at least one annual report under the Exchange Act; and (iv) the issuer is not eligible to use the requirements for smaller reporting companies for its annual and quarterly reports. 17 C.F.R. § 240.12b-2(2) (2013).

20 JOBS Act § 107(a).

21 JOBS Act § 107(b).

22 JOBS Act § 106(a) (codified at 15 U.S.C. § 77f(e) (2013)).

23 15 U.S.C. § 77e (2013).

24 *Id.* Many times, this is a Form S-1 Registration Statement under the Securities Act of 1933; however, there are various types of registration statements depending on the issuer and

Previously, only foreign private issuers in limited circumstances were allowed to submit draft registration statements.[25] Under the JOBS Act, any EGC may submit a draft registration statement to the SEC for "confidential nonpublic review."[26] This permits EGCs to begin the IPO process without publicly announcing and disclosing sensitive business information that is required to be in a registration statement.[27] It is noteworthy that the issuer remains subject to the prohibitions on making offers under Section 5 of the Securities Act because the registration statement has not been publicly filed, unless the issuer uses an exception such as the "testing the waters" provisions of the JOBS Act.[28] The SEC has provided guidance and instructions regarding the submission of confidential submissions.[29] The company must publicly file with the SEC its registration statement—including the "initial confidential submission and all amendments thereto"—no later than twenty-one days before the issuer conducts a road show.[30] If the company, for whatever reason, elects not to complete the

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transaction. *See* Sec. & Exch. Comm'n Forms list, http://www.sec.gov/forms#.UzOKySgx_zI (last visited Mar. 26, 2014).

[25] *See* Sec. & Exch. Comm'n Non-Public Submissions from Foreign Private Issuers (May 20, 2012), http://www.sec.gov/divisions/corpfin/internatl/nonpublicsubmissions.htm (last visited Mar. 26, 2014).

[26] JOBS Act § 106(a).

[27] *See* JOBS Act § 106(a). A Registration Statement must include: information about the business and risks, planned use of proceeds, a description of the securities to be offered, the offering price determination methodology, and potential dilution, among other details. *See, e.g.,* Registration Statement under the Securities Act of 1933 (Form S-1), *available at* http://www.sec.gov/about/forms/forms-1.pdf.

[28] 15 U.S.C. § 77e (2013); JOBS Act § 105(c).

[29] *Jumpstart Our Business Startups (JOBS) Act Spotlight*, Sec. & Exch. Comm'n, http://www.sec.gov/spotlight/jobs-act.shtml (last visited Mar. 26, 2014).

[30] JOBS Act § 106(a). A road show is "an offer . . . that contains a presentation regarding an offering by one or more members of the issuer's management . . . and includes discussion of one or more of the issuer, such management, and the securities being offered . . . ." 17 C.F.R. § 230.433(h)(4) (2013).

Note that in the SEC's Electronic Data Gathering, Analysis, and Retrieval system ("EDGAR"), the initial confidential submission is available under the submission type DRS, which signifies "Draft Registration Statement." *Draft Registration Statements to Be Submitted and Filed on EDGAR*, Sec. & Exch. Comm'n (Sept. 26, 2012), http://www.sec.gov/divisions/corpfin/cfannouncements/drsfilingprocedures.htm (last visited Mar. 26, 2014).

IPO, it may withdraw the draft registration statement without ever making it public.[31]

2. Scaled Disclosure Requirements

EGCs have reduced, or scaled, disclosure requirements.[32] Unlike the typical requirement for issuers to include three years of audited financial information in a registration statement, EGCs must only include two years of audited financial statements and selected financial data and may take advantage of a similarly reduced Management Discussion and Analysis of Financial Condition and Results of Operations (commonly, "MD&A") section.[33]

Further, EGCs benefit from reduced compensation disclosure requirements and rolled back Dodd-Frank Act executive compensations reforms. The scaled executive compensation requirements applicable to smaller reporting companies now apply also to EGCs.[34] Additionally, EGCs will not be required to make internal pay equity or "golden parachute" disclosures required by the Dodd-Frank Act.[35]

Finally, EGCs have the choice of whether to comply with new or revised financial accounting standards until such standards apply to private companies[36] but may not pick-and-choose exemptions with respect to such standards.[37] In addition to not being subject to the auditor attestation of internal controls requirement under Section 404(b) of the Sarbanes-Oxley Act,[38] EGCs may also

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[31] *See* 17 C.F.R. § 230.477 (2013). In effect, this could allow a company to "avoid the market stigma associated with a failed offering." G. Michael O'Leary & David C. Buck, *JOBS Act Options for General Counsel to Ponder in IPOs*, TEXAS LAWYER (May 13, 2013), *available at* http://www.andrewskurth.com/pressroom-publications-976.html.

[32] *See infra* notes 33-40, 52-57 and accompanying footnotes.

[33] JOBS Act § 102(b)(1), (c); *Compare* JOBS Act § 102(b)(1) *with* 17 C.F.R. §§ 210.3-02a, 229.303 (2013).

[34] JOBS Act § 102(c); 17 C.F.R. § 229.402 (2013). In general, "smaller reporting companies" are issuers with a public float of less than $75 million, or, if the issuer's float is zero, annual revenues less than $50 million. 17 C.F.R. § 229.10(f)(1) (2013).

[35] JOBS Act § 102(a).

[36] JOBS Act § 102(b).

[37] JOBS Act § 107(b).

[38] JOBS Act § 103; Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 404(b), 116 Stat. 745 (2002) (codified at 15 U.S.C. § 7262(b)). The 404(b) internal controls audit has been a controversial piece of the Sarbanes-Oxley Act. *See, e.g.,* GOVERNANCE, RISK, AND COMPLIANCE

avoid compliance with certain Public Company Accounting Oversight Board rules[39] and new financial accounting standards until such standards are applicable to private companies.[40]

3. Testing the Waters

The JOBS Act also changed the restrictions on communications by the issuer when the offering is in process. Such rules—commonly referred to as "gun jumping" rules—are intended to avoid conditioning the market in advance of the offering.[41] These restrictions prohibit oral and written offers in connection with public offerings of securities before a registration statement is filed and apply based on the content of the information and timing in relation to the filing and effective date of the registration statement.[42] Under the JOBS Act, however, EGCs and authorized persons can "engage in oral or written communications with potential investors that are qualified institutional buyers or institutions that are accredited investors" before and after the filing of the registration statement.[43]

HANDBOOK: TECHNOLOGY, FINANCE, ENVIRONMENTAL, AND INTERNATIONAL GUIDANCE AND BEST PRACTICES 911 (Anthony Tarantino, ed., 2008).

[39] JOBS Act § 104. Such exemptions include mandatory audit rotation and auditor discussion and analysis supplements, if such rules were to be adopted by the Public Company Accounting Oversight Board ("PCAOB"). *Id.* This exemption also applies to any new rules adopted by the PCAOB after the effective date of the JOBS Act, provided that the SEC has not "determine[d] that the application of such additional requirements is necessary or appropriate in the public interest." *Id.*

[40] JOBS Act § 106(b).

[41] *See, e.g.,* Memorandum, Securities Offerings and Gun Jumping: What you Can and Cannot Do, Skadden Arps Slate Meagher & Flom LLP (Nov. 2012), *available at* http://www.skadden.com/sites/default/files/publications/Corporate_Finance_Alert_Securities_Offerings_and_Gun_Jumping_What_You_Can_and_Cannot_Do.pdf (hereinafter, "Skadden Gun Jumping Memorandum").

[42] *Id.*

[43] JOBS Act § 105(c). In general, under Rule 501 of Regulation D under the Securities Act, an "accredited investor" includes banking, insurance, and investment institutions; employee benefit plans; business development companies; certain 501(c)(3) organizations; directors or insiders of the issuers; individuals (i) with an individual net worth or joint net worth with that person's spouse of $1,000,000, excluding the value of a home, or (ii) annual income in excess of $200,000, or $300,000 jointly; trusts with total assets greater than $5,000,000, and entities in which the equity owners are all accredited investors. 17 C.F.R. § 230.501(a) (2013). The term "qualified institutional buyer" (or, more commonly, "QIBs") is defined in Rule 144A under the Securities Act and includes insurance companies, investment or business development companies, employee benefit plans, banks, and entities owned entirely by accredited investors, provided that a QIB

These communications allow EGCs to "test the water" regarding interest in the offering before a registration statement has been filed.[44] Importantly, however, the JOBS Act does not exempt EGCs or others from potential liability in association with offers.[45]

4. Research Reports and Analyst Involvement

The JOBS Act changed and eliminated several rules surrounding broker-dealers, research analysts, investment bankers, and EGC issuers. First, broker-dealers may now publish research reports with respect to an EGC that is the subject of a proposed offering regardless of whether a registration statement has been filed or has become effective.[46] Previously, a quiet period made such publication impermissible because the report could be deemed an offer for sale, thus causing a violation of Section 5(c) of the Securities Act that would give rise to liability under Sections 12(a)(1) and (2) of the Securities Act.[47] Now, such a report will not "constitute an offer for sale or offer to sell a security, even if the broker or dealer is participating or will participate in the registered offering of the securities of the issuer."[48] To accomplish this, the JOBS Act specifically excludes "[t]he publication or distribution by a broker or dealer of a research report about an emerging growth company that is the subject of a proposed public offering" from the definition of "offer to sale" and "offer to sell" in Section 2(a)(3) of the Securities Act.[49]

Additionally, analysts may now communicate with management of EGCs even when non-analysts, such as investment bankers, are present, which was previously a prohibited arrangement.[50] Finally, investment bankers may now,

"owns and invests on a discretionary basis at least $100 million in securities," or $10 million for broker-dealers. 17 C.F.R. § 230.144A (2013).

44 JOBS Act § 105(c); *see, e.g.*, Skadden Gun Jumping Memorandum, *supra* note 41.

45 JOBS Act § 105(c).

46 JOBS Act § 105(a).

47 15 U.S.C. § 77l (2013).

48 JOBS Act § 105(a).

49 *Id.*

50 JOBS Act § 105(b).

without limit on who may do so, arrange communication between analysts and potential investors.[51]

5. Post-IPO Disclosure and Reporting Requirements for EGCs

The JOBS Act's special rules for EGCs do not end once the IPO is complete.[52] Providing that the issuer remains an EGC, it may take advantage of continued reduced disclosure requirements.[53] First, with respect to Exchange Act disclosure obligations such as periodic and other reports, EGCs do not have to provide selected financial data "for any period prior to the earliest audited period presented in connection with its first registration statement that became effective."[54] Exemption from new or revised financial accounting standards also continues.[55] Second, EGCs are exempt from Sarbanes-Oxley's Section 404(b) internal controls audit requirements[56] and are not required to comply with certain PCAOB standards.[57] Third, in addition to continued scaled compensation disclosure requirements, EGCs do not have to hold "say-on-pay," "say-on-frequency," and "golden parachute" votes regarding executive compensation, as implemented under the Dodd-Frank Act.[58] The JOBS Act also carved out "pay for performance" compensation disclosures for EGCs.[59]

B. Thresholds for Registering Securities

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51 *Id.*

52 *See infra* notes 33-40, 52-57 and accompanying footnotes.

53 *Id.*

54 JOBS Act § 102(b)(2).

55 *Id.*

56 JOBS Act § 103.

57 JOBS Act § 104.

58 JOBS Act § 102(a); 15 U.S.C. § 78n-1(e)(2) (2013). The "say on pay" vote allows shareholders of public companies to cast a non-binding vote on executive compensation at least every three years. 15 U.S.C. § 78n-1(a)(1) (2013). Moreover, at least once every six years, shareholders shall vote on the frequency of the "say on pay" vote. 15 U.S.C. § 78n-1(a)(2) (2013). A separate shareholder vote on golden parachute compensation is also required. 15 U.S.C. § 78n-1(b) (2013). Once an issuer no longer qualifies for EGC treatment, these votes must occur within one year, or three years if an issuer was an EGC for less than two years. JOBS Act § 102(a).

59 JOBS Act § 102(a)(3) (excluding compliance with section 953(b)(1) of the Dodd-Frank Act).

Section 12(g) of the Exchange Act includes certain thresholds for when an issuer must register its securities and become a "reporting company."[60] These provisions require a private company with $10 million or more in assets to become a reporting company once it exceeds the holder of record threshold.[61] More specifically, the issuer must register any class of its equity securities and becomes subject to the continuous disclosure requirements (e.g., annual and periodic reporting) of the Exchange Act.[62] The JOBS Act increased the holder of record threshold for non-banks from 500 to (i) 2,000 persons or (ii) 500 persons who are not accredited investors.[63] Securities received under employee compensation plans, which are exempt from Section 5 of the Securities Act, do not count towards the shareholder threshold.[64] The holder of record threshold and deregistration threshold for banks and bank holding companies were also increased, as the shareholder threshold increased to 2,000 persons and the deregistration threshold increased from 300 to 1,200 persons.[65]

C. Crowdfunding, Offering Exemptions, and the General Solicitation Ban

Section 5 of the Securities Act prohibits the offer or sale of securities, absent registration or an exemption.[66] In general, exemptions are based on the type of security or the nature and size of the transaction.[67] A detailed review of all

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60 15 U.S.C. § 78l(g) (2012); 17 C.F.R. § 240.12g-1 (2012).

