Market Trends 2017/18: The Jobs Act

A Lexis Practice Advisor® Practice Note by
by Rebecca DiStefano, Greenberg Traurig, P.A.

Rebecca DiStefano

OVERVIEW

The U.S. economy was spotlighted during an unprecedented national Presidential election in 2016 with campaign debate focused on the preservation and initiation of new jobs. This topic, of course, is not a new one. In response to the economic malaise following the 2009 financial crisis, the Jumpstart Our Business Startups Act of 2012 (112 P.L. 106, 126 Stat. 306) (JOBS Act), signed into law by President Obama, on April 5, 2012, implemented striking changes to the Securities Act of 1933, as amended (Securities Act). The JOBS Act mandated that the U.S. Securities and Exchange Commission (SEC) relax historically rigid financial regulations to enable fledgling start-ups and developmental companies to advertise their ideas and solicit individuals for investments in emergent enterprises. The statute also provided an on-ramp of greater disclosure flexibility for smaller companies to transition to public companies. The economic rhetoric of the 2016 presidential election raises the question as to whether these changes made a difference. How is the JOBS Act playing out in reality? Based on economic studies conducted by the SEC, unregistered exempt securities offerings have eclipsed registered offering activity in the years following the financial crisis and passage of the JOBS Act.

Given the utility of unregistered offerings in post-recession capital formation, this article focuses on post-2012 and more recent 2017 trends in small capital formation relating to JOBS Act mandated changes, including Regulation Crowdfunding (Regulation CF) for online raises up to $1.07 million, amended Regulation A (known informally as Regulation A+) for raises up to $50 million, and Rule 506(c) (17 C.F.R. § 230.506) of Regulation D permitting public solicitations to tap into unlimited quantities of capital from accredited investors. For an overview of how these regulations compare, see Regulation D, Regulation A+, and Regulation Crowdfunding Requirements Chart. This article also examines Title I of the JOBS Act, adopted to provide access to public markets by smaller companies known as emerging growth companies.

TITLE III: REGULATION CF (EFFECTIVE SINCE MAY 16, 2016)

A significant development during 2016 was the effectiveness in May 2016 of regulations under Title III of the JOBS Act - Crowdfunding. As of May 16, 2016, the SEC regulations under Title III – Crowdfunding, also known as the "Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012" or the "Crowdfund Act," became effective. Touted by some as the best option under the JOBS Act for equity fundraising by pre-revenue ventures, the Regulation CF rules allow investors to invest amounts of as little as $100. In addition to creating new channels to raise capital, the intent was to open investment avenues for new, first-time investors.

The JOBS Act also designed a new kind of financial intermediary to foster the new capital-raising initiatives. Although the term crowdfunding has been used for several years colloquially (in the real estate industry, especially, to refer to the way real estate platforms raise capital by giving non-private equity investors access to deals), these new platforms, some of which have an online presence, have raised capital under the exemption of Rule 506 of Regulation D under the Securities Act. Provided with the long-anticipated regulation, start-up companies are now permitted to tap funds up to $1.07 million in reliance on Section 4(a)(6) (15 U.S.C.S. § 77d) of the Securities Act during a 12-month period. The new structures operate separately from many existing processes. An issuer is not required to aggregate amounts sold under other non-crowdfunding offerings during the preceding 12-month period for calculating quantities that may be sold in a Regulation CF offering. For further information on crowdfunding, see Crowdfunding Regulations and Market Trends 2016/17: Crowdfunding.

Newly Created Funding Portals

Regulation CF created a new category of financial intermediary, known as a funding portal. A funding portal is an entity that acts as an intermediary in a transaction involving the offer or sale of securities under section 4(a)(6) for the account of others that does not do any of the following:

- Offer investment advice or make recommendations
- Solicit purchases, sales, or offers to buy securities offered or displayed on its platform
- Compensate promoters and others for solicitations or pay based on the sale of securities
- Hold, possess, or handle investor funds or securities

Fund portals that are not registered broker-dealers must register with the SEC. SEC rules require these registered funding portal intermediaries to:

- Provide investors with educational materials
- Take measures to reduce the risk of fraud
- Make available information about the issuer and the offering on the portal
- Provide communication channels to permit discussions about offerings on the platform
- Facilitate the offer and sale of crowdfunded securities

Broker-dealers and funding portals that are registered with the SEC and are members of the Financial Industry Regulatory Authority (FINRA) are permitted to act as Regulation CF intermediaries and facilitate the sale of crowdfunded securities. Effective January 29, 2016, FINRA adopted SEC approved FINRA Funding Portal Rules (Funding Portal Rules 100, 110, 200, 300, 800, 900, and 1200) and related forms (Form FP-NMA, Form FP-CMA, Funding Portal Rule 300(c) Form, and Form FP-Statement of Revenue), which are summarized in the FINRA Notice to Members 16-06 and available at http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=12218. For further information on crowdfunding intermediaries, see Crowdfunding Intermediaries and State Intermediary Licensing Requirements for Participation in Offerings.

