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## Market Trends: The Jobs Act

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### 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 Securities and Exchange Commission (SEC) relax historically rigid financial regulations to enable fledgling startups 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 recent 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 2016 trends in small capital formation relating to JOBS Act mandated changes, including amended Regulation A (known informally as Regulation A+) for raises up to \$50 million, recently effective Regulation Crowdfunding (Regulation CF) for online raises to \$1 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 progress under Title I of the JOBS Act, which was 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 first-time investors to invest amounts of as little as \$100. Although the term crowdfunding has been used for several years colloquially (in the real estate industry, especially, for the way real estate platforms raise capital by giving non-private equity investors access to deals), these 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 million in reliance on section 4(a)(6) (15 U.S.C.S. § 77d) of the Securities Act during a 12-month period. 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 [An Overview of the SEC’s Crowdfunding Regulations](#).

### Newly Created Funding Portals

Regulation CF created a new category of financial intermediary, known as a funding portal intermediary. A funding portal is a broker acting 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

In addition, the 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 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](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=12218). For further information on crowdfunding intermediaries, see [Crowdfunding Intermediaries and Understanding State Intermediary Licensing Requirements for Participation in Offerings](#).

### ***Portal Registrations during 2016***

The SEC's electronic filing database EDGAR reveals 22 portals registered during 2016 as Funding Portals by filing their Form Funding Portal with the SEC. Some commentators have predicted for 2017 that given the crowded space and the number of issuers in the space presently, 2017 will see the failure of one or more portals. Currently, data is not available to comprehensively quantify the capital raised or commitments. However, by some accounts including the industry publications report that Crowdfund Insider, crowdfunding investor commitments through December 16, 2016 have now surpassed \$15 million. See NextGen Crowdfunding Announces Title III Update: Equity Campaigns Surpass \$15 Million Milestone, Crowdfundinsider.com (December 16, 2016), available at <https://www.crowdfundinsider.com/2016/12/93792-nextgen-crowdfunding-announces-title-iii-update-equity-campaigns-surpass-15-million-milestone/>. This quantity could be dismissed as a slow start, but industry insiders seem confident in the exponential potential growth of this financing option for start-ups.

### ***2016 FINRA Enforcement Action and Settlement with Crowdfunding Portal***

In November 2016, FINRA shut down the Virginia-based crowdfunding portal uFundingPortal (UFP) for allegedly allowing 16 issuers to sell securities through the portal without having filed the requisite paperwork with the SEC and despite numerous other red flags. A representative of FINRA confirmed that the UFP crowdfunding portal case was the first FINRA settlement over alleged violations of the JOBS Act, according to a report by Law 360 available at <https://www.law360.com/securities/articles/870969/finra-bars-crowdfunding-portal-in-1st-jobs-act-settlement>.

FINRA's Letter of Acceptance, Waiver and Consent dated November 8, 2016 (the Settlement) stated in part that the portal "lacked a reasonable basis for believing that certain companies offering securities through its online crowdfunding portal had complied with applicable regulatory requirements; had reason to believe those companies or their offerings presented the potential for fraud or other investor protection concerns; included on its website issuer communications that it knew or had reason to know contained untrue statements of material facts or were other false or misleading; and did not reasonably supervise the activities of its online crowdfunding portal." See the Settlement at p. 2. FINRA stated UFP was thus in violation of Rules 301(a) and 301(c)(2) of SEC Regulation Crowdfunding and FINRA Funding Portal Rule 200(a), 200(c)(3), and 300(a).

### ***Form C Disclosures - Industry***

Since the effectiveness of Regulation CF, disclosure research indicates that approximately 377 Form C reports have been filed with the

SEC. A sampling of 34 Form C reports and amendments filed in December 2016 reveal offerings in the following industries:

- Consumer Services/Products (5)
- Business Services (1)
- Financial Services (1)
- Technology (5)
- Entertainment, including gaming & sports (7)
- Restaurants/Brewers/Spirits/Energy Drink (6)
- Manufacturing (2)
- Wholesale Retail apparel (1)
- Agriculture (1)
- Online Services (5)

### ***Regulation Crowdfunding Securities Offered***

In addition to common stock and debt offerings, the Regulation Crowdfunding offering statements filed in 2016 indicate that start-up issuers are increasingly offering a security entitled SAFE (Simple Agreement for Future Equity), which is not equity or a convertible note but more akin to a warrant that promises the investor an equity stake in the company if there is an initial public offering or other liquidity event. The SAFE does not typically offer an interest payment or contain a maturity date. At least one offering in the sampling contained a revenue sharing interest security offered to investors.