61 15 U.S.C. § 78l(g) (2012); 17 C.F.R. § 240.12g-1. Various anecdotes for companies including Facebook and Google provide examples for the concern regarding surpassing the 500-shareholder threshold. *See, e.g.,* Skelton & Bitter, *supra* note 10, at n. 177; Steven M. Davidoff, Facebook and the 500-Person Threshold, N.Y. TIMES DEALBOOK (Jan. 3, 2011, 4:03 PM), http://dealbook.nytimes.com/2011/01/03/facebook-and-the-500-person-threshold/?_php=true&_type=blogs&_r=0.

62 15 U.S.C. § 78l(g) (2012); 17 C.F.R. § 240.12g-1 (2012).

63 JOBS Act § 501; 15 U.S.C. § 78l(g) (2013). For purposes of the Exchange Act, "person means a natural person, company, government, or political subdivision, agency, or instrumentality of a government." 15 U.S.C. § 78b(a)(9) (2013). Shareholders of private companies typically hold their shares directly—as opposed to holding in "street name"—and would be counted individually for Section 12(g) purposes. *See, e.g.,* Memorandum, 'Jumpstart Our Business Startups Act' Signed Into Law, Skadden, Arps, Slate, Meagher & Flom LLP (April 2012).

64 JOBS Act § 502 (codified at 15 U.S.C. § 78l(g)(5)).

65 JOBS Act § 601; 15 U.S.C. § 78l(g)(1), (4) (2013).

66 15 U.S.C. § 77e (2013).

67 *See, e.g.,* Joan M. Heminway & Shelden R. Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 911-21 (2011); James E. Bitter & Todd B. Skelton,

available exemptions is beyond the scope of this paper; instead, only the exemptions affected by the JOBS Act will be addressed. First, one of the most high-profile provisions of the JOBS Act is the newly created crowdfunding exemption, Section 4(6) of the Securities Act.[68] Second, the JOBS Act expanded Section 3(b) of the Securities Act by requiring new rulemaking by the SEC to increase the maximum offering limit under the Regulation A exemptions.[69] Additionally, the JOBS Act eliminated the ban on general solicitation and advertising in connection with offerings made under Rule 506 of Regulation D and Rule 144A under the Securities Act.[70] The SEC has issued rules with respect to each of these three changes, which are the subject of Part III of this paper.

III. RULEMAKING UPDATE: 2013 IN-REVIEW

In 2013, the SEC continued its rulemaking obligations under the JOBS Act. In addition to promulgating final rules with respect to lifting the ban on general solicitation in certain private securities offerings and disqualifying "felons and other 'bad actors'" from Rule 506 of Regulation D, the SEC proposed rules regarding crowdfunding, the small offering exemption under Regulation A, and filing a Form D in Rule 506(c) offerings before the issuer engages in general solicitation.[71]

A. Removal of the Ban on General Solicitation in Certain Offerings & Disqualifying Bad Actors

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Reforms for Hire: The JOBS Act Legislation, 14 TRANSACTIONS: TENN. J. BUS. L. 13, 14-27 (2012). For instance, bank securities are exempt from the Securities Act because such issuers and offerings are monitored via other regulatory regimes. MICHAEL P. MALLOY, PRINCIPLES OF BANK REGULATION 274-75 (3d ed. 2011).

68 JOBS Act § 302.

69 JOBS Act § 401(a).

70 JOBS Act § 201(a)(1).

71 Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, 78 Fed. Reg. 44,771 (July 24, 2013); Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings, Securities Act Release No. 33-9414, 78 Fed. Reg. 44,730 (July 24, 2013); Crowdfunding, Securities Act Release No. 33-9470, 78 Fed. Reg. 66,427 (proposed Nov. 5, 2013); Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, Securities Act Release No. 33-9497, 79 Fed. Reg. 3,926 (proposed Jan. 23, 2014) Amendments to Regulation D, Form D and Rule 156, Securities Act Release No. 33-9416, 78 Fed. Reg. 44,806 (proposed July 24, 2014); Amendments to Regulation D, Form D and Rule 156; Re-Opening of Comment Period, Securities Act Release No. 33-9458, 78 Fed. Reg. 61,222 (proposed Oct. 3, 2013).

The JOBS Act eliminated the ban on general solicitation and advertising in connection with offerings made under Rule 506(c) of Regulation D and Rule 144A under the Securities Act.[72] While the two rules are already important mechanisms for accessing capital markets in the United States, the goal underlying lifting the ban is to make it easier for companies to attract investors.[73] Prior to the JOBS Act, general solicitation and advertising—e.g., advertising in newspapers and on the radio, television, or Internet—was prohibited in offerings under Rules 506 and 144A, in accordance with Rule 502(c).[74] Rule 506 of Regulation D is a nonexclusive safe harbor for compliance with Section 4(a)(2) of the Securities Act, which exempts "transactions by an issuer not involving any public offering."[75] There is no maximum offering limit in Rule 506, making the exemption widely used, provided that such offerings are made only to accredited investors or up to thirty-five non-accredited investors.[76] Rule 144A is a widely used "safe harbor exemption from the registration requirements [of Section 4(a)(1)] of the Securities Act of 1933 for resales of restricted securities to 'qualified institutional buyers . . . .'"[77] Rule 144A transactions are private

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[72] JOBS Act § 201(a)(1), (2).

[73] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, 78 Fed. Reg. 44,771, 44,773 (July 24, 2013); Fact Sheet, Eliminating the Prohibition on General Solicitation and General Advertising in Certain Offerings, Securities and Exchange Commission (July 20, 2013).

[74] 17 C.F.R. § 230.144A(d)(1) (2012); 17 C.F.R. § 230.506 (2012); 17 C.F.R. § 230.502(c) (2013) (providing examples of forms of general solicitation); Use of Electronic Media, Securities Act Release No. 33–7856, 65 Fed. Reg. 25,843, 25,851-52 (May 4, 2000) (providing "guidance on the use of electronic media by issuers" and market intermediaries in conducting offerings). Rule 144A did not include an explicit prohibition on general solicitation, but the restriction on selling on to QIBS had "the same practical effect." Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, 78 Fed. Reg. 44,771, 44,773 (July 24, 2013).

[75] 17 C.F.R. § 230.506 (2012); 15 U.S.C. § 77d(a)(2) (2013). Rule 506 states that "[o]ffers and sales of securities by an issuer that satisfy the [enumerated] conditions . . . shall be deemed to be transactions not involving any public offering within the meaning of [S]ection 4(2) . . . ." *Id.* Note that Section 4(a)(2) of the Securities Act is formerly Section 4(2). 15 U.S.C. 77d(a)(2) (2013).

[76] 17 C.F.R. § 230.506(b) (2012). However, "[e]ach purchaser who is not an accredited investor, either alone or with his purchaser representative(s)," must have, or the issuer must "reasonably believe[] immediately prior to making any sale" that such purchaser possesses, "such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment." *Id.* at § 230.506(b)(ii).

[77] Resale of Restricted Securities, Securities Act Release No. 6862 (Apr. 23, 1990). The term "qualified institutional buyer" is defined in Rule 144A under the Securities Act and includes

transactions wherein non-issuer holders may resell to qualified institutional buyers ("QIBs") restricted securities that are not listed on a national securities exchange or quoted in an automated inter-dealer quotation system.[78] Under the pre-JOBS Act Rule 144A, securities could be "offered or sold only to a qualified institutional buyer or to an offeree or purchaser that the seller and any person acting on behalf of the seller reasonably believe is a qualified institutional buyer."[79]

1. Final Rule Lifting the Ban on General Solicitation

In July 2012, the SEC adopted a final rule to implement the removal of the prohibition on general solicitation and advertising in offerings made under Rule 506(c) of Regulation D and Rule 144A under the Securities Act (the "Solicitation Rule").[80] The SEC first released the proposed rule for comment in August 2012.[81] Under the Solicitation Rule, general solicitation and advertising to any investor is permitted, provided that purchasers of the securities are only accredited investors or QIBs under Rule 506(c) and Rule 144A, respectively.[82] To be clear, the prohibition on general solicitation and advertising still applies to offerings made in reliance on the Section 4(a)(2) or Regulation D exemptions other than those made under Rule 506(c).[83]

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insurance companies, investment or business development companies, employee benefit plans, banks, and entities owned entirely by accredited investors, provided that a QIB "owns and invests on a discretionary basis at least $100 million in securities," or $10 million for broker-dealers. 17 C.F.R. § 230.144A (2013). Further, "[r]estricted securities" are "[s]ecurities acquired directly or indirectly from the issuer, or from an affiliate of the issuer, in a transaction or chain of transactions not involving any public offering." 17 C.F.R. § 230.144(a)(3) (2013).

Section 4(a)(1) of the Securities Act is formerly Section 4(1). JOBS Act § 201 (codified at 15 U.S.C. 77d(a)(1) (2013)).

[78] 17 C.F.R. § 230.144A(d)(3) (2012).

[79] 17 C.F.R. § 230.144A(d)(1) (2012).

[80] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, 78 Fed. Reg. 44,771, 44,804-05 (July 24, 2013) (hereinafter, the "Solicitation Rule").

[81] Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9354, 77 Fed. Reg. 54,464 (proposed Sept. 5, 2012).

[82] Solicitation Rule, 78 Fed. Reg. at 44,804-05 (to be codified at 17 C.F.R. § 230.506(c)(2)).

[83] Solicitation Rule, 78 Fed. Reg. at 44,774.

To implement this change, a new section (c) was added to amended Rule 506 and the conditions of Rule 502 were revised.[84] As a result of these changes, general solicitation is now permissible under Rule 506(c), provided that certain conditions are met.[85] These conditions include: (i) Rule 501 and Rules 502(a) and (b) must be satisfied, (ii) purchasers of securities must be accredited investors, and (iii) the issuer must take reasonable steps to verify that the purchasers are accredited investors.[86]

The Solicitation Rule—in Rule 506(c)(2)(ii)—provides non-exclusive guidance regarding the requirement that issuers take reasonable steps to verify that a natural person who purchases securities is an accredited investor.[87] Issuers are "deemed to take reasonable steps" if it uses one of the non-exclusive, non-mandatory methods, provided "that the issuer does not have knowledge that such person is not an accredited investor."[88] The four methods include:

Method	**Steps**
Income	(i) Review "any Internal Revenue Service form that reports the purchaser's income for the two most recent years," and (ii) Obtain "written representation from the purchaser that he or she has a reasonable expectation of reaching the income level necessary to qualify as an accredited investor during the current year[.]"[89]
Net Worth	(i) Review one or more of the following types of documentation dated within the prior three months: *(1)* With respect to assets: Bank statements, brokerage statements and other statements of securities holdings, certificates of deposit, tax assessments, and appraisal reports issued by independent third parties; and *(2)* With respect to liabilities: A consumer report from at

84 Solicitation Rule, 78 Fed. Reg. at 44,804-05 (to be codified at 17 C.F.R. §§ 230.502, 506(c)).

85 Solicitation Rule, 78 Fed. Reg. at 44,804-05 (to be codified at 17 C.F.R. § 230.506(c)).

86 Solicitation Rule, 78 Fed. Reg. at 44,804-05 (to be codified at 17 C.F.R. § 230.506(c)(1), (2)).

87 JOBS Act § 201(a)(1); Solicitation Rule, 78 Fed. Reg. at 44,804-05 (to be codified at 17 C.F.R. § 230.506(c)(2)(ii)).

88 Solicitation Rule, 78 Fed. Reg. at 44,804-05 (to be codified at 17 C.F.R. § 230.506(c)(2)(ii)).

89 Solicitation Rule, 78 Fed. Reg. at 44,804 (to be codified at 17 C.F.R. § 230.506(c)(2)(ii)(A)).

	least one of the nationwide consumer reporting agencies; or (ii) Obtain "written representation from the purchaser that all liabilities necessary to make a determination of net worth have been disclosed."[90]
Certain Written Confirmation	Obtain "written confirmation from one of the following . . . that such person or entity has taken reasonable steps to verify that the purchaser is an accredited investor within the prior three months and has determined that such purchaser is an accredited investor: *(1)* A registered broker-dealer; *(2)* An investment adviser registered with the [SEC]; *(3)* A licensed attorney who is in good standing under the laws of the jurisdictions in which he or she is admitted to practice law; or *(4)* A certified public accountant who is duly registered and in good standing under the laws of the place of his or her residence or principal office."[91]
Prior Accredited Investor Status	Obtain certification by a "person who purchased securities in an issuer's Rule 506(b) offering as an accredited investor prior to September 23, 2013 and continues to hold such securities" that such person qualifies as an accredited investor at the time of sale for the same issuer's Rule 506(c) offering.[92]

Should a person qualify as an accredited investor based on their joint income or net worth with that person's spouse, the issuer should review the applicable forms and obtain written representations from "both the person and the spouse."[93]

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[90] Solicitation Rule, 78 Fed. Reg. at 44,804 (to be codified at 17 C.F.R. § 230.506(c)(2)(ii)(B)).

[91] Solicitation Rule, 78 Fed. Reg. at 44,804-05 (to be codified at 17 C.F.R. § 230.506(c)(2)(ii)(C)).

[92] Solicitation Rule, 78 Fed. Reg. at 44,804-05 (to be codified at 17 C.F.R. § 230.506(c)(2)(ii)(D)).

[93] Solicitation Rule, 78 Fed. Reg. at 44,805 (to be codified at 17 C.F.R. § 506(c) (providing instructions)).