Portal Registrations through April 2018

The SEC's electronic filing database EDGAR reveals 41 portals registered through April of 2018 as Funding Portals by filing their Form Funding Portal with the SEC, an increase from the 22 portals registered during 2016. Some of the recently-registered 2017 portals have focused on regional issuers, including a portal dedicated to state regulated offerings in Minnesota, Wisconsin, and Iowa (Silicon Prairie Holdings, Inc.), and industry-specific portals, including one dedicated to startups in the cannabis and hemp industry (Fundanna Crowdfunding). Notwithstanding the growing number of registered portals, some of these portals have hosted few offerings. The industry publication Crowdfund Insider, which tracks crowdfunding investor commitments, reports that Title III offerings have disappointed expectations and only recently surpassed $100 million in funding. Other industry analysts, however, view Regulation CF as maintaining steady-growth with potential, although in need of regulatory reforms. See Report: Reg CF Offerings Top $100 Million in Capital Raised, Crowdfundinsider.com (January 25, 2018), available at https://www.crowdfundinsider.com/2018/01/127592-report-reg-cf-offerings-top-100-million-capital-raised/. The portals WeFunder Portal, LLC, StartEngine, and SeedInvest have led the industry in volume of offerings and commitments based on SEC filings. The consensus among industry insiders is the potential growth of this financing option for start-ups has been stymied due to an unreasonably low aggregate funding cap on capital raised during a 12-month period (in proportion to the burdens of the regulation) and the difficulty using special purpose vehicles for purchases.

Form C Disclosures – Top Industries

Form C reports and amendments filed with the SEC and compiled by industry publication Crowdfund Capital Advisors in its report “The 2017 State of Regulation Crowdfunding” (2017 Reg CF Report) reveal a total of 634 Regulation CF offerings filed with the SEC through the end of December 31, 2017. Issuers that filed annual reports and reported creating jobs created on average 13.9 jobs. Below sets forth the current top 14 industries by deals and commitments (quantified by number of campaigns) as compiled by CCLEAR Dashboard through April 22, 2018:

- Application Software – (139)
- Beverages – Alcoholic (63)
- Personal Services (51)
- Entertainment (47)
- Consumer (46)
- Restaurants (43)
- Computer Hardware (44)
- Retail (38)
- Autos (30)
- Manufacturing (30)
- Medical (18)
- Advertising (14)
- Industrial (13)
- Utilities (13)

Regulation CF Securities Offered

The 2017 Regulation CF Report found that equity offerings were the most-often filed in 2017 (228 transactions), with the SAFE (Simple Agreement for Future Equity) offered in 141 additional transactions. A SAFE is not equity or a convertible note but a derivative instrument that promises the investor an equity stake in the company sometime in the future conditioned on whether there is an initial public offering or other liquidity event. The SAFE does not typically offer an interest payment or contain a maturity date. Debt offerings filed in 2017 totaled 89 transactions. A smaller percentage of offerings included membership interests, convertible debt securities, and preferred securities, with at least one revenue sharing interest security offered to investors. In addition, several offerings for tokenized securities or initial coin offerings (ICOs) have been filed to date utilizing derivative securities such as the SAFT (Simple Agreement for Future Tokens), closely related to the SAFE and popularized in the crypto-asset finance sector during 2017.

Interpretations in Crowdfunding Issuer Communications and Advertising

The Regulation CF advertising rules may not be intuitive for many business persons and lawyers. Rule 204(a) (17 C.F.R. § 227.204) of Regulation CF provides that issuers and persons acting on the issuer's behalf may advertise the terms of the Section 4(a)(6) offering. The staff of the Division of Corporation Finance of the SEC (the Staff) has clarified that advertising by an issuer may extend beyond the confines of the Rule 204(b) Tombstone-like notice, provided that the issuer's advertisement does not contain terms of the offering. In that event, the issuer is not restricted in providing notice of its offering through social media or other mediums, subject to anti-fraud rules. See Compliance and Disclosure Interpretation (C&DI) Question 204.03 released on May 13, 2016. The terms of the offering are defined in the rules to include information about the securities including the type of security and the duration of the offering. For an overview of permitted issuer communications in general in registered offerings, see When is a Communication an Offer of Securities? Chart.

Interpretations in Crowdfunding Issuer Disclosure and Reporting

During 2017, the Staff published two additional C&DIs addressing related party disclosure and calculation of the number of holders of record in the context of Regulation CF.