### ***Interpretation in Crowdfunding Issuer Communications and Advertising***

The Regulation CF advertising rules may not be intuitive for many business persons and lawyers. While 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 Compliance and Disclosure Interpretation (C&DI) by the staff of the Division of Corporation Finance of the SEC has clarified that advertising by an issuer may extend beyond the confines of the Rule 204(b) Tombstone-like notice. C&DI Question 204.03 released on May 13, 2016, provides that if the issuer's advertisement does not contain terms of the offering, the issuer is not restricted in providing notice of its offering through social media or other mediums, subject to anti-fraud rules. 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](#).

### ***Notable Transactions***

Regulation CF's groundbreaking deal in 2016 was by Beta Bionics, Inc., the artificial pancreas biotechnology company based in Boston, which closed its round of funding under Regulation CF of \$1 million through equity shares sold on the crowdfunding portal Wefunder Portal, LLC (Wefunder). Beta'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 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., a California based fan-owned entertainment studio, raising its initial \$1 million also through intermediary portal Wefunder

### ***Intermediary Compensation***

In each of the deals above hosted on the Wefunder platform, the progress report on Form C-U disclosed the amount of compensation to be paid to the intermediary was 3% 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.

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 Initial Title III Deals and Timeline***

Structures of the initial 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 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 approximately four months 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.
- 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.

## **TITLE IV: Regulation A+ (Effective since June 2015)**

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

In the 12-18 months 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 filings 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](https://www.sec.gov/dera/staff-papers/white-papers/Knyazeva_RegulationA-.pdf) (the "Regulation A+ Study").

According to the Regulation A+ Study, prospective issuers have publicly filed offering statements for 147 Regulation A+ offerings, seeking up to approximately \$2.6 billion in financing. Of those, approximately 81 offerings seeking up to approximately \$1.5 billion have been qualified by the SEC. The study further provides that approximately \$190 million has been reported raised during that period, but cautions that such number likely understates the true amount raised due to reporting timeframes. See Regulation A+ Study at page 1. For further information on Regulation A+, see "[Regulation A-Plus](#)" Limited Public Offerings under Securities Act Section 3(b) (2).

### ***Size of Regulation A+ Deals***

The Regulation A+ Study states 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 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 reveals that the length of the SEC qualification process for new Regulation A offerings is 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 2016 Regulation A Filings***

In 2016, 218 Form 1-A registration statements were filed with the SEC. A sampling of 43 Form 1-A registration statements and amendments (total of 48) filed in December 2016 reveal offerings in the following industries with most of the offerings concentrated in real estate and business services:

- Real Estate/Construction (8)
- Crude Petroleum & Natural Gas (1)
- Laboratory Analytical Instruments (1)
- Aircraft/Transportation Equipment (3)
- Pharmaceutical/Medical/Surgical (3)
- Finance Services/Mortgage Bankers (2)
- Business Services (11)
- Social Media/Communications (3)
- Entertainment/Production/Sports (6)
- Computer Programming Services/Software (2)
- Semiconductors (1)
- Manufacturing (1)
- Home Goods/Consumer Products (1)

Of the 4th quarter sampling filings researched, 19 were Tier 1 offerings and 29 were Tier 2 offerings.

## **Deal Structures**

A random sampling of 10 Regulation A+ offerings filed in December 2016 found the following deal structures and terms:

- Nine of the 10 offerings were minimum-maximum best efforts offerings
- Only one was a firm commitment underwritten offering with a syndicated selling group of underwriters with securities to be listed on The Nasdaq Stock Market LLC and two additional offerings utilized SEC registered broker-dealers on a best efforts basis.
- Two of the 10 offerings contemplated the issuance of debt securities, including:
  - o A debt offering issuing limited recourse obligations (LROs) in distinct series, each corresponding to a real estate development project to be financed by a commercial loan
  - o A debt offering issuing 9% unsecured promissory notes.