Finally, the Solicitation Rule revised Form D, which is a notice filing for issuers making offerings under Regulation D, to include a check box in which the issuer would indicate its reliance upon Rule 502(c) of Regulation D.[94]

2. Bad Actors Disqualification for Rule 506 of Regulation D

On the same day it adopted the Solicitation Rule, the SEC adopted another final rule disqualifying "issuers and other market participants from relying on Rule 506 [of Regulation D] if "felons and other 'bad actors'" are participating in the Rule 506 offering" (the "Bad Actors Rule").[95] Section 926 of the Dodd-Frank Act required the SEC to disqualify certain securities offerings under Rule 506 of Regulation D, similar to the disqualification rules of Rule 262 of Regulation A.[96]

The Bad Actors Rule added a new section (d) to Rule 506 of Regulation D, disqualifying an offering from reliance on Rule 506(b) and 506(c) of Regulation D if the issuer or a person covered by Rule 506(d) has a relevant criminal conviction, regulatory or court order or other disqualifying event that occurred on or after September 23, 2013.[97]

In addition to the issuer, the Bad Actors Rule includes "bad acts" by the following:

> [A]ny predecessor of the issuer; any affiliated issuer; any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer; any beneficial owner of 20% or more of the issuer's outstanding voting equity securities . . .; any promoter connected with the issuer in any capacity at the time of such sale; any investment manager of an issuer that is a pooled investment fund; any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in

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94 Solicitation Rule, 78 Fed. Reg. at 44,805 (to be codified at 17 C.FR. pt. 239 (Form D)).

95 Disqualification of Felons and Other "Bad Actors" From Rule 506 Offerings, Securities Act Release No. 33-9414, 78 Fed. Reg. 44,730 (July 24, 2013) (hereinafter, "Bad Actors Rule").

96 Bad Actors Rule, 78 Fed. Reg. at 44,731; Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 926, 124 Stat. 1376, 1851 (2010); 17 C.F.R. § 230.262 (2013).

97 Bad Actors Rule, 78 Fed. Reg. at 44, 770 (to be codified at 17 C.F.R. § 230.506(d)).

> connection with such sale of securities; any general partner or managing member of any such investment manager or solicitor; or any director, executive officer or other officer participating in the offering of any such investment manager or solicitor or general partner or managing member of such investment manager or solicitor[.][98]

The Bad Actors Rule includes an expansive list of relevant bad acts, including, for instance, felonies or misdemeanors "in connection with the purchase or sale of any security" or "[i]nvolving the making of any false filing with the [SEC]" within ten years of the sale,[99] orders or judgments "entered within five years before such sale, that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct" relating to securities; final orders by agencies barring certain association or conduct; revocation of registration as a broker or dealer; and other, related events.[100]

The Bad Actors Rule does not disqualify Rule 506 offerings retrospectively, but the new section (e) to Rule 506 provided that issuers must disclose in writing to each purchaser any "bad actor" events that occurred prior to September 23, 2013.[101]

3. Proposed Rule Requiring the Filing of a Form D in Rule 506(c) Offerings Before the Issuer Engages in General Solicitation

In connection with the Solicitation Rule and Bad Actors Rule, the SEC also released for comment proposed amendments to Regulation D, Form D, and Rule 156 under the Securities Act.[102] These amendments would increase the disclosure obligations of an issuer relying on Regulation D.[103] The SEC noted in the Solicitation Rule that many comments received by the SEC regarding the

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98 Bad Actors Rule, 78 Fed. Reg. at 44, 770 (to be codified at 17 C.F.R. § 230.506(d)(1)).

99 The relevant time period for felony and misdemeanor convictions is five years for issuers, predecessors, and affiliated issuers. *Id.*

100 Bad Actors Rule, 78 Fed. Reg. at 44,770-71 (to be codified at 17 C.F.R. § 230.506(d)(i)-(viii)).

101 Bad Actors Rule, 78 Fed. Reg. at 44,771 (to be codified at 17 § C.F.R. 230.506(e)).

102 Amendments to Regulation D, Form D and Rule 156, Securities Act Release No. 33-9416, 78 Fed. Reg. 44,806 (proposed July 24, 2014).

103 Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,851-55.

proposed rule were concerned with fraud and compromised investor protection.[104] Thus, the proposed amendments to Regulation D "are intended to enhance the Commission's understanding of the Rule 506 market" and "facilitate the assessment of the effects of [Rule 506(c)] on investor protection and capital formation."[105]

As proposed, issuers would be required to file a Form D in Rule 506(c) offerings fifteen days before engaging in general solicitation and file a closing amendment within thirty days after the termination of such offering.[106] Further, under a new Rule 509 of Regulation D, written solicitation materials would need to meet requirements regarding legends and disclosures and, under Rule 510T of Regulation D, would temporarily have to be submitted to the SEC.[107] An issuer would also be required to include in Form D greater information about offerings made under Regulation D.[108] Under Rule 507 of Regulation D, failure by an issuer, or any predecessor or affiliate, to comply with the Form D filing requirements would disqualify such issuer from relying on Rule 506 for one year.[109]

Additionally, the proposed amendments would bring the sales literature of private funds under the antifraud provisions of Rule 156 under the Securities Act.[110] Rule 156 applies the antifraud provisions of Section 17(a) of the Securities

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104 Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Securities Act Release No. 33-9415, 78 Fed. Reg. 44,771, 44,774 (July 24, 2013).

105 Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,808.

106 Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,851 (to be codified at 17 C.F.R. § 230.503(a)).

107 Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,852 (to be codified at 17 C.F.R. § 230.509, 510T). Submission of solicitation materials is temporary under proposed Rule 510T, and the submissions may not be available to the public. Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,809.

108 Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,852-55 (to be codified at 17 C.F.R. § 239.500).

109 Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,851 (to be codified at 17 C.F.R. § 230.507).

110 Amendments to Regulation D, Form D and Rule 156, 78 Fed. Reg. at 44,851 (to be codified at 17 C.F.R. § 230.156).

Act and Section 10(b) of and Rule 10b-5 under the Exchange Act to investment company sales literature.[111]

Comments were originally due by September 23, 2013, but the SEC re-opened the comment period until November 4, 2013.[112] The SEC has not yet adopted final rules regarding the proposed amendments.

4. Anticipated Use of Rule 506(c)

Issuers and legal counsel remain cautious as to the requirements and what conduct is acceptable in this new environment.[113] Few companies thus far have indicated interest in general solicitation.[114] Many commentators believe that hedge funds—who typically rely on private placement exemption for offerings—will be among the first to utilize general solicitation under Rule 506(c).[115] The elimination of the ban on general solicitation and advertising permits public marketing by hedge funds, allowing such entities to attempt to build a brand with

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111 17 C.F.R. § 230.156(a) (2013). Under Rule 156, it is unlawful "to use sales literature which is materially misleading in connection with the offer or sale of securities issued by an investment company. Under these provisions, sales literature is materially misleading if it: (1) Contains an untrue statement of a material fact or (2) omits to state a material fact necessary in order to make a statement made, in the light of the circumstances of its use, not misleading." *Id.*

112 Amendments to Regulation D, Form D and Rule 156; Re-Opening of Comment Period, Securities Act Release No. 33-9458, 78 Fed. Reg. 61,222 (proposed Oct. 3, 2013).

113 *See, e.g.,* Rosanne E. Felicello, *The JOBS Act from a Securities Litigation Perspective*, 9 SEC. LITIG. REP. 20, 21 (2012) (discussing the potential for litigation over "reasonable steps" taken to verity investor status); Emily Chasan, *New Private Fundraising Rules Attract Meager Interest*, WALL ST. J. (Mar. 24, 2014, 4:37 PM), http://blogs.wsj.com/cfo/2014/03/24/new-private-fundraising-rules-attract-meager-interest/; Ruth Simon & Angus Loten, *Fundraising Rules Murky Despite JOBS Act*, WALL ST. J., Nov. 13, 2013, http://online.wsj.com/news/articles/SB10001424052702304868404579194061455051506.

114 Emily Chasan, *New Private Fundraising Rules Attract Meager Interest*, WALL ST. J. (Mar. 24, 2014, 4:37 PM), http://blogs.wsj.com/cfo/2014/03/24/new-private-fundraising-rules-attract-meager-interest/; Erin Griffin, *General Solicitation off to a Slow (But Promising) Start*, FORTUNE (Feb. 25, 2014, 3:35 PM), http://tech.fortune.cnn.com/tag/icrowd/.

115 *See, e.g.,* JOBS Act: Implications, Implementation, and Prediction, Bank of America (2013), http://corp.bankofamerica.com/business/ci/hedge-fund-consulting; Emily Chasan, *New Private Fundraising Rules Attract Meager Interest*, WALL ST. J. (Mar. 24, 2014, 4:37 PM), http://blogs.wsj.com/cfo/2014/03/24/new-private-fundraising-rules-attract-meager-interest/.

institutions and higher net worth individuals.[116] However, hedge funds engaged in trading commodity futures or option contracts may run afoul of Commodities Futures Trading Commission ("CFTC") rules that restrict advertising commodity pools as part of an exemption from certain CFTC registration.[117]

Given the verification requirements of Rule 506(c) and associated risks and costs, firms and issuers with more robust processes and compliance systems in place should have the advantage in pursuing Rule 506(c) offerings. In fact, systems for complying with Rule 506(c) verification requirements may create revenue opportunities for certain investment companies.[118]

For now, it seems that *caution* is the mantra to follow with respect to publicly marketing investment opportunities under the Solicitation Rule.[119]

B. Proposed Crowdfunding Rule

One of the most high-profile provisions of the JOBS Act was the newly created crowdfunding exemption, Section 4(a)(6) of the Securities Act.[120] Crowdfunding was identified by entrepreneurs as an innovative, online method of fundraising and coincided with the rise of social networks.[121] In addition to supporting causes and various projects, crowdfunding allows small businesses and entrepreneurs to finance their endeavors with smaller contributions from many individuals rather than banks; angel, venture, and private equity funds; and

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116 *See* JOBS Act: Implications, Implementation, and Prediction, Bank of America (2013), http://corp.bankofamerica.com/business/ci/hedge-fund-consulting.

117 17 C.F.R. § 4.13(a)(3) (requiring that "such interests [in the pool] are offered and sold without marketing to the public in the United States" with respect to funds relying on the exemption from registration as a commodity pool operator).

118 *See* Tanya Price, *General Solicitation Ban Lifted Today – Three Things You Must Know About It*, FORBES (Sept. 23, 2013, 12:00 AM), http://www.forbes.com/sites/tanyaprive/2013/09/23/general-solicitation-ban-lifted-today-three-things-you-must-about-it/ (referencing third-party services for verifying investor qualification).

119 *See, e.g.*, Anton Root, *Ban on General Solicitation Lifted, But Caution Prevails*, CROWDSOURCING.ORG (Oct. 21, 2013, 8:17 PM), http://www.crowdsourcing.org/editorial/ban-on-general-solicitation-lifted-but-caution-prevails/28964.

120 JOBS Act § 302 (if adopted, to be codified as 15 U.S.C. 77d(a)(6)).

121 C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 5 (2012).

wealthy individuals.[122] Moreover, contributors to crowdfunded ventures may realize altruistic benefit from supporting others in their community and funding businesses and endeavors for which they are passionate.[123] Website crowdsourcing platforms such as Kickstarter, IndiGogo, and Kiva have become widely popular in recent years.[124] Current versions of crowdfunding have generally not "involved the offer of a share in any financial returns or profits that the fundraiser may expect to generate from business activities financed through crowdfunding."[125]

Crowdfunding becomes more complicated when debt or equity financing, as opposed to simple fundraising, is involved.[126] Some crowdfunding models—e.g., those with profit or revenue-sharing interests—could result in the offer and sale of securities in violation of federal securities laws.[127] Additionally, purchaser qualification restrictions, broker-dealer registration with the SEC, and restrictions on general solicitation and advertising in connection with securities offerings further complicate crowdfunding under the current federal securities laws.[128] Therefore, the JOBS Act sought to permit crowdfund investing through an exemption from registration.[129] The objective of the crowdfund investing

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122 Stuart R. Cohn, *The New Crowdfunding Registration Exemption: Good Idea, Bad Execution*, 64 FLA. L. REV. 1433, 1434 (2012); Joan M. Heminway & Shelden R. Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 931 (2011); Heather L. Traeger et al., *Democratizing Entrepreneurship: An Overview of the Past, Present, and Future of Crowdfunding*, 45 BLOOMBERG SECURITIES REGULATION & LAW REPORT 208, 209 (2013).

123 Heminway & Hoffman, *supra* note 67, at 906; *see* Lisa T. Alexander, *Cyberfinancing For Economic Justice*, 4 WM. & MARY BUS. L. REV. 309, 312 (2013); Bob Knorpp, *Toy-Fair Lesson: Crowdfunding Is Much More than Child's Play*, ADVER. AGE (Mar. 14, 2014), http://adage.com/article/digital/toy-fair-shows-crowdfunding-child-s-play/292141/ (discussing successful Kickstarter campaign).

124 Bradford, *supra* note 121, at 5; Traeger, *supra* note 122, at 215-17 (listing crowdfunding platforms).

125 Crowdfunding, Securities Act Release No. 33-9470, 78 Fed. Reg. 66,427, 66,429 (proposed Nov. 5, 2013).

126 Joan M. Heminway, *What Is A Security in the Crowdfunding Era?*, 7 OHIO ST. ENTREPRENEURIAL BUS. L. J. 335, 356-57 (2012); Heminway & Hoffman, *supra* note 67, at 906.