C&DI Question 201.02, released on April 5, 2017, concerns Rule 201(r) of Regulation CF, which requires that an issuer disclose any related party transaction that exceeds 5% of the amount raised by the issuer in reliance on section 4(a)(6) during the preceding 12-month period, including the amount the issuer seeks to raise in the current offering. The Staff opined in this C&DI that the dollar amount threshold at which disclosure of related party transactions is required should be based on the target offering amount plus any amount already raised in reliance on 4(a)(6) in the preceding 12-month period. This means that an issuer can disregard (for the purposes of the 5% calculation) any additional proceeds beyond the target amount that it may end up raising, even if there is the possibility of such additional proceeds at the time of disclosure.

C&DI Question 202.01, released the same day, added that for purposes of determining eligibility to terminate its duty to file ongoing reports under Rule 202(b)(2) of Regulation CF, the issuer should count all holders of record of securities of the same class of securities issued in the Regulation CF offering for which the reporting obligation exists, regardless of whether the holders of record purchased their securities in the Regulation CF offering

Notable Transactions

Regulation CF's first groundbreaking deal in 2016 was by Beta Bionics, Inc. (Beta Bionics), the artificial pancreas biotechnology company based in Boston. Beta Bionics closed its round of funding under Regulation CF of $1 million through equity shares sold on the crowdfunding portal Wefunder Portal, LLC (Wefunder). Beta Bionic's progress filing disclosed that Eli Lilly, the pharmaceutical maker of insulin, had previously invested in a Series A preferred round.

Other deals comprising the initial $10 million raised in 2016 during the formative months of the regulation include issuers in the restaurant and entertainment sector including:

- Brewer's Table - East Austin, LLC., a craft brewery, with $396,500 through portal NextSeed
- Cleveland Whiskey, LLC, an Ohio based spirits company, with $731,164 raised selling LLC units on Wefunder

- Hops & Grain Production, LLC, a Texas based craft microbrewery, raising $1 million through a debt offering facilitated on Wefunder
- Legion M Entertainment, Inc. (Legion M), a California based fan-owned entertainment studio, raising its initial $1 million also through intermediary portal Wefunder

Regulation CF campaigns raising social interest, and reportedly the most funds, since inception of the regulation, as released on the CCLEAR Dashboard through March 2018, include the following offerings (with concurrent or subsequent raises under other exemptions noted):

- Ondello, Inc. (HelloMD), a California based telehealth community of medical cannabis patients connected with doctors who prescribe marijuana raising to date [$3,094,722 through the portal Seedinvest]
- Legion M, raising an aggregate of $1,193,522 through Wefunder
- Waverly Labs, Inc., a New York based consumer products company offering a wearable speech translation product raising $1,069,915 through Start Engine
- WhiteClouds, Inc., a Utah based 3D printing company raising $1,070,000.00 in investments through Wefunder
- GeoOrbital, Inc., a Massachusetts based company selling an electric wheel device attachable to a bicycle raising $1,070,000 on Start Engine
- Unlimited Tomorrow, a Colorado based producer of a human-like prosthetic device, reported raising $1,568,964, in combined Reg CF and Regulation D 506(c) offerings, through the intermediary First Democracy VC

Intermediary Compensation

In each of the deals above hosted on the Wefunder platform, the progress report on Form C discloses compensation to be paid to the intermediary of between 3-4% as a percentage of the offering amount raised.

The progress report for the Brewer's Table deal disclosed that NextSeed charges the issuer 10% of the total offering amount as compensation for its services in connection with the offering, provided that NextSeed will only charge 5% for funds raised from investors referred by the issuer.

The intermediary First Democracy VC is entitled to a fee consisting of 7.0% commission based on the amount of investments raised in the offering and 2.0% of the total number of notes sold by Unlimited Tomorrow in the current Regulation CF round and in prior rounds.

The platform SeedInvest is entitled to 7.5% of the offering amount for conducting the Ondello, Inc. offering as well as equity compensation equal to 5% of the number of securities sold in the offering.

In a sampling of 34 Regulation CF offerings filed or amended during December 2016, the intermediary compensation ranged from 3%, in most cases, to 12% on the high end.