## **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. For further information, see [Understanding the Impact of the JOBS Act 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) remain a small fraction of the total (2%) of the capital reported raised pursuant to Regulation D since the rule became effective on September 23, 2013, 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).

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 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 [General Solicitation and Startup Capital-Raising under Rule 506 of Regulation D](#) and [Knowing the Components of Regulation D](#).

## **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 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 initial public offerings (IPOs) by smaller issuers by reducing various disclosure and compliance requirements for emerging companies 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 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.

## **IPO Activity Post-JOBS Act**

The data for the IPO market shows that during 2014 IPOs increased, from 226 in 2013 to 291 in 2014, but decreased during the first half of 2015, from 158 in 2014 to 101 in 2015 (which was still slightly stronger than first half of 2013). EGCs represented 85 percent of IPOs that have gone into effect since the JOBS Act's enactment through mid-2015. See Ernst & Young, *THE JOBS Act -2015 mid-year update* (September 2015) at page 1-2.

IPOs continued to slow in the second half of 2015 and declined sharply during 2016 with only 105 offerings pricing in total in 2016 raising \$18.8 billion, an over 30 percent drop from 2015. See Renaissance Capital, *US IPO Market 2016 Annual Review* (December 16, 2016) (the Renaissance Report) at page 1.

### ***EGC Disclosure Elections in Selected 2016 IPOs.***

In 2016, the IPO activity sampling for this report of 10 high-performing IPOs showed that five of the sampling companies elected to disclose two years of financial statements, as opposed to three years and four omitted or limited Compensation, Discussion and Analysis (CD&A).

### ***IPO Industry Insights***

According to the Renaissance Report, healthcare was the most active industry in the IPO market during 2016 with 40% of the IPOs. See Renaissance Report at page 4. In the IPO market, technology IPO activity is expected to be spurred in 2017, following a two-year drought in technology IPOs. The report opines that technology companies have not proceeded to public markets to avoid public-market valuations. See Renaissance Report at page 1.

### **2017 Outlook**

#### ***Will Regulation CF Buoy up Capital in 2017?***

Based on the inaugural seven months of deal activity, some portals have been visibly active with Form C-U reports for its issuers being filed, while other registered portals have languished on the sidelines and will be crowded out by competition in 2017. Direct marketers are expected to participate in offerings on behalf of issuers and portals given that the SEC Staff has provided clarifications on advertising in this context and the business and legal community has assimilated this information. Some excitement has been generated in the start-up finance industry, and by most accounts the Regulation CF funding will continue to gain momentum and up-tick in 2017. Finally, portals are now becoming and will likely continue to become more specialized to cater to niche industry sectors including real estate funds, biotechnology, and cloud-based technologies, as well as focus specifically on attracting accredited investors.

#### ***Secondary Market Development for Regulation A+***

Market participants are interested in whether a secondary market for trading in Regulation A securities will develop. A sampling of the recently qualified Regulation A offerings reveals that Form 1-A filings either do not mention a secondary market or provide risk disclosure that a public market does not presently exist and is unlikely to develop in the future. The SEC's Regulation A+ Study does indicate that a number of the issuers purport to be quoted on Over-the-counter or OTC Markets while at least one issuer was seeking a New York Stock Exchange listing. A number of the offering statements contained disclosure that the issuer was planning to seek OTC quotation in the future. 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.

#### ***Rule 506(c) May Gain Traction during 2017***

During 2017, issuers will survey their options in the unregistered exempt market and may elect to take advantage of the online portal and general solicitation route under Rule 506(c) as the contours of JOBS Act advertising and general solicitation become more defined and focused. Several of the newly registered SEC portals display offerings by exemption type (including Rule 506(c) offerings (as well as 506(b), Regulation A and Regulation CF)), making this option more readily available and visible to the accredited investor community inclined to browse and access these portal communities.

It remains to be seen if accredited investors will flock to the current portal community in mass, whether through financial intermediary involvement or direct marketing participants. Clearly, however, legal professionals and business persons are now warming up to less inhibited communications and offering solicitations—a cornerstone of the JOBS Act—breathing life into entrepreneurial dreams.

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