127 Heminway & Hoffman, *supra* note 67, at 906; Bradford, *supra* note 121, at 7.

128 Crowdfunding, Securities Act Release No. 33-9470, 78 Fed. Reg. 66,427, 66,429 (proposed Nov. 5, 2013). With regard to the broker registration obstacle, "a third party that operates a Web site to effect the purchase and sale of securities for the account of others generally would, under existing regulations, be required to register with the [SEC] as a broker-dealer and comply with the laws and regulations applicable to broker-dealers." *Id.*

129 JOBS Act §§ 301-305.

exemption is to make it easier and less expensive for startup businesses to raise relatively smaller amounts of capital online through securities offerings to a large pool of individual investors.[130]

Title III of the JOBS Act included various requirements for this new exemption regarding brokers and funding portals, aggregate offering and investor purchase amounts, exemption qualifications, issuer conduct and disclosures, and restrictions on resale.[131] Congress' crowdfunding mechanism was not self-effectuating, however, and implementation instead requires significant rulemaking by the SEC.[132] In October 2013—eighteen months after the passage of the JOBS Act, the SEC issued proposed rules for companies to offer and sell securities through crowdfunding under Section 4(a)(6) of the Securities Act (the "Proposed Crowdfunding Rule").[133] To be clear, the currently in-use models of crowdfunding such as Kickstarter and IndiGogo are distinct from the securities model of crowdfunding contemplated by the JOBS Act and Proposed Crowdfunding Rule. Until the effective date of any final rule regarding crowdfund investing adopted by the SEC, such activity may be unlawful.[134]

1. Eligibility and Caps

Under the Proposed Crowdfunding Rule, the maximum aggregate amount of securities an issuer may sell under Section 4(a)(6) is $1 million during a twelve-month period.[135] The aggregate amount of securities an issuer may sell to any investor in reliance on Section 4(a)(6) is also capped.[136] An issuer may sell to an

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130 *President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, *supra* note 2.

131 JOBS Act §§ 301-305; *see also* James E. Bitter & Todd B. Skelton, *Reforms for Hire: The JOBS Act Legislation*, 14 TENN. J. BUS. L. 13, 21-27 (2012).

132 *See* JOBS Act §§ 301-305.

133 Crowdfunding, Securities Act Release No. 33-9470, 78 Fed. Reg. 66,427, 66,551 (proposed Nov. 5, 2013). The Proposed Crowdfunding Rule contemplates adding the crowdfunding regulation as Part 227 in Title 17 of the *Code of Federal Regulations*. *Id.*

134 *See, e.g.,* Heminway & Hoffman, *supra* note 67, at 906.

135 Crowdfunding, 78 Fed. Reg. at 66,551 (to be codified at 17 C.F.R. § 227.100(a)(1)). For purposes of the Proposed Crowdfunding Rule, "*issuer* includes all entities controlled by or under common control with the issuer . . . [and] any predecessor of the issuer." *Id.* (to be codified at 17 C.F.R. § 227.100(c)).

136 Crowdfunding, 78 Fed. Reg. at 66,551 (to be codified at 17 C.F.R. § 227.100(a)(2)). A natural person's annual income and net worth are calculated in the same manner as for accredited investors under 17 C.F.R. § 230.501 and may include the person's spouse. *Id.* (proposing

investor, during the twelve-month period preceding the transaction and including the securities sold, the greater of: (i) $2,000 or five percent of their annual income or net worth, whichever is greater, if both their annual income and net worth are less than $100,000, or (ii) ten percent of their annual income or net worth, whichever is greater, if either their annual income or net worth is equal to or more than $100,000, provided that the amount sold is not more than $100,000.[137]

Crowdfunding would not be available to all companies, and companies that do use the crowdfunding exemption would be required to use an intermediary.[138] Companies not eligible to use the Section 4(a)(6) exemption include non-U.S. companies; Exchange Act reporting companies; certain investment companies; companies disqualified under the proposed disqualification rules that are similar to the Bad Actor disqualification rules described in Part III.A.2, *supra*; companies that have failed to comply with the Proposed Crowdfunding Rule's annual reporting requirements; and companies that have "no specific business plan or [have] indicated [their] business plan is to engage in a merger or acquisition with an unidentified company or companies."[139]

2. Crowdfunding Disclosure Obligations

The Proposed Crowdfunding Rule imposes disclosure requirements on companies that conduct crowdfunded offerings.[140] Issuers must supply the following:

- information about the company—e.g., name, address, legal status, ownership, capital structure, material terms of any indebtedness, and financial condition and data,
- the name and business experience of officers and directors,
- the names of owners of twenty percent or more of the company,
- a description of the company's business and its business plan,

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Instructions 1 and 2 to paragraph (a)(2)). Issuers may rely on intermediaries, described in Part III.B.2, for calculating eligibility. *Id.* (proposing Instruction 3 to paragraph (a)(2)).

137 Crowdfunding, 78 Fed. Reg. at 66,551 (to be codified at 17 C.F.R. § 227.100(a)(2)).

138 Crowdfunding, 78 Fed. Reg. at 66,551 (to be codified at 17 C.F.R. § 227.100(a)(3)). An issuer is restricted to using one intermediary for an offering and may not use more than one intermediary to conduct concurrent crowdfunded offerings. *Id.* (proposing Instruction 1 to paragraph (a)(3)).

139 Crowdfunding, 78 Fed. Reg. at 66,551-52 (to be codified at 17 C.F.R. § 227.100(b)).

140 Crowdfunding, 78 Fed. Reg. at 66,552-54 (to be codified at 17 C.F.R. § 227.201(a)-(v)).

- a discussion of risk factors,
- the target offering amount and deadline for reaching such target amount,
- whether the company will accept investments in excess of the target offering amount and how such oversubscriptions will be allocated,
- the intended use of proceeds in a "reasonably detailed description,"
- information regarding closing the transaction and cancelling a commitment,
- the price, terms, and valuation method of the securities offered,
- details regarding intermediary compensation,
- information about previous exempt offerings within the past three years,
- certain related-party transactions,
- financial statements of the company that would have to be accompanied by a copy of the company's tax returns or reviewed or audited by an independent public accountant or auditor, depending on the offering amount including other offerings within the preceding twelve months,[141] and
- any matters that trigger the disqualification rules on or after the effective date of the final crowdfunding rule.[142]

This information shall be contained in a Form C: Offering Statement (Form C) that must be filed with the SEC and provided to investors and the issuer's intermediary.[143] Moreover, as long as the offering is ongoing any material

[141] For an offering, including all other offerings of the issuer under Section 4(a)(6) in the preceding twelve months, the following information is required: (i) income tax returns for the most recent year and any financial statements for offerings amounts of $100,000 or less; (ii) financial statements reviewed by an independent accountant for offering amounts more than $100,000 but less than $500,000; and (iii) audited financial statements for offerings amounts greater than $500,000. Crowdfunding, 78 Fed. Reg. at 66,553 (to be codified at 17 C.F.R. § 227.201(t)).

[142] Crowdfunding, 78 Fed. Reg. at 66,552-54 (to be codified at 17 C.F.R. § 227.201(a)-(v)).

[143] Crowdfunding, 78 Fed. Reg. at 66,554 (to be codified at 17 C.F.R. § 227.203(a)(1)). The information must be available on the intermediary's platform for at least twenty-one days before

changes, additions, and updates must be filed and made available to potential investors through Form C: Amendment (Form C-A).[144] Significantly, "if the amendment reflects material changes, additions or updates, . . . investors must reconfirm an investment commitment within five business days or the investor's commitment will be considered withdrawn."[145] Additionally, issuers must disclose to the SEC, investors, and its intermediary "its progress in meeting the target offering amount no later than five business days after the issuer reaches one-half and 100 percent of the target offering amount" through a Form C: Progress Update (Form C-U).[146]

Further, an issuer that has offered and sold securities in reliance on Section 4(a)(6) has ongoing reporting obligations that necessitate filing an annual report—the Form C: Annual Report (Form C-AR)—with the SEC and posting it on the issuer's webpage.[147] The report must include the results of operations and financial condition, financial statements meeting certain specifications, and certain information from the above-listed disclosures.[148] An issuer would be subject to these requirements until (i) it became an Exchange Act reporting company, (iii) *all* securities issued in reliance on Section 4(a)(6) are repurchased by the issuer or other party, or (iii) the issuer liquidates or dissolves.[149]

Relatedly, the Proposed Crowdfunding Rule allows an issuer to maintain its Section 4(a)(6) exemption despite insignificant deviations from a term, condition, or requirement, provided that the issuer has a made a reasonable good faith attempt to comply and did not know of the failure of an intermediary.[150]

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any securities are sold and must remain available until offering is completed or cancelled. Crowdfunding, 78 Fed. Reg. at 66,557 (to be codified at 17 C.F.R. § 227.303(a)).

144 Crowdfunding, 78 Fed. Reg. at 66,554 (to be codified at 17 C.F.R. § 227.203(a)(2)).

145 Crowdfunding, 78 Fed. Reg. at 66,554, -58 (to be codified at 17 C.F.R. §§ 227.203(a)(2)), 227.304(c)).

146 Crowdfunding, 78 Fed. Reg. at 66,555 (to be codified at 17 C.F.R. § 227.203(a)(3)).

147 Crowdfunding, 78 Fed. Reg. at 66,554-55 (to be codified at 17 C.FR. §§ 227.202(a), 203(b)).

148 Crowdfunding, 78 Fed. Reg. at 66,555 (to be codified at 17 C.F.R. § 227.203(b)(1)).

149 Crowdfunding, 78 Fed. Reg. at 66,554 (to be codified at 17 C.F.R. § 227.202(a)). An issuer must file a Form C: Termination of Reporting (Form C-TR) within five days of becoming eligible to cease filing annual reports. *Id.* at 66,555 (to be codified at 17 C.FR. § 227.203(b)(2)).

150 Crowdfunding, 78 Fed. Reg. at 66,562 (to be codified at 17 C.FR. § 227.502(a)).

The SEC may, however, still bring an enforcement action for such failure to comply.[151]

3. Crowdfunding Intermediaries and Platforms

As directed by the JOBS Act, issuers of crowdfunded offerings must utilize an intermediary—specifically, a registered broker under Section 15(b) of the Exchange Act or registered funding portal—and crowdfunding transactions must be "conducted exclusively through the intermediary's platform."[152] A "funding portal" under the Proposed Crowdfunding Rule is a broker that acts as an intermediary in an offer or sale of crowdfunded securities that does not offer investment advice, compensate employees or solicit sales or offers to buy securities on its platform, or hold investor funds or securities.[153] Funding portals are registered with the SEC.[154] A "platform" is "an Internet Web site or other similar electronic medium through which a registered broker or a registered funding portal acts as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6)."[155]

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[151] Crowdfunding, 78 Fed. Reg. at 66,562 (to be codified at 17 C.FR. § 227.502(b)).

[152] Crowdfunding, 78 Fed. Reg. at 66,551 (to be codified at 17 C.F.R. § 227.100(a)(3). Intermediaries must also "be a member of the Financial Industry Regulatory Authority or any other applicable national securities association." Crowdfunding, 78 Fed. Reg. at 66,555 (to be codified at 17 C.F.R. 227.300(a)(2)). Further, intermediaries and associated persons may not have or receive a financial interest in any issuer conducting an offering through its platform. *Id.* (to be codified at 17 C.F.R. § 227.300(b)).

[153] Crowdfunding, 78 Fed. Reg. at 66,556 (to be codified at 17 C.F.R. § 227.300(c)(2)). With respect to handling investor funds, brokers must comply with 17 C.F.R. 240.15c2-4 regarding the transmission or maintenance of payments received in connection with underwritings, whereas funding portals must use qualified third parties. *Id.* (to be codified at 17 C.F.R. § 227.300(e)).

[154] Crowdfunding, 78 Fed. Reg. at 66,559 (to be codified at 17 C.F.R. § 227.400(a)-(g)). The Proposed Crowdfunding Rule requires funding portal registration with the SEC through filing a Form Funding Portal. *Id.* Successor funding portals and funding portals desiring to withdraw must timely file the Form Funding Portal. *Id.* Funding portals are required to maintain fidelity bond coverage. *Id.* Nonresident funding portals must satisfy additional requirements, and the SEC and the foreign jurisdiction of the nonresident funding portal must have an information sharing agreement in place. *Id.* Funding portals registered under Rule 400 are exempt from registering as a broker under Section 15(a)(1) of the Exchange Act. Crowdfunding, 78 Fed. Reg. at 66,560 (to be codified at 17 C.F.R. § 227.401). However, funding portals must implement certain procedures and records policies and comply with anti-money laundering, privacy, and inspections requirements. Crowdfunding, 78 Fed. Reg. at 66,561 (to be codified at 17 C.F.R. §§ 227.403, 404).

[155] Crowdfunding, 78 Fed. Reg. at 66,552 (to be codified at 17 C.F.R. § 227.100(d)).

An intermediary must have a reasonable basis for believing an issuer is in compliance with the requirements of Section 4A(b) of the Securities Act and must "establish[] means to keep accurate records of the holders of the securities it would offer and sell through the intermediary's platform."[156] An intermediary must deny an issuer from using its platform or cancel an offering if it believes the issuer or relevant persons are subject to the disqualification rules or believes the issuer or offering raises fraud or investor protection concerns.[157] Further, before accepting an investment commitment, intermediaries must have a reasonable basis for believing investors satisfy the applicable requirements and must also obtain certain representations and a questionnaire.[158]

The Proposed Crowdfunding Rule also provides requirements regarding opening investor accounts with intermediaries, including, for example, the delivery of educational materials and certain disclosures to investors.[159] Moreover, the communication channels of an intermediary's platform must meet certain specifications,[160] and intermediaries must provide notifications containing certain information to an investor upon receiving an investment commitment and before confirming a transaction.[161] Further, intermediaries are prohibited from paying for "personally identifiable information of any investor or potential investor" in crowdfunded securities, but they may "compensate a person for directing issuers or potential investors to the intermediary's platform" if that compensation is not based on the purchase or sale of a crowdfunded security unless such compensation is to a registered broker or dealer.[162]

Finally, the Proposed Crowdfunding Rule provides a conditional safe harbor for funding portals.[163] Funding portals may, within certain limitations, use objective criteria to determine which securities to offer or highlight on the

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[156] Crowdfunding, 78 Fed. Reg. at 66,556 (to be codified at 17 C.F.R. § 227.301(a), (b)).