Deal Structures of Notable Title III Deals and Timeline

Structures of Regulation CF deals described above as notable early transactions have been varied and included the following, based on the Form C filings:

- Beta Bionics, the first equity crowdfunding start-up, closed its Title III round selling 10,000 Class C common shares at $100 per share in a minimum-maximum offering of $50,000 minimum for a total investment of $1,000,000.00. The Company's stock purchase agreement contains a Market Stand-Off Agreement, with the investors agreeing not to sell or transfer their shares (i.e., a lock up) for 180 days following effectiveness of a Securities Act registration. The offering funded in approximately three months from the initial filing on May 16, 2016.
- Brewer's Table, an early Title III offering, offered Revenue Sharing Notes in a minimum-maximum offering of $250,000 minimum and $300,000 maximum, with a minimum investment of $100. The offering exceeded its maximum by almost a third at $396,500. The deal also included a revenue sharing percentage of 5.25% of each month's gross revenue, commencing five (5) months following closing. The offering funded its oversubscribed amount within 60 days.
- Hops & Grain also offered Revenue Sharing Notes in a minimum-maximum structure similar to Brewer's Table with a revenue sharing percentage of 10%. The Company completed the full $1,000,000 placement within the approximately four month period between the initial filing and Form C-U progress update.
- Cleveland Whiskey sold non-voting Class D Units in a limited liability company entity. The offering closed within five months of its initial filing.
- Ondello, Inc. (HelloMD) combined concurrent offerings under (i) Regulation CF, offering of up to $1,070,000 in shares of Series A Preferred Stock, and (ii) Regulation D, Rule 506(c), offering up to $6 million in equity securities. The Regulation CF offering was fully subscribed and closed within four months of the initial Form C filing.
- Legion M Entertainment garnered its total investment by selling Class A common stock in a minimum-maximum offering with its minimum set at $500,000. The offering closed within three months of its initial filing. Legion reported in its Form C-AR, filed April 24, 2017, that the Regulation CF round was oversubscribed with in excess of $1.3 million, with the company closing $999,999 in Regulation CF funding and $193,522 in a Regulation D, Rule 506 round to accommodate the oversubscription.
- Waverly Labs, Inc., specializing in real-time translation through Bluetooth earbuds, received commitments for the maximum of $1.07 million of Regulation CF funding and sold its Series C Common Stock within 3 days of opening the offering, according to public reporting by its funding portal web site.
- WhiteClouds, Inc., which derives revenue from the design and manufacture of custom, 3D printed models for use in various industries, reported $1.07 million in investments in its SAFE instrument, within 4-5 months of the initial Form C filing.
- GeoOrbital, Inc., a developer and seller of an "all-in-one" electric bike wheel that can be attached to most bicycles to make them electric, filed its Form C-U progress update, indicating it had sold $1.07 million of Convertible Promissory Notes, at an offering price of $1 per note, stating the final amount was subject to final receipt of committed investments.
- Unlimited Tomorrow, is offering "Crowd Notes", with $1,568,964 reported in funding on its Form C-AR/A as of this writing. The Crowd Notes convert into a series of non-voting preferred stock, at a discount of 20% of the price per share of the new preferred stock sold in an equity financing subject to other conditions. The offering commenced January 2018.

Regulation CF Inflation Adjustments

Effective April 12, 2017, the SEC adopted new rules amending Regulation CF and Form C to adjust dollar amounts to inflation. Under the amendments, the rounded inflation adjusted maximum amount an issuer can sell under Regulation CF in a 12-month period increased from $1 million to $1.07 million. Similarly, the adjusted maximum amount that can be sold to an investor under Regulation CF in a 12-month period is now increased from $100,000 to $107,000. Finally, the adjustments increased the cap on securities permitted to be sold to an investor if the investor's annual income or net worth is less than $107,000 from $2,000 to $2,200. The dollar amounts are statutorily required to be adjusted by the SEC once every five years for changes in the Consumer Price Index for All Urban Consumers.

TITLE IV: REGULATION A+ (EFFECTIVE SINCE JUNE 2015)

Increased Issuer Activity following Amendments to Regulation A under the JOBS Act

In the three-year period following the effectiveness of the Regulation A+ rules, companies are taking advantage of the exemption from securities registration afforded by Regulation A+ at a rate surpassing that under the prior Regulation A regime. The prior Regulation A had an offering cap of $5 million, which was perceived as cost inefficient, according to the November 2016 study prepared for the SEC's Division of Economic and Risk Analysis. See A. Knyazeva, *Regulation A+: What Do We Know So Far?* (November 2016), available at https://www.sec.gov/dera/staff-papers/white-papers/Knyazeva_RegulationA-.pdf (the "Regulation A+ Study"). Although this study has not been updated as yet, it can be illustrative of the trends seen in the amended Regulation A filings for the first portion of the period in which it has been in effect.

