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JOBS Act benefits - don't get lost in the crowd

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Earlier this year, President Obama signed the Jumpstart Our Business Startups Act, referred to as the JOBS Act, into law in an effort to provide small businesses with greater flexibility when trying to raise capital.

There has been significant commentary surrounding the "crowdfunding" exception, which now permits certain small businesses to raise up to $1 million of pooled capital annually through a registered broker or Internet portal.

Although this exception is beneficial, the JOBS Act effected significant changes to other exemptions, specifically Rule 506 of Regulation D and Regulation A, which may greatly benefit companies looking to raise more than $1 million annually.

By way of background, the primary federal securities laws were adopted in 1933 and 1934 in response to the stock market crash of 1929 and the ensuing Great Depression. The Securities Act of 1933 prohibits offers and sales of securities unless the securities are registered with the Securities and Exchange Commission or an exemption under the 1933 Act applies.

The registration requirements seek to protect investors through a disclosure-based regime. If a company wants to solicit sales on a broad basis to investors of varying degrees of sophistication, it must be prepared to satisfy the rigorous registration and disclosure requirements under the 1933 act and the related regulations.

The exemptions provide relief from the more onerous requirements if a company is raising a limited amount of capital or is soliciting it in a more limited manner.

The change to Rule 506 removes the bar on general solicitation or advertising in connection with sales of securities exclusively to "accredited investors." The Rule 506 exemption is generally favored by companies seeking to raise capital from investors who qualify economically as "accredited investors" because it does not impose a dollar limit on the size of the offering. By contrast, Rule 504 and Rule 505 have annual limits of $1 million and $5 million, respectively.

Historically, companies have not been able to use Rule 506 to raise capital from a very broad group of people. The exemption has not been available when any form of "general solicitation" or "general advertising" is used.

These terms have been interpreted broadly, so companies relying on Rule 506 typically have only sold to a limited pool of investors with whom the company or persons acting on its behalf had a pre-existing business relationship.

The JOBS Act seeks to remove this limitation. It requires the SEC to issue regulations that eliminate the bar on general solicitation or general advertising under Rule 506 when sales of securities are made only to accredited investors.

The change to Regulation A increases the capital ceiling from $5 million to $50 million. The Regulation A exemption is a hybrid exemption because the issuer must file a short form registration statement with specific disclosures with the SEC.

Historically, it stood in contrast to the Rule 505 and Rule 506 exemptions because it permitted broad solicitation, through distribution of a written circular or by scripted radio or television advertisements filed with the SEC. However, it could only be used for annual offerings of $5 million or less, which made it unattractive in light of the costs associated with a short form registration.

Under the JOBS Act, the ceiling has increased from $5 million to $50 million. Thus, if a company wants to raise more than $5 million annually from both accredited and non-accredited investors, Regulation A may have renewed appeal.

Whether the new legislation will jumpstart small business growth will remain to be seen. However, it is a positive step and should provide companies with a broader set of options for raising capital. The laws remain intricate and, in each case, companies will need to exercise due care to ensure compliance.

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