[157] Crowdfunding, 78 Fed. Reg. at 66,556 (to be codified at 17 C.F.R. § 227.301(c)). Thus, "an intermediary must, at a minimum, conduct a background and securities enforcement regulatory history check on each issuer whose securities are to be offered by the intermediary and on each officer, director or beneficial owner of 20 percent or more of the issuer's outstanding voting equity securities." *Id.*

[158] Crowdfunding, 78 Fed. Reg. at 66,557 (to be codified at 17 C.F.R. § 227.303(b)).

[159] Crowdfunding, 78 Fed. Reg. at 66,556-57 (to be codified at 17 C.F.R. § 227.302).

[160] Crowdfunding, 78 Fed. Reg. at 66,557 (to be codified at 17 C.F.R. § 227.303(c)).

[161] Crowdfunding, 78 Fed. Reg. at 66,557 (to be codified at 17 C.F.R. § 227.303(d), (f)).

[162] Crowdfunding, 78 Fed. Reg. at 66,558 (to be codified at 17 C.F.R. § 227.305).

[163] Crowdfunding, 78 Fed. Reg. at 66,560 (to be codified at 17 C.F.R. § 227.402).

funding portal's platform, provide search and categorization functions for offerings on the platform, provide communication channels for investors and issuers, advertise the platform, advise issuers about an offering's structure or content, and pay for referrals not based on personally identifiable information or based on the purchase or sale of crowdfunded securities on the platform, and pay or receive compensation from brokers in connection with offers or sales of securities, among other activities.[164]

4. Other Provisions

The Proposed Crowdfunding Rule contains several other noteworthy provisions. First, "if the sum of the investment commitments does not equal or exceed the target offering amount at the offering deadline, no securities will be sold in the offering, investment commitments will be cancelled and committed funds will be returned."[165] Further, "[a]n investor may cancel an investment commitment for any reason until 48 hours prior to the deadline identified in the issuer's offering materials."[166] An issuer may close the offering earlier if the target is reached, so long as timely notification is provided, the offering remains open for twenty-one days, investors can cancel until forty-eight hours before the new deadline, and the target has still been reached as of the new deadline.[167]

Second, "[a]n issuer may not advertise directly or indirectly the terms of an offering made in reliance on Section 4(a)(6) . . . , except for notices that direct investors to the intermediary's platform."[168] The contents of such notice are limited to a statement that the issuer is conducting a crowdfunded offering, the intermediary's name and platform link, the offering's terms, and limited factual information regarding the issuer's business.[169] Issuers are, however, allowed to communicate with investors and potential investors through the intermediary's platform.[170]

164 Crowdfunding, 78 Fed. Reg. at 66,560-61 (to be codified at 17 C.F.R. § 227.402(b)(1)-(13)).

165 Crowdfunding, 78 Fed. Reg. at 66,552 (to be codified at 17 C.F.R. §§ 227.201(g), 227.304(d)).

166 Crowdfunding, 78 Fed. Reg. at 66,558 (to be codified at 17 C.F.R. § 227.304(a)).

167 Crowdfunding, 78 Fed. Reg. at 66,558 (to be codified at 17 C.F.R. § 227.304(b)).

168 Crowdfunding, 78 Fed. Reg. at 66,555 (to be codified at 17 C.FR. § 227.204(a)).

169 Crowdfunding, 78 Fed. Reg. at 66,555 (to be codified at 17 C.F.R. § 227.204(b)).

170 Crowdfunding, 78 Fed. Reg. at 66,555 (to be codified at 17 C.F.R. § 227.204(c)). Relatedly, issuers may compensate promoters of the offering, so long as the promoter uses channels provided by the issuer's platform and the issuer takes reasonable steps to ensure the promoter

Next, crowdfunded securities are subject to restrictions on resale.[171] A purchaser of such securities may not transfer the securities within one year of the date the securities were purchased, unless transferred to the issuer, an accredited investor, to a family member or trust, in connection with death or divorce, or in a registered offering.[172]

Finally, securities issued in reliance on the Section 4(a)(6) exemption are excluded from the determination of whether an issuer must register with the SEC under Section 12(b)(1) of the Exchange Act.[173]

5. The Proposed Rule in Perspective

The SEC accepted comments regarding the Proposed Crowdfunding Rule until February 3, 2014.[174] The text of the proposed rules and accompanying forms alone spans forty-eight pages in the *Federal Register*.[175] Given that this is a very complicated area to regulate, adoption of final rules by the SEC and Financial Industry Regulatory Association will likely occur no earlier than the end of 2014.

While supporters of the JOBS Act believed it would jumpstart small businesses and improve access to capital, other commentators and SEC officials expressed concern regarding the JOBS Act's possible adverse impact on fraud and investor protection.[176] Crowdfunding under Title III of the JOBS Act

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discloses the compensation and relationship. Crowdfunding, 78 Fed. Reg. at 66,555 (to be codified at 17 C.F.R. § 227.205).

171 Crowdfunding, 78 Fed. Reg. at 66,562 (to be codified at 17 C.F.R. § 227.501(a)).

172 *Id.*

173 Crowdfunding, 78 Fed. Reg. at 66,565 (to be codified at 17 C.FR. § 240.12g-6).

174 Crowdfunding, 78 Fed. Reg. at 66,427.

175 Crowdfunding, 78 Fed. Reg. at 66,551-99.

176 *Compare* H.R. 3606, 112th Cong. (2012) (enacted), *and President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, *supra* note 2, *with* Letter from Mary L. Schapiro, Chairman of Securities and Exchange Commission, to The Honorable Tim Johnson and The Honorable Richard C. Shelby, U.S. Senate Committee on Banking, Housing, and Urban Affairs (Mar. 13, 2012), *available at* http://www.aicpa.org/Advocacy/Issues/DownloadableDocuments/404b/3-13-12_SEC_Chm_Schapiro_Letter_to_Johnson.pdf *and* Steven M. Davidoff, *Trepidation and Restrictions Leave Crowdfunding Rules Weak*, N.Y. TIMES DEALBOOK (Oct. 29, 2013, 5:10 PM), http://dealbook.nytimes.com/2013/10/29/trepidation-and-restrictions-leave-crowdfunding-rules-weak/?_php=true&_type=blogs&_r=0.

demonstrates the struggle of this balance.[177] After successful challenges and scrutiny regarding recent SEC rulemaking and given the difficulties presented by regulating crowdfunding, perhaps an innovative approach to crowdfunding by the SEC was not to be expected.[178] However, the Proposed Crowdfunding Rule for the most part regurgitates Title III of the JOBS Act, which was designed by Congress.[179]

The heavy mechanism put in place by Congress will likely deter the anticipated users of crowdfunding.[180] The disclosure obligations imposed on issuers are not insignificant.[181] Moreover, website platforms must be created, background checks must be performed, disclosures must be drafted and disseminated, and third parties must be hired to hold investor funds.[182] Thus, the people who were supposed to use crowdfunding—for instance, garage startups—will likely not be able to afford to use the exemption as proposed.[183] Small

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177 Letter from Mary L. Schapiro, Chairman of Securities and Exchange Commission, to The Honorable Tim Johnson and The Honorable Richard C. Shelby, U.S. Senate Committee on Banking, Housing, and Urban Affairs (Mar. 13, 2012), *available at* http://www.aicpa.org/Advocacy/Issues/DownloadableDocuments/404b/3-13-12_SEC_Chm_Schapiro_Letter_to_Johnson.pdf.

178 *See, e.g., Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011) (vacating Rule 14a-11 regarding proxy access as a result of inadequate economic analysis by the SEC); Steven M. Davidoff, *Trepidation and Restrictions Leave Crowdfunding Rules Weak*, N.Y. TIMES DEALBOOK (Oct. 29, 2013, 5:10 PM), http://dealbook.nytimes.com/2013/10/29/trepidation-and-restrictions-leave-crowdfunding-rules-weak/?_php=true&_type=blogs&_r=0.

179 *Compare* JOBS Act §§ 301-305 *with* Crowdfunding, Securities Act Release No. 33-9470, 78 Fed. Reg. 66,428, 66,551-99 (proposed Nov. 5, 2013); *see, e.g.*, Steven M. Davidoff, *Trepidation and Restrictions Leave Crowdfunding Rules Weak*, N.Y. TIMES DEALBOOK (Oct. 29, 2013, 5:10 PM), http://dealbook.nytimes.com/2013/10/29/trepidation-and-restrictions-leave-crowdfunding-rules-weak/?_php=true&_type=blogs&_r=0.

180 *See* Steven M. Davidoff, *Trepidation and Restrictions Leave Crowdfunding Rules Weak*, N.Y. TIMES DEALBOOK (Oct. 29, 2013, 5:10 PM), http://dealbook.nytimes.com/2013/10/29/trepidation-and-restrictions-leave-crowdfunding-rules-weak/?_php=true&_type=blogs&_r=0.

181 *See supra* notes 140-151 and accompanying text.

182 *See supra* notes 152-164 and accompanying text.

183 *See* Andrew Ackerman, *SEC Urged to Change "Crowdfunding Rules,"* WALL ST. J., Feb. 28, 2014, at C3 (reporting concern that the requirement to have audited financial information for certain crowdfunded offerings is prohibitively expensive); Noam Noked, *SEC Crowdfunding Rulemaking under the JOBS Act—an Opportunity Lost?*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Mar. 9, 2014, 8:34 AM), https://blogs.law.harvard.edu/corpgov/2014/03/09/sec-crowdfunding-rulemaking-under-the-jobs-act-an-opportunity-lost/.

businesses and entrepreneurs are essentially squeezed out of the market under the Proposed Crowdfunding Rule. By the time a final rule comes around, much of the excitement surrounding crowdfunding will likely have dissipated.[184] Maintaining adequate investor protection measures is critical, but perhaps Congress killed crowdfunding before it even started.[185]

C. Proposed Rule Expanding Exempt Offerings under Regulation A

Second, the JOBS Act expanded the Regulation A exemption for small offerings by requiring new rulemaking by the SEC.[186] Historically, Regulation A[187]—authorized by Section 3(b) of the Securities Act, which has been re-designated Section 3(b)(1)[188]—has been infrequently utilized because of the small offering threshold, SEC filing requirements, and state registration requirements.[189] Formerly, the maximum twelve-month aggregate offering amount was $5 million for Regulation A, of which no more than $1.5 million can be offered by selling security holders—e.g., insiders.[190] Under the JOBS Act, a newly created Section 3(b)(2) of the Securities Act would allow unregistered, public offerings of up to

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184 *See* Thaya B. Knight et al., *A Very Quiet Revolution: A Primer on Securities Crowdfunding and Title III of the JOBS Act*, 2 MICH. J. OF PRIVATE EQUITY & VENTURE CAPITAL L. 135, 152 (2012) (commenting on entrepreneurs' "'ready, fire, aim' exuberance" in the context of crowdfunding).

185 Joan MacLeod Heminway, *How Congress Killed Investment Crowdfunding: A Tale of Political Pressure, Hasty Decisions, and Inexpert Judgments that Begs for a Happy Ending*, 102 KY. L.J. (forthcoming 2014); Sherwood Neiss & Jason Best, *How to Save Crowdfunding Before its Dead on Arrival*, VENTUREBEAT (Feb. 8, 2014, 7:00 AM), http://venturebeat.com/2014/02/08/how-to-save-crowdfunding-before-its-dead-on-arrival/; *see* Andrew A. Schwartz, *Keep It Light, Chairman White: SEC Rulemaking Under the CROWDFUND Act*, 66 VAND. L. REV. EN BANC. 43 (2013).

186 JOBS Act § 401(a).

187 17 C.F.R. §§ 230.251-263 (2013) ("Regulation A").

188 15 U.S.C. § 77c(b)(1) (2013). Other exemptions authorized under Section 3(b) include Rules 504 and 505. 17 C.F.R. §§ 230.504, 505 (2013).

189 17 C.F.R. § 230.251-263 (2012); Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, Securities Act Release No. 33-9497, 79 Fed. Reg. 3,926, 3,928 (proposed Jan. 23, 2014); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 12-839, SECURITIES REGULATION: FACTORS THAT MAY AFFECT TRENDS IN REGULATION A OFFERINGS 1-2 (2012); Bitter & Skelton, *supra* note 10, at 15-16. In fact, as a result of the abbreviated registration statement-like Form 1-A offering statement and the prospectus-like offering circular filings required by Regulation A, such offerings are often referred to as "mini-public offerings." *See* Stephen J. Choi, *Behavioral Economics and the Regulation of Public Offerings*, 10 LEWIS & CLARK L. REV. 85, 115 (2006).

190 17 C.F.R. § 230.251 (2012).

$50 million within a twelve-month period.[191] The SEC issued proposed rules regarding this new exemption, which has become known as "Regulation A+", in December 2013 (the "Regulation A+ Proposal").[192]

The Regulation A+ Proposal contemplates two tiers of offerings under Regulation A.[193] Tier 1 allows for offerings up to $5 million within a twelve-month period, with no more than $1.5 million being offered by selling security holders ("Tier 1 offerings").[194] Tier 1 offerings resemble offerings under the already existing Regulation A. Tier 2 offerings, on the other hand, are offerings up to $50 million within a twelve-month period, with no more than $15 million being offered by selling security holders ("Tier 2 offerings").[195] Tiers 1 and 2 share the same basic requirements, and Tier 2 offerings are subject to additional requirements under the Regulation A+ Proposal.