Size of Regulation A+ Deals

The Regulation A+ Study showed that Tier 2 Regulation A offerings comprised approximately half of all offerings and over half of qualified offerings. As expected, a typical Tier 2 issuer was seeking to raise a larger amount. The median (average) amount sought by a Tier 2 issuer in a given offering was $20 ($26) million among all filings and $20 ($26) among qualified offerings. By comparison, the median (average) amount sought by a Tier 1 issuer in a given offering was $6 ($10) million among all filings and $5 ($7) million among qualified offerings. See Regulation A+ Study at page 7. For further information on the respective tiers in Regulation A+, see "Regulation A-Plus" Tier 1 and Tier 2 Offerings Summary Chart.

Regulation A+ Offering Industry Distribution

The Regulation A+ Study further provided that the top industries filing Regulation A offering statements since effectiveness up to the date of the study included Business Services, Real Estate, Non-depository credit institutions, Investment Offices, and Depository institutions. See Regulation A+ Study at page 19.

Regulation A+ Use of Intermediaries and Brokers

The Regulation A+ Study concluded that traditional underwriters were involved with less than 20% of the Regulation A offerings and that the underwriters named were involved in a number of the Regulation A offerings reviewed.

Registered broker-dealers, registered investment advisors, finders, or promoters were reported in the Study to be used in approximately 38% of all offerings and 36% of qualified offerings. The reported rate of intermediary use was significantly higher for Tier 2 offerings, consistent with the higher incidence of nationwide solicitation and with the larger offer amounts in Tier 2 offerings. See Regulation A+ Study at page 11.

Timeline

The Regulation A+ Study's sampling of qualified filings revealed that the length of the SEC qualification process for new Regulation A offerings was a median time of 78 days from initial public filing to qualification as compared to an average of 228 days to qualify between 2002 through 2011 prior to the JOBS Act amendments. Perhaps not surprisingly, Tier 2 offerings were general associated with a longer timeline than Tier 1 offerings, according to the Regulation A+ Study.

Trends in 2017 Regulation A Filings

A random sampling of 20 Form 1-A offering statements and amendments filed or amended in December 2017 revealed offerings in the following industries: Computer Services network with solutions to optimize cloud and computing performance (1); aircraft engines development and aviation consultancy (1); drone product design, manufacturing, and distribution (1); television programming (1); investment and wealth management (1); life sciences 3D printing (1); state-chartered banks (2); REITs and real estate capital finance (8); film entertainment complex and virtual reality entertainment (2); Bitcoin and cryptocurrency exchange (1); and an inventory and purchase order-based lending finance business (1).

Out of the 20 December 2017 filings reviewed, four were Tier 1 offerings and 16 were Tier 2 offerings. This random sampling of one month of filings in 2017 (including 20 filings of over 32 filed or amended Form 1-A offering statements during this period) is a small portion of the estimated total 353 filings overall, publicly available, since the effective date of Regulation A+ and therefore may not be indicative of a trend.

Deal Structures

The sampling of 20 Regulation A+ offerings filed or amended in December 2017 found the following deal structures and terms:

- 19 of the 20 offerings were best efforts offerings and 1 offering related to a share issuance in a merger.
- Although none of the 20 offerings sampled revealed a firm commitment underwritten offering, four of the issuers had engaged with a placement agent or selling agents named in their Form 1-A, and 15 of the companies characterized their offering as “self-underwritten” or otherwise on a “best efforts” basis, with selling efforts to be accomplished solely though company officers and directors, although several of the issuers reserved the right to pay commissions to an SEC registered broker-dealer to be later engaged.
- Four of the 20 sampled offerings contemplated the issuance of debt securities for real estate and lending and finance businesses, including:
    - A debt offering issuing 6% senior secured demand notes to loan funds to real estate investors to finance the development or rehabilitation of residential and commercial real estate
    - An offering by an issuer investing in real estate and mortgage-backed securities issuing subordinated interest-only promissory notes in $50,000 minimum increments allowing the note purchaser the option of selecting a term of 3, 5, or 7 years; or one year, and payable upon 30 days’ written demand thereafter; or otherwise payable upon 30 days’ written demand
    - A debt issuance of three-year 8% interest-bearing debentures for a private real estate lender offering senior secured and junior secured acquisition, bridge, and construction financing for U.S. based real estate projects
    - A debt issuance of 5% three-year bonds to fund an early-stage business lending to manufacturers, wholesalers, and retailers secured by inventory and retail inventory and purchase order financing

Secondary Market Development for Regulation A+

The secondary market for trading in Regulation A+ securities began to evolve in 2017 and a limited number of issuers began trading on the Nasdaq Stock Market (Nasdaq) and the New York Stock Exchange (NYSE), as well as the OTC marketplace. Although the Regulation A+ rules provide for the preemption of state securities law registration and qualification for securities initially sold in Tier 2 offerings, secondary sales require state law compliance and state law exemptions vary from state to state making compliance cost-prohibitive. As of April 2018, eight companies (identified below) have completed SEC qualification and have been granted listing on national exchanges. In April 2017, the SEC's Advisory Committee on Small and Emerging Companies (ACSEC) made recommendations to the SEC concerning market liquidity for Regulation A, Tier 2 securities. The ACSEC cited substantive differences in various state exemptions for secondary trading and stated that given the lack of uniformity, the development of a national marketplace would continue to be inhibited as investors will continue to be reluctant to invest in an early stage venture with an uncertain exit. The ACSEC recommended that where an issuer is current in its ongoing reports, that the SEC take steps to "reduce friction" on secondary trading and use its authority under Section 18 (15 U.S.C.S. § 77r) of the Securities Act to preempt from state regulation the secondary trading in those compliant Tier 2 issuers. The viability of the enhanced Regulation A+ regime will depend, in part, on the issuer's ability to create trading markets and liquidity in the Regulation A+ securities.

2018 Progress Update for Regulation A+

As of April 2018, the Regulation A+ initial public offering (IPO) financing structure is expanding (albeit slower than may have been anticipated) following a series of IPO launches in the summer of 2017, including: Myomo, Inc. (MYO), a medical robotics company, which began trading on the NYSE on June 12, 2017; Adomani, Inc. (ADOM), a provider of advanced zero-emission electric and hybrid vehicles, which launched on June 15, 2017 on Nasdaq; and ShiftPixy, Inc. (PIXY), a provider of HR and employment compliance solutions, which began trading on June 29, 2017 on Nasdaq.

Other exchange-listed mini-registrations include the following:

- Chicken Soup For The Soul Entertainment (Nasdaq: CSSE) (entertainment).
- Arcimoto (Nasdaq: FUV) (developed an electric powered three-wheeled EV)
- Fat Brands (Nasdaq: FAT) (franchising casual dining)
- Level Brands' (NYSE: LEVB) (branding and marketing)
- Longfin Corp(Nasdaq: LFIN) (cryptocurrency)

Enforcement Action shortly following Regulation A+ IPO

Longfin Corp, qualified with the SEC in November 2017, began trading on Nasdaq shortly thereafter. On December 15, 2017, the Company reported through an 8-K filing that it acquired a blockchain empowered technology. Longfin's trading of its securities on Nasdaq has been halted, and Longfin is a defendant in an SEC enforcement action filed on April 4, 2018 in the Southern District of New York, alleging $27 million in unregistered distributions of the company's securities in connection with the acquisition.

TITLE II: REGULATION D, RULE 506(C) (EFFECTIVE SINCE SEPTEMBER 2013)

Rule 506(c) under Title II of the JOBS Act allows an issuer to solicit investors and advertise its offering, provided the investment opportunity is confined to accredited investors. Offerings under Regulation D were previously required to be conducted without any general solicitation of investors. Subsection 506(c) changes that requirement. An offering may engage in general solicitation of investors if the securities are sold to only those investors who can affirmative demonstrate "accredited investors" status. For further information, see JOBS Act Impact on Private Placement Transactions. By some economists' accounts, the 506(c) offering continues to be underutilized by companies who in some instances would like to continue to rely on their pre-existing relationship networks to complete an offering. According to one economic analysis, amounts reported raised under Rule 506(c) in the two-year period immediately following effectiveness of the rule remained a small fraction of the total (2%) of the capital reported raised pursuant to Regulation D during that same period, suggesting that most issuers of unregistered securities are not yet seeking investors through general solicitation and general advertising. See Bauguess, Rachita, Gullapalli, and Ivanov, "Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2014" (October 2015), at page 2 (the Regulation D Study). Although the economic study has not been updated, more recent reports and anecdotal evidence indicates that use of Rule 506(c) remains modest.

The reticence to utilize the Rule 506(c) general solicitation flexibility appears to be due to regulatory uncertainty for standard advertising, vetting of accredited investor status, and liability concerns. Some issuers also fear the perception that use of general solicitation signals to the market that the company lacks a pre-existing network of sophisticated investors and does not have favorable financing options. For further information on Rule 506, see Rule 506 General Solicitation and Startup Capital-Raising and Regulation D Components. There may also be some concern that investors may push back on the information required to be provided under the new provision.