1. Requirements for both Tier 1 and Tier 2 Offerings

In order to be eligible to use the exemptions under Regulation A, an issuer must be organized in and have its principal place of business in the United States or Canada.[196] However, Regulation A would not be available to issuers that are: already Exchange Act reporting companies; developing companies that have "no specific business plan or purpose, or [have] indicated [their] business plan is to merge with an unidentified company"; certain investment companies; companies seeking to offer and sell asset-backed securities or fractional undivided interests in oil, gas, or other mineral rights; companies that have been subject to registration revocation or denial during the prior five years; companies that have

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191 JOBS Act § 401(a).

192 Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, Securities Act Release No. 33-9497, 79 Fed. Reg. 3,926 (proposed Jan. 23, 2014) (hereinafter, "Regulation A+ Proposed Rule").

193 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(a)).

194 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. §230.251(a)(1)).

195 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. 230.251(a)(2)). For offerings up to $5 million, an issuer could choose to proceed under either Tier 1 or Tier 2. *See id.*

196 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at Rule 251(b)(1)). This is unchanged from the already existing Regulation A. 17 C.F.R. § 230.251(a)(1) (2012).

failed to satisfy Exchange Act reporting requirements during the preceding two years; and companies disqualified as "bad actors."[197]

Next, certain "testing the waters" solicitation materials are allowed under the Regulation A+ Proposal.[198] Issuers seeking to use Regulation A must file with the SEC a Form 1-A offering statement (the "offering statement") before making any offer of securities.[199] Once the offering statement has been filed, oral offers, written offers made pursuant to Rule 254,[200] and communications pursuant to Rule 255[201] are permissible.[202] However, no sales of securities may be made until the offering statement has been qualified and a Preliminary Offering Circular has been delivered to any person who "indicated an interest in purchasing securities in the offering" before the qualification of the Offering Statement.[203] Further, an issuer or underwriter must deliver a Final Offering Circular to purchasers within two business days of the sale.[204]

Notably, the Regulation A+ Proposal provides for the submission of draft offering statements.[205] This was not previously available under Regulation A and

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[197] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(b)(2)-(8)). The disqualification provisions reflect the "bad actor" rules described *supra*. Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,005-06 (to be codified at 17 C.F.R. § 230.262).

[198] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(d)(1)).

[199] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(d)(1)). Proposed Rule 252 of Regulation A+ Proposal addresses offering statement requirements. Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,0001.

[200] 17 C.F.R. § 230.254 (2012).

[201] 17 C.F.R. § 230.255 (2012).

[202] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(d)(1)(ii)).

[203] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(d)(2)(A)-(B)). In some instances, dealers must provide a current offering statement to a purchaser before or with confirmation of the sale. Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,001 (to be codified at 17 C.F.R. § 230.251(d)(2)(iii)). An offering statement may be qualified automatically twenty days after it was filed, unless SEC expressly delays qualification. 17 C.F.R. § 230.252(g) (2013).

[204] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(d)(2)).

[205] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,001 (to be codified at 17 C.F.R. § 230.252(f)).

mirrors the draft registration statement submission available to EGCs.[206] Accordingly, issuers who have not previously sold securities under an offering statement qualified under Regulation A or an effective registration statement under the Securities Act may file a draft offering statement for non-public review by the SEC, provided that such offering statement is not qualified less than twenty-one days after the public filing of the draft submission and any related correspondence or amendments thereto.[207]

Unchanged from before the JOBS Act, the Regulation A+ Proposal does not integrate a particular offering with prior offers or sales of securities but does include a six-month "look-forward" for offers or sales of certain securities.[208] Additionally, the Regulation A+ Proposal prohibits at the market offerings, but does allow for certain continuous or delayed offerings.[209]

Finally, the Regulation A+ Proposal revises and modernizes certain components of the offering process.[210] It also provided various other rules regarding the withdrawal or abandonment of offering statements[211] and created a safe harbor for certain insignificant deviations from Regulation A requirements.[212]

2. Reporting Requirements for Tier 1 Offerings

Issuers of Tier 1 offerings under the Regulation A+ Proposal must file an exit report (Form 1-Z) within thirty days of termination or completion of the offer.[213]

3. Additional Requirements and State Securities Law Exemption for Tier 2 Offerings

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206 *Compare* 17 C.F.R. § 230.252 (2012), *with* Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,001 (to be codified at 17 C.F.R. § 230.252(f)), *and* JOBS Act § 106(a) (codified at 15 U.S.C. §77f(e) (2013)).

207 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,001 (to be codified at 17 C.F.R. § 230.252(f)).

208 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(c)).

209 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(d)(3)) (defining "*at the market* offering" as "an offering of equity securities into an existing trading market for outstanding shares of the same class at other than a fixed price").

210 Regulation A+ Proposed Rule, 79 Fed. Reg. at 3,929 (to be codified at Jan. 23, 2014).

211 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,005 (to be codified at 17 C.F.R. § 230.259(d)).

212 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,005 (to be codified at 17 C.F.R. § 230.260).

213 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,003 (to be codified at 17 C.F.R. § 230.257(a)).

The Regulation A+ Proposal provides a ten-fold increase in the maximum offering, so Section 3(b)(2) may provide issuers greater flexibility in raising capital and reduce the burden in issuing certain types of securities.[214] Necessarily, the SEC added certain investor protection measures to Tier 2 offerings, which allow for $50 million aggregate offering amounts.

First, in Tier 2 offerings, an investor may not purchase in the offering an aggregate purchase price that is ten percent of the greater of such purchaser's annual income and net worth.[215]

Additionally, issuers of Tier 2 offerings are subjected to filing ongoing annual (Form 1-K), semiannual—for the first half of each fiscal year of the issuer—(Form 1-SA), and current (Form 1-U) reports.[216] An issuer's successor assumes the duty to satisfy such reporting obligations.[217] An issuer, or its successor, must comply with such reporting obligations until the issuer becomes an Exchange Act reporting company.[218] However, an issuer's ongoing reporting obligations are suspended when a class of securities is held of record by less than 300 persons and the issuer has satisfied its reporting obligations.[219]

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[214] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(a)(2)); *see, e.g.,* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 12-839, SECURITIES REGULATION: FACTORS THAT MAY AFFECT TRENDS IN REGULATION A OFFERINGS 20 (2012).

[215] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,000 (to be codified at 17 C.F.R. § 230.251(d)(2)(C)). The purchaser's representation is sufficient for complying with the Regulation A+ Proposal's investor purchase price limitation, provided that Rule 501 of Regulation D is used in connection with the determination for natural persons. *Id.*

[216] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,004 (to be codified at 17 C.F.R. § 230.257(b)). The Regulation A+ Proposal included sample forms. Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,008-64. The semiannual reporting requirement commences with the "first half of the fiscal year following the most recent fiscal year for which full financial statements were included in the offering statement, or, if the offering statement included financial statements for the first half of the fiscal year following the most recent full fiscal year, for the first half of the following fiscal year." Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,004 (to be codified at 17 C.F.R. § 230.257(b)(3)).

[217] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,004 (to be codified at 17 C.F.R. § 230.257(b)(5)).

[218] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,004 (to be codified at 17 C.F.R. § 230.257(d)(1)).

[219] Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,004 (to be codified at 17 C.F.R. § 230.257(d)(2)).

Significantly, Tier 2 offerings require audited financial statements.[220] If the offering statement did not include audited financials for the issuer's preceding, full fiscal year, the issuer must file such audited financial statements within 120 days of the offering statement qualification date.[221] Moreover, if the offering statement was qualified in the second half of the issuer's current fiscal year, unaudited financial statements for the first half of the fiscal year must be included in the offering statement or filed within ninety days of the offering statement qualification date.[222]

Finally, Tier 2 offerings preempt state securities law registration requirements. The Regulation A+ Proposal accomplishes this by redefining "qualified purchaser" to include "any offeree of such security [offered pursuant to Regulation A] and, in a Tier 2 offering, any purchaser of such security."[223] The SEC determined that given the range of investor protections provided under the Regulation A+ Proposal, state securities law requirements would be preempted for Tier 2 offerings.[224] Thus, the added hurdle of complying with state securities law requirements is no longer an obstacle for Tier 2 Regulation A offerings.[225] Interestingly, the Regulation A+ Proposal also explores alternative approaches regarding the state securities law issue, including the coordinated review program proposed by the North American Securities Administrators Association.[226]

4. The Regulation A+ Proposal Moving Forward

The Comment Period for the SEC's Regulation A+ Proposal closed on March 24, 2014.[227] Given the delay thus far and the challenges posed by the Regulation A+ Proposal, it seems reasonable not to expect final rulemaking regarding this new offering exemption until the end of the year at the earliest.

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220 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,004 (to be codified at 17 C.F.R. § 230.257(b)(2)).

221 *Id.*

222 *Id.*

223 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,003 (to be codified at 17 C.F.R. § 230.256).

224 Regulation A+ Proposed Rule, 79 Fed. Reg. at 3,931.

225 Regulation A+ Proposed Rule, 79 Fed. Reg. at 4,003 (to be codified at 17 C.F.R. § 230.256); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO 12-839, SECURITIES REGULATION: FACTORS THAT MAY AFFECT TRENDS IN REGULATION A OFFERINGS 20 (2012).

226 Regulation A+ Proposed Rule, 79 Fed. Reg. at 3,968.

227 Regulation A+ Proposed Rule, 79 Fed. Reg. 3,926.

It will be interesting to see whether the investor protection measures included in the Regulation A+ Proposal will be modified. Providing audited financial statements presents a significant expense not present in pre-JOBS Act Regulation A offerings and may make Tier 2 offerings unattractive, thus continuing Regulation A's low usage.[228]

IV. ANALYSIS OF 2013 EMERGING GROWTH COMPANY OFFERINGS

This Part examines domestic IPO activity for "emerging growth companies" in 2013.

A. Data

This analysis examines public equity offerings priced from January 1, 2013 to December 31, 2013. The sample includes IPOs priced in 2013 in the United States for domestic issuers (collectively, the "IPO Companies"). Companies that have IPOs pending or that have merely filed a registration statement are not included in the sample. Foreign issuers, "blank check" companies, and special purpose acquisition companies ("SPACs") are omitted from the sample in order to capture data for companies with actual operations.[229] Data was obtained from the SEC's Electronic Data Gathering and Retrieval (EDGAR) system, Bloomberg, Nasdaq.com, and research firm IPOScoop.com LLC. The sample of IPO Companies includes 183 issuers.[230]

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[228] *See supra* notes 189, 220-222 and accompanying text.

[229] A "blank check company" is a "development stage company that has no specific business plan or purpose or has indicated its business plan is to engage in a merger or acquisition with an unidentified company or companies, other entity, or person." 17 C.F.R. § 230.419 (2013). Further, special purpose acquisition companies ("SPACs") are a type of "bank check" company that pool funds to engage in a merger or acquisition within a set time frame. Usha Rodrigues & Mike Stegemoller, *Exit, Voice, and Reputation: The Evolution of SPACs*, DEL. J. CORP. L., 849, 871 (2013).

However, approximately eighteen real estate investment trusts ("REITs") were retained in the sample because of their similarities to an operating company and to create a comprehensive list of domestic issuers for this study.

[230] The IPO Companies sample did not include all offerings that would qualify as an initial public offering in the United States. *See supra* note 229 and accompanying text. For this reason, other sources may report a different total number of IPOs for the year 2013. For instance, PricewaterhouseCoopers ("PwC") reported 237 IPOs in 2013. *PwC's Q4 IPO Watch Finds 2013 IPO Volume Hits Highest Level in Six Years*, PRICEWATERHOUSECOOPERS LLP (Dec. 19, 2013), *available at* http://www.pwc.com/us/en/press-releases/2013/pwc-q4-2013-ipo-watch-press-release.jhtml (omitting one IPO that priced on December 18).

B. Findings

Of the 183 total IPO Companies, 146, or 79.8%, were classified as EGCs. In aggregate, the IPO Companies raised $47.4 billion in proceeds from the offerings, and the EGC subset, collectively, raised $24.1 billion. 38.8%, or 71, of the offerings this year generated proceeds less than $100 million, while 46.6%, or 68, of EGC offerings met this "small offering" threshold.[231]

The IPO Companies' shares averaged a 17.3% first-day performance, whereas EGCs alone had an 18.7% average first-day return.[232] The IPO Companies, collectively, yielded a 37.5% average return for the period from the issuers' IPO date until December 31, 2013,[233] and EGCs yielded 39.5% for that period.[234] The Standard & Poor's 500 Index, by comparison, rose 29.6% during 2013, while the NASDAQ Composite Index and Dow Jones Industrial Average rose 38.3% and 26.5%, respectively, during the same period. The average offering price for all IPO Companies was $16.53, and the EGC subset averaged $15.88. EGC IPOs priced in a range of $4.00-$44.00, which happened to be the high-low range for IPO Companies collectively.

IPO activity was heaviest in the fourth quarter of 2013, as 30.1% of the IPO Companies priced during that period. (*see infra* **Figure 1**). EGCs volume was heaviest during the third quarter, as 31.5%, or 46, of the EGCs priced during that period. Forty, or 27.4%, EGCs priced during the fourth quarter. Moreover, the fourth quarter accounted for 42.6% of the total offering value for the year (*see infra* **Figure 2**). This was also the case for EGCs, with the fourth quarter accounting for 39.3% of the total proceeds raised by EGCs. The largest IPO of

231 For an interesting article on smaller IPOs, *see* Steven Davidoff, *Disappearing Small IPO and Lifecycle of Small Firm*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG. (Mar. 6, 2014, 9:12 AM), https://blogs.law.harvard.edu/corpgov/2014/03/06/disappearing-small-ipo-and-lifecycle-of-small-firm/ (considering reasons for the decline of small IPOs).

232 The topic of IPO pricing is beyond the scope of this paper; however, there is abundant literature regarding the topic. *See, e.g.*, work by Alexander Ljungqvist (http://people.stern.nyu.edu/aljungqv/research2.htm).

233 The return for the full sample of IPO Companies includes the last trading day for Omthera Pharmaceuticals, which was July 17, 2013, rather than the year-end date. Omthera Pharmaceuticals' IPO date was April 11, 2013. AstraZeneca acquired the company on July 18, 2013. Omthera Pharmaceuticals, Current Report (Form 8-K) (July 18, 2013).

234 The first-day and year-end returns were calculated solely on the basis of price appreciation and were not dividend-inclusive. This decision was made in order to account for the disparate lengths of trading time periods from the IPO date until December 31, 2013 for the issuers in the sample.

the year was Plains GP Holdings, L.P. on October 13, 2013, which raised $2.8 billion and did not have EGC status.[235] Social media company Twitter Inc. was the largest IPO by an EGC in 2013, at $1.8 billion.[236] The smallest IPO by an EGC was $6 million, raised by Cancer Genetics, Inc.[237]

Figure 1

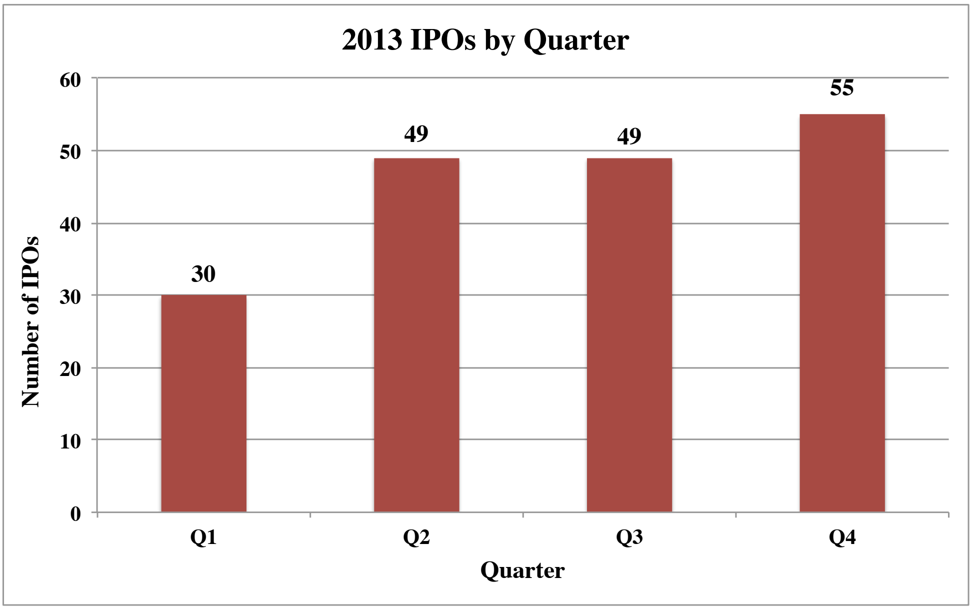

Figure 2

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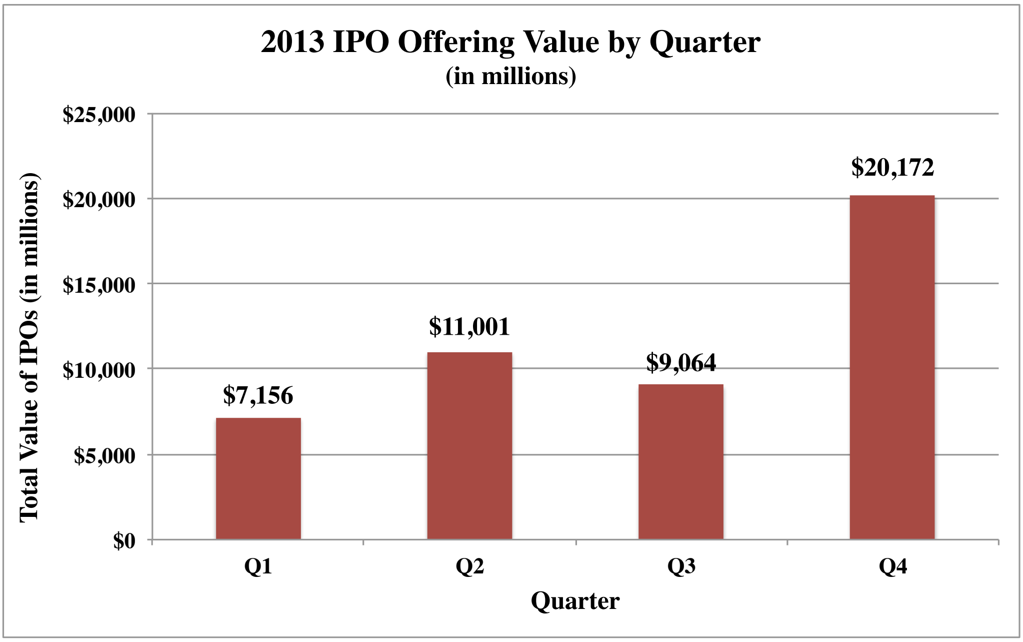
[235] Plains GP Holdings, L.P., Registration Statement, Form S-1/A (Oct. 7, 2013). The company trades on the NYSE under the ticker "PAGP."

[236] Twitter Inc., Registration Statement (Form S-1/A) (Nov. 4, 2013). The company trades on the NYSE under the ticker "TWTR."

[237] Cancer Genetics, Inc., Registration Statement (Form S-1/A) (Apr. 4, 2013). The company has since registered additional shares. Cancer Genetics, Inc., Registration Statement (Form S-1/A) (Oct. 17, 2013). The company trades on the NASDAQ under the ticker "CGIX."



The IPO Companies represented a range of industries. Companies in the healthcare and financial industry accounted for 25.7%, or 47 issuers, and 20.2%, or 37 issuers, of the total IPOs, respectively (*see infra* **Figure 3**). EGCs were fairly representative of the broader distribution of industries, but healthcare was slightly larger at 30.1%, or 44 issuers (*see infra* **Figure 4**).

Figure 3

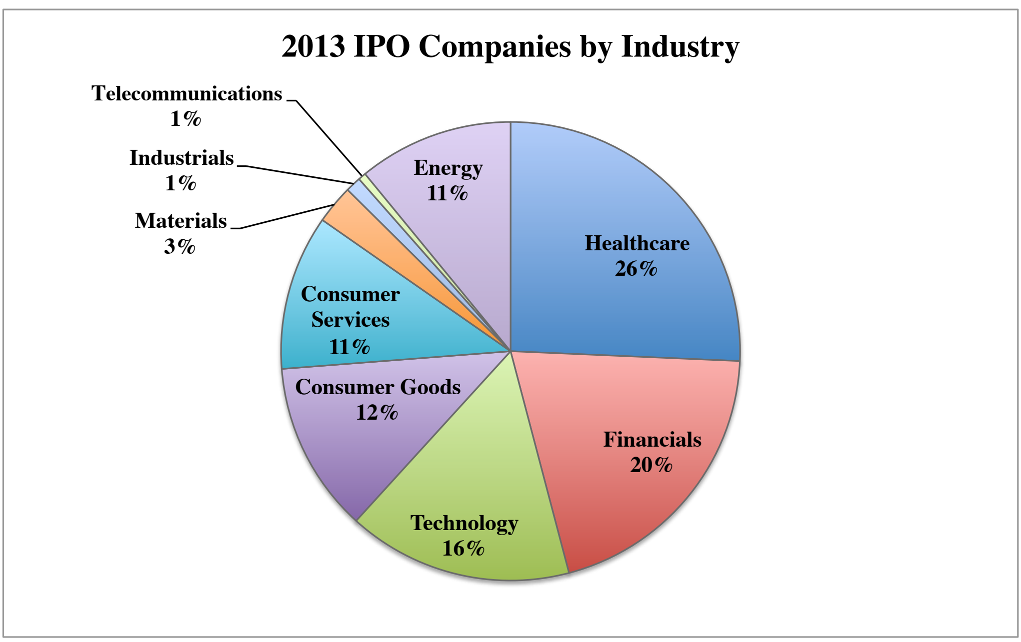
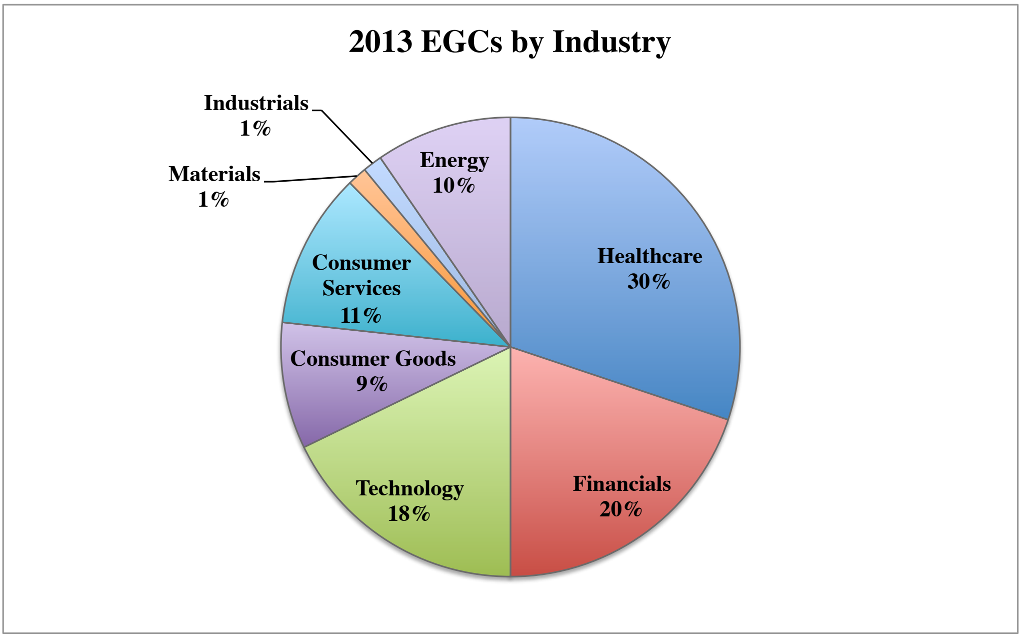


Figure 4



IPO Companies, collectively, split near evenly between the New York Stock Exchange ("NYSE") and the NASDAQ Stock Market ("NASDAQ"), as 50.8%, or 93, of IPO companies listed on the NYSE. The NASDAQ and the American Stock Exchange ("AMEX")—technically, NYSE MKT, LLC—accounted for 47.5% and 1.6%, respectively. EGCs, on the other hand, preferred the NASDAQ, as 55.5%, or 81, EGCs listed on that exchange's markets. NYSE and AMEX accounted for 43.2% and 1.4% of the EGC listings, respectively.

The overwhelming majority of IPO Companies—84.2%, or 154 issuers—were incorporated in the state of Delaware. Maryland was the other state in which a significant number—9.3%, or 17—of IPO Companies were incorporated. The EGC subset mirrored this, with 82.9%, or 121, incorporated in Delaware and 9.6%, or 14, incorporated in Maryland.

With regard to principal place of business, California and Texas were the predominant states for both IPO Companies and the EGC subset. Forty-five issuers, or 24.6% of IPO Companies, and 29.5%, or 43, of the EGC subset maintained their principal place of business in California. Texas accounted for 12.6%, or 23, of all IPO Companies and 12.3%, or 18, of EGCs. New York, at 7.7%, was the third most prevalent state for IPO Companies, while EGCs had a relatively strong presence in Massachusetts at 7.5%, or 11 issuers.

A majority of issuers that qualified for EGC treatment took advantage of the opportunity to confidentially file a draft registration statement, as 78.8%, or 115, of EGCs in this sample initially filed non-publicly.[238]

C. Analysis

Even though the number of IPOs in 2013 has surpassed the totals of recent years, the data in this paper does not provide evidence of whether the increase in the number of IPOs is due to the JOBS Act.[239] Market factors, including record high levels for the S&P 500 and Dow Jones Industrial Average indexes, quantitative easing and monetary policy decisions by the Federal Reserve and other central banks, investor appetite for new debt and equity issues, and concern regarding sequestration, the debt ceiling, consumer confidence, and reductions in quantitative easing by the Federal Reserve, have certainly influenced the number and success of IPOs since the Financial Crisis.[240] Additionally, the current market environment has provided private equity funds an exit opportunity for companies in their portfolios, which has further influenced the number of IPOs.[241]

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238 Draft registration statements are available under the submission type "DRS" in the SEC's EDGAR system. *Draft Registration Statements to Be Submitted and Filed on EDGAR*, Sec. & Exch. Comm'n (Sept. 26, 2012), http://www.sec.gov/divisions/corpfin/cfannouncements/drsfilingprocedures.htm (last visited Mar. 26, 2014).