Increased Use of Rule 506(c) in 2017 Fueled by ICO Launches

Private capital markets in the United States and worldwide sought an unregulated financing option during 2017 through initial coin offering launches of a new asset class: tokens, digital "coins," and tokenized securities. Many technology start-ups were fueled through such unregulated offerings during late 2016 and 2017, financing over $4 billion in early stage ventures. A limited portion of these token financings were also conducted under Regulation D, Rule 506. Regulation D capital funding of token offerings continues during 2018 given the SEC's clear guidance that it has jurisdictional authority in the digital assets financing because certain of these offerings constitute securities offerings and must either be registered or qualify for an exemption. ICO launches are also gradually migrating to well-known crowdfunding portals hosting the "SEC-compliant ICO" or "regulated ICO" in the wake of recent enforcement activities of the SEC and state regulators. SEC enforcement activities have involved, in some cases, delivering the alleged violators subpoenas issued through the SEC's newly-created enforcement division cyber unit. In other 2018 cases, the SEC's cyber unit sought court-ordered injunctive relief, emergency asset freezes, and appointments of receivership in a number of alleged fraudulent schemes charging the defendants with the fabrication of the business prospects of self-described "blockchain ventures" in the offering of digital securities.

In view of the increasing market in online platform fundraising, accredited investors continue to be highly coveted as online portal communities expand. During 2018, it is anticipated that platforms and portal communities will increasingly become more specialized by affinity groups, social causes, and local and regional geography as well as industry sector. Until public markets offer greater opportunities for investors, the availability of private offerings and related communications for the accredited investor community will continue to be robust.

TITLE I: IPO ON-RAMP

The provisions of Title I of the JOBS Act created a category of emerging growth companies or issuers with less than $1 billion (currently $1.07 billion) in annual gross revenue during their most recently completed fiscal year (EGCs). Title I, entitled "Reopening American Capital Markets to Emerging Growth Companies," was designed to revitalize IPOs by smaller issuers by reducing various disclosure and compliance requirements for EGCs during a public offering and for up to five years thereafter. EGCs are provided with a phase-in period of up to five years to comply with the more burdensome disclosure and accounting requirements of federal securities laws. For further information, see Emerging Growth Company Practice Guide, Top 10 Practice Tips: Emerging Growth Companies, Emerging Growth Company versus Smaller Reporting Company Comparison Chart, and IPO Requirements for Emerging Growth Companies Checklist. IPO companies have varied with their use of the EGC disclosure flexibility.

Under the JOBS Act inflation adjustments discussed above, the SEC will index to inflation the annual gross revenue cap amount used to determine EGC status every five years, with the next adjustment scheduled for 2022.

IPO Activity Post-JOBS Act

The data for the IPO market shows that during 2017, 160 IPOs were priced, an increase of 50% over 2016, though market analysts warned that deal activity continued to be thin given overall strength and performance of the general U.S. and worldwide stock markets. Biotech and technology IPOs were the star performers of 2017, with several of the largest IPOs underperforming due to reported fundamental business-specific issues. See Renaissance Capital, US IPO Market 2017 Annual Review (December 15, 2017) (the 2017 Renaissance Report), available at http://www.renaissancecapital.com/review/2017USReview.pdf?inf_contact_key=4cba20ba8a76c74accaecc47c6db9998d3f0e503f107744851ded45ccf097a76, at page 1.

The noticeable decline of publicly-listed U.S. companies received more attention in 2017. In its October 2017 report to the President of the United States on the state of the capital markets (the 2017 Treasury Report), the U.S. Department of the Treasury reported that while the number of U.S. public companies has declined by half since 1996, other developed countries have not experienced the same trend and have instead experienced increases. Similarly, the U.S. IPO activity has trended in sharp decline following 1996, although some data supports a short-term bump in performance following passage of the JOBS Act.

SEC Chairman Jay Clayton, the Council of Institutional Investors, and the U.S. Chamber of Commerce released in-depth studies during 2017 addressing this troubling trend and citing continued burdensome regulatory regimes causing issuers to resist or postpone entrance into the public markets. Some of the studies presented proposals for JOBS Act reforms to stimulate the U.S. IPO markets, included extending the “on-ramp” accommodations of the JOBS Act from five years to ten years for all EGCs and making the JOBS Act on-ramp available for all companies seeking an IPO for five years, regardless of whether they meet the definition of an EGC.

IPO Industry Insights

According to the Renaissance Capital U.S. IPO report of Q1 2018, biotechnology and technology generally were the most active industries in the IPO market through March 31, 2018 with an increase in billion-dollar “unicorn” deals (i.e., private companies valued in excess of $1 billion). In the IPO market, technology IPO activity is expected to gain momentum in 2018, following a strong 2017 in technology IPOs. Prior Renaissance reports opined that technology companies had not proceeded to public markets to avoid public-market valuations; however, the Q1 report forecasts larger private tech companies preparing for their public debuts.

JOBS Act Recalibration Now Recommended by the Treasury Department

The 2017 Treasury Report signals that amendments to the JOBS Act are on the horizon and recalibration may be supported in the short term by the current SEC Commissioners. The report notes that:

“[a]fter a few years of experience following the JOBS Act, it is time to take another look at how these tools can be improved. Treasury’s recommendations also seek to maintain the efficacy of the private equity markets, which will continue to be important for some companies and entrepreneurs. These recommendations include maintaining an appropriate regulatory structure for finders, expanding the range of eligible investors, empowering investor due diligence efforts, and modifying the rules for private funds investing in private offerings."

Given opportunities have diminished for investors in the public markets, there is concern (and the 2017 Treasury Report notes) that there may be an unintended consequence to the regulatory policy resulting in further wealth disproportionality in the United States given the restrictions on offerings by public markets, a dearth of U.S. company listings, and growing scarcity of offerings to non-accredited investors.

MARKET OUTLOOK

Will Regulation CF Buoy up Capital in 2018?

Based on the inaugural eighteen months of deal activity, portals have increased in number and continue to be dominated by three portals that are visibly active with Form C-U filings for its issuers, while other registered portals have languished on the sidelines and will be required to adjust their business models through additional financing options or specializations to remain relevant. Regulation CF funding will likely remain an option of last resort for companies overlooked by angel investors and venture capital funds, although utilized by local and regional offerors. Portals will likely recommend combining and supplementing parallel Regulation CF raises with concurrent or subsequent Regulation D and Regulation A+ offerings. Finally, portals are expected to continue to become more specialized to cater to niche industry sectors including cryptocurrencies, blockchain technology development, artificial intelligence, machine learning, cyber and crypto security, real estate funds, biotechnology, and cloud-based technologies, as well as focus specifically on attracting accredited investors.

Regulation A+ Improvement Act of 2017

In March 2018, the U.S. House of Representatives passed the H.R. 4263: Regulation A+ Improvement Act of 2017 which, if passed by the Senate and signed into law by the President, will increase the offering cap of Regulation A+ offerings from $50 million to $75 million, further enhancing the attractiveness of Regulation A+ as an IPO option for underwriters and broker-dealers. However, the SEC Commissioners Kara Stein, Robert Jackson, Jr. and Chairman Jay Clayton voted to retain the $50 million limits in April given that a small number of companies have raised the maximum amount of $50 million under Tier 2 and reports indicate the majority of the Commissioners wish to see more deal activity before they recommend rule reform. The bill has been received in the Senate, referred to the Committee on Banking, Housing and Urban Affairs, and awaiting further action.

In an unusual public dissent, two SEC Commissioners penned their disagreement with the SEC Commission's decision to table reform to Regulation A+ limits of $50 million. Commissioners Hester Peirce and Michael Piwowar voiced the disagreement in a letter addressed to the Chairman of the Committee on Banking, Housing and Urban Affairs, citing a depressed interest in Regulation A+'s low financial caps, and missed opportunity resulting from not raising the Tier 2 limits to $75 million, pointing out "sufficient time has passed to warrant serious consideration of the dearth of Tier 2 activity since our adoption of the relevant rules. Is the 'relatively modest use' of Tier 2—as the October 2017 report of the Department of the Treasury puts it—perhaps related to an overly restrictive $50 million cap, which artificially depresses interest in the exemption?"

Rebecca DiStefano
Shareholder at Greenberg Traurig LLP

Rebecca G. DiStefano is a shareholder at Greenberg Traurig, P.A. in Florida. She is both a transactional and regulatory attorney and advisor in the areas of securities regulation, mergers & acquisitions, and corporate law. In these practice areas, Rebecca primarily counsels clients in general capital formation matters, Regulation D, Regulation A+, Regulation Crowdfunding, registrations, as well as general solicitation under the JOBS Act of 2012 and the Securities Act of 1933, the continuing disclosure requirements of the Securities Exchange Act of 1934, as well as exit strategies for founders and business owners through implementation of ESOPS, sales to private equity and synergistic buyers with attention to attendant corporate governance planning and best practices throughout the life cycle of the company. Rebecca also represents clients before government agencies and SROs including the Securities and Exchange Commission and FINRA. Her clients include investment banks, institutional corporate trustees, public and private companies as well as entrepreneurs and start-ups in a variety of industries including financial services, real estate, healthcare and technology.

Rebecca has been recently recognized in the 2016 and 2017 editions of The Best Lawyers in America© in the category of Corporate Law and in the 2009 edition of the Legal 500 United States. She is an advocate for children and adults diagnosed with Type One Diabetes and currently serves as Vice President of the Greater Palm Beach County Chapter of JDRF (formerly known as Juvenile Diabetes Research Foundation) and has served on its Board of Directors since 2013.