239 *PwC's Q4 IPO Watch Finds 2013 IPO Volume Hits Highest Level in Six Years*, PRICEWATERHOUSECOOPERS LLP (Dec. 19, 2013), *available at* http://www.pwc.com/us/en/press-releases/2013/pwc-q4-2013-ipo-watch-press-release.jhtml (omitting one IPO that priced on December 18, 2013 and reporting 69, 168, 124, and 146 IPOs for 2009, 2010, 2011, and 2012, respectively).

240 *IPO Market Momentum Breaks Full Year 2012 Totals, According to PwC's Q3 IPO Watch*, PRICEWATERHOUSECOOPERS LLP (Oct. 2, 2013), *available at* http://www.pwc.com/us/en/press-releases/2013/q3-2013-ipo-watch-press-release.jhtml; *see* Leslie Picker & Ari Levy, *IPO Dot-Com Bubble Echo Seen Muted as Older Companies Go Public*, BLOOMBERG, Mar. 6, 2014, http://www.bloomberg.com/news/2014-03-06/ipo-dot-com-bubble-echo-seen-muted-as-older-companies-go-public.html (comparing the recent surge in IPOs to the "dot-com bubble" in 2000); Telis Demos, *Companies Rush to List Shares*, WALL ST. J., Mar. 6, 2014, http://online.wsj.com/news/articles/SB10001424052702304732804579421600478593172 (commenting on continued pace of IPOs in 2014).

241 *See, e.g.*, *Private Equity: Heading for the Exits?*, FORBES (Apr. 18, 2013), http://www.forbes.com/sites/baininsights/2013/04/18/private-equity-heading-for-the-exits/.

Certainly, companies have taken advantage of the JOBS Act provisions, as evidenced most simply by the fact that 79.8% of issuers in the IPO Companies sample received EGC treatment. Further, the opportunity to file draft registration statements was broadly used, given that 78.8% of EGCs filed non-publicly first.[242] In fact, several issuers filed multiple amended draft registration statements.[243] The contents of draft registration statements and time periods between confidentially and publicly filing draft registration statements may be areas for further study. According to one study, which analyzed 209 domestic companies that had filed draft registration statements, issuers publicly filed a registration statement, on average, seventy-four days after their draft filing.[244]

The JOBS Act afforded EGCs several benefits, including reduced disclosure requirements and what was expected to be a more efficient—i.e., faster and less expensive—IPO process.[245] Because "small businesses and startups are driving the recovery and job creation," the JOBS Act was supposed to enable "small and young firms across the country to grow and hire faster."[246] However, many companies that have sold securities or otherwise taken advantage of the JOBS Act are arguably not the type of startup or company envisioned by Congress.

In August 2012, Manchester United—yes, the prominent U.K. soccer team—listed on the NYSE (ticker: MANU) to raise $400 million in an equity

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242 Supporting this finding, PwC has reported that "[t]he confidential filing provision of the JOBS Act continued to be well received in the third quarter [of 2013], as 50 of the 58 (86 percent) EGC IPOs previously filed confidentially with the SEC." *IPO Market Momentum Breaks Full Year 2012 Totals, According to PwC's Q3 IPO Watch*, PRICEWATERHOUSECOOPERS LLP (Oct. 2, 2013), *available at* http://www.pwc.com/us/en/press-releases/2013/q3-2013-ipo-watch-press-release.jhtml. Further, in April 2013, Ernst & Young found that "[a]pproximately 63% of the EGCs that have filed IPO registration statements since the JOBS Act was enacted in April 2012 have taken advantage of the confidential review accommodation." *The JOBS Act: One-year Anniversary*, ERNST & YOUNG (April 2013), *available at* http://www.ey.com/Publication/vwLUAssets/The_JOBS_Act:_One-year_anniversary/$FILE/JOBSActAnniversary_CC0368_9April2013.pdf.

243 *See, e.g.,* Control4 Corporation, Draft Registration Statement (Form DRS/A) (May 23, 2013) (fourth DRS filing) (describing the company as a "leading provider of automation and control solutions for the connected home").

244 Maxwell Murphy, *Confidential Discussions of IPO Plans Kept Brief*, WALL ST. J., Feb. 18, 2014, http://blogs.wsj.com/cfo/2014/02/18/confidential-discussions-of-ipo-plans-kept-brief/.

245 *See supra* notes 11-59 and accompanying text.

246 *President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, *supra* note 2.

offering.[247] MANU's registration statement included the following language: "We are an 'emerging growth company' under the US federal securities laws and will be subject to reduced public company reporting requirements."[248] MANU has maintained its status as an EGC and notes that it "may take advantage of specified reduced reporting and other burdens that are otherwise applicable generally to public companies."[249] Surely, this is not the job-creating "startup" envisioned by Title I of the JOBS Act.[250] This trend continued in 2013, as numerous foreign issuers with only distant connection to the United States that qualified as EGCs were omitted from the sample of IPO Companies. This development may be an opportunity for further research.

Further, special purpose acquisition corporations ("SPACs") are increasingly utilizing the IPO on-ramp.[251] This type of entity "offered a rare chance for the average investor to participate in the rarified world of investing in private targets, while simultaneously offering those targets an easy route to an IPO."[252] The JOBS Act made it easier and appealing for SPACs, in addition to private company targets, to go public.[253] Indeed, the data set for this paper culled from the initial data numerous SPACs and blank check companies. This may also be an area worthy of further investigation.

At the other end of the spectrum, Ophthotech Corporation (NASDAQ: OPHT) ("Ophthotech") is a biopharmaceutical company that develops treatments for eye diseases.[254] Ophthotech has two drug candidates for wet age-related macular degeneration—Fovista™, which is beginning Phase 3 clinical

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247 Manchester United Ltd., Registration Statement (Form F-1/A) (Aug. 3, 2012); Jason Zweig, *When Laws Twist Markets*, WALL ST. J., Aug. 3, 2012, http://online.wsj.com/news/articles/SB10000872396390443545504577567213170814048 (commenting on MANU's IPO).

248 Manchester United Ltd., Registration Statement (Form F-1/A) (Aug. 3, 2012).

249 Manchester United Ltd., Annual Report (Form 20-F) (Oct. 24, 2013).

250 *See President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, *supra* note 2.

251 Usha Rodrigues, *SPACs and the JOBS Act*, 3 HARV. BUS. L. REV. ONLINE 17, 18 (2012), http://www.hblr.org/?p=2488.

252 *Id.* at 19.

253 *Id.*

254 Ophthotech Corporation, Quarterly Report (Form 10-Q) (Nov. 13, 2013).

trials, and ARC1905, which is still in Phase 1 trials.[255] Incorporated in 2007, Ophthotech is a "development stage company," as defined by the Financial Accounting Standards Board Accounting Standards.[256] The company has generated no revenues and has incurred significant operating losses, and all of the company's financial resources are devoted to research and development.[257] Ophthotech executed its IPO on September 30, 2013 and generated $167 million in proceeds. Ophthotech qualifies as an EGC and prominently states this in its SEC filings, as required.[258] Its quarterly report for the period ended September 20, 2013 indicates that, as an EGC, "[t]he Company has elected to delay the adoption of such new or revised accounting standards. As a result of this election, the Company's financial statements may not be comparable to the financial statements of other public companies."[259] In its registration statement, Ophthotech indicated that it had submitted a draft registration statement to the SEC on July 15, 2013.[260] There were no other references to the draft filing in the registration statement.[261] Ophthotech registered additional shares with the SEC in February 2014.[262]

Twitter, Inc. (NYSE: TWTR), the well-known social media company that allows users to make posts 140 characters at a time, IPO'd on November 7, 2013.[263] Twitter also qualifies as an EGC.[264] Twitter's IPO generated $1.8 billion in proceeds. Twitter's revenue for the year ended December 31, 2012 was $316 million and $422 million for the nine months ended September 30, 2013.[265] Its

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[255] Ophthotech Corporation, Registration Statement (Form S-1/A), 1 (Sept. 24, 2013); OPHTHOTECH, http://www.ophthotech.com/product-candidates/ (last visited Mar. 27, 2014).

[256] Ophthotech Corporation, Registration Statement (Form S-1/A), 6, F-6 (Sept. 24, 2013).

[257] Ophthotech Corporation, Registration Statement (Form S-1/A), 11 (Sept. 24, 2013).

[258] Ophthotech Corporation, Registration Statement (Form S-1/A) (Sept. 24, 2013).

[259] Ophthotech Corporation, Quarterly Report (Form 10-Q) (Nov. 13, 2013).

[260] Ophthotech Corporation, Registration Statement (Form S-1/A), 70 (Sept. 24, 2013) (discussing how the draft filing influenced the board of directors' decision to grant stock options).

[261] *Id.*

[262] Ophthotech Corporation, Registration Statement (Form S-1MEF) (Feb. 11, 2014).

[263] *See* Twitter Inc., Registration Statement (Form S-1/A) (Nov. 4, 2013); Olivia Oran & Gerry Shih, *Twitter Shares Soar in Frenzied NYSE Debut*, REUTERS (Nov. 7, 2013, 6:24 PM), http://www.reuters.com/article/2013/11/07/us-twitter-ipo-idUSBRE99N1AE20131107.

[264] Twitter Inc., Registration Statement (Form S-1/A) (Nov. 4, 2013).

[265] Twitter Inc., Registration Statement (Form S-1/A), 12 (Nov. 4, 2013).

registration statement indicates that Twitter has opted not to comply with Sarbanes-Oxley Section 404's audit of internal controls, as allowed by the JOBS Act.[266] Twitter reserved the right to choose to take advantage of other JOBS Act benefits but stated "[w]e have irrevocably elected not to avail ourselves of [the] accommodation allowing for delayed adoption of new or revised accounting standards, and, therefore, we will be subject to the same new or revised accounting standards as other public companies that are not emerging growth companies."[267] Twitter's registration statement makes no mention of its draft registration statement filing.[268] Many articles leading up to Twitter's IPO mischaracterized the confidential draft filing of the registration statement, construing it as something akin to a secret IPO.[269] However, it is called a "draft" filing for a reason; investors still get full access to the registration statement before deciding to invest in the company when it goes public.[270] The draft registration statement simply provides companies an opportunity to "work out the kinks" before filing publicly.[271] It seems that fixing issues early through this process may help to avoid problems like the SEC's criticism of daily-deal service Groupon, Inc.'s creative accounting treatment.[272]

Manchester United and various SPACs surely cannot be the EGCs that Congress intended.[273] Moreover, given that 72.7% of the IPO Companies are classified as an EGC suggests the treatment may be too broad. The JOBS Act's

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266 Twitter Inc., Registration Statement (Form S-1/A), 42 (Nov. 4, 2013).

267 *Id.*

268 Twitter Inc., Registration Statement (Form S-1/A) (Nov. 4, 2013). Twitter's draft registration is available on the SEC's EDGAR database. Twitter Inc., Draft Registration Statement (Form DRS/A) (Sept. 26, 2013).

269 James Surowiecki, *The Virtues of Twitter's Confidential I.P.O. Filing*, THE NEW YORKER (Sept. 13, 2013), http://www.newyorker.com/online/blogs/currency/2013/09/the-virtues-of-twitters-confidential-ipo-filing.html (providing a good explanation of the process as well as links to misleading articles).

270 *See* JOBS Act § 106(a) (codified at 15 U.S.C. § 77f(e) (2013)).

271 *Id.*

272 *After Facebook and Groupon Stumble, A Cautious IPO for Twitter*, KNOWLEDGE@WHARTON (Sept. 25, 2013), http://knowledge.wharton.upenn.edu/article/facebook-groupon-stumble-cautious-ipo-twitter/; Jonathan Weil, *Groupon IPO Scandal is the Sleaze That's Legal*, BLOOMBERG (Apr. 4, 2012, 7:00 PM), http://www.bloomberg.com/news/2012-04-04/groupon-ipo-scandal-is-the-sleaze-that-s-legal.html.

273 *See President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, *supra* note 2.

"IPO on-ramp" was created to provide special treatment to small, young companies to spur growth.[274] Instead, this paper reveals that most companies that happen to meet the requirements to be an EGC are availing themselves of the benefits of the JOBS Act. On the one hand, registration and reporting costs may be reduced, but, on the other hand, investors do not receive as much information.[275] This necessarily implies that comparison between companies, even in the same industry, becomes more complex and difficult for investors.[276] With the JOBS Act, Congress hastily rolled back dozens of longstanding rules, ostensibly in the name of job creation.[277] In doing so, the JOBS Act created unintended beneficiaries and consequences.

V. CONCLUSION

The JOBS Act resulted in substantial changes to the federal securities laws with the goal of enhancing access to capital markets in the United States.[278] However, "despite the positive intent of encouraging small business capital formation, the JOBS Act scaled back investor protection mechanisms by undoing or exempting key parts of the Sarbanes-Oxley Act," the Dodd-Frank Act, the Securities Act, and the Exchange Act.[279] EGC treatment was attractive to a majority of the companies that went public in 2013, as illustrated by the IPO Companies sample. This trend seems likely to continue. However, additional time is needed to fully evaluate the impact of the JOBS Act legislation and associated rulemaking.

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[274] *Id.*

[275] *See supra* notes 32-40, 52-59 and accompanying text.

[276] *See e.g.*, Ophthotech Corporation, Quarterly Report (Form 10-Q) (Nov. 13, 2013) (stating that "the Company's financial statements may not be comparable to the financial statements of other public companies").

[277] *President Obama To Sign Jumpstart Our Business Startups (JOBS) Act*, *supra* note 2.

[278] *Id.*

[279] Bitter & Skelton, *supra* note 10, at 35.