



Leveraging the JOBS Act to Raise Capital


October 4th, 2012

Wayne Pinnell
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Agenda


- Welcome
- Investor Readiness
- JOBS Act
- Crowdfunding
- General Solicitation
- Section 4(2)
- Rule 506(D)
- Closing & Questions



Haskell & White LLP

Who we are

- ✓ We are a middle-market focused firm powered by 65 client-centered professionals and 9 entrepreneurial partners with two offices – Irvine and San Diego
- ✓ We practice with the technical competencies and experience of larger accounting firms and the attentiveness and responsiveness of smaller accounting firms
- ✓ We are members of *The Leading Edge Alliance* – an international association of firms
- ✓ We serve a variety of industries with our niche focus areas in SEC, Real Estate and M&A
- ✓ Our SEC clients include both accelerated and non-accelerated filers; we serve pre-revenue companies, as well as businesses with revenues in the hundreds of millions
- ✓ In January 2011, we received our second consecutive “clean” PCAOB inspection report



Investor Readiness

Business Key Ingredients

- What key ingredients do you need to start a business?
 - An Idea – some product or service for which there is demand or the ability to create demand
 - A Market – the demographics of the type and location of the customers you plan to reach
 - A Business Plan – the overarching plan covering “Now, Where, How”




Investor Readiness


Business Key Ingredients

- Sources of Funding
 - Traditional Sources:
 - Friends and Family
 - Angels, Venture Capital
 - Bank Financing
 - Investment bankers, IPOs
 - And, the new way coming soon – *Crowdfunding*.
- “Why” for funding
 - The business plan should cover your plans for the funding you receive and “what’s in it for them” – what you are promising in return; the Value Proposition.
 - Are you prepared to handle what you get? Smart decisions and money management, required.



JOBS Act

- Introduction to JOBS Act – “Jumpstart Our Business Startups Act”
- Congress passed this legislation In March 2012, the President signed it into law in April.
- Intended to cause the creation of jobs and economic growth by improving access to capital markets for Emerging Growth Companies.
- EGC defined as those with less than \$1 Billion in annual revenue
- EGCs will receive favorable treatment when dealing with the SEC until they reach \$1 Billion in revenue or 5 years the company’s equity IPO, including:
 - Scaled back financial reporting to go public; relaxed rules for adopting new standards
 - Opportunity for confidential submission of registration statement, before committing to IPO, essentially allowing time to “test the waters”
 - Exemption from Sarbanes-Oxley § 404(b)



JOBS Act

- **Current Status:**
 - The SEC has many rules to write/adopt as mandated; and they are behind. The SEC is still working thru requirements of 2011's Dodd-Frank Act.
 - No exemption from securities registration for private companies raising capital in a crowdfunding.

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What is CrowdFunding?

- **Collective Action + Fundraising**



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What is CrowdFunding?

- **Donation**
 - Gift
 - Prize/Rewards
 - Product Pre-Orders
- **Investment**
 - Debt
 - Equity

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What is CrowdFunding?
Donation

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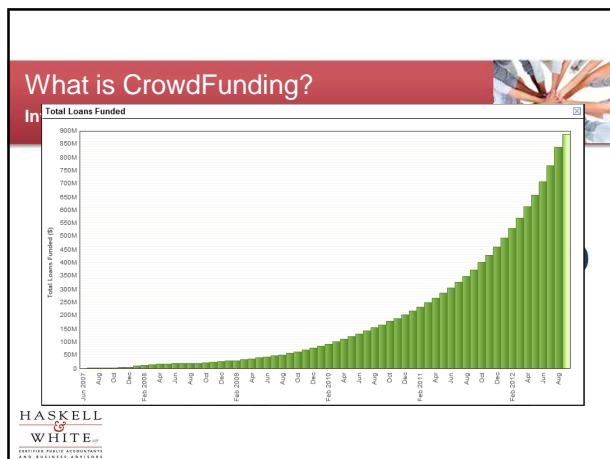
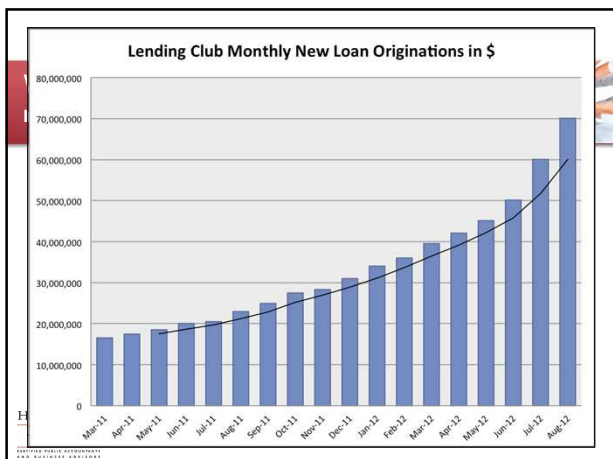
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What is CrowdFunding?
Investment

- **Collective Action + Fundraising**



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JOBS Act
HR3606

- TITLE I--REOPENING AMERICAN CAPITAL MARKETS TO EMERGING GROWTH COMPANIES
- TITLE II--ACCESS TO CAPITAL FOR JOB CREATORS
- **TITLE III--CROWDFUNDING**
- TITLE IV--SMALL COMPANY CAPITAL FORMATION
- TITLE V--PRIVATE COMPANY FLEXIBILITY AND GROWTH
- TITLE VI--CAPITAL EXPANSION
- TITLE VII--OUTREACH ON CHANGES TO THE LAW

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JOBS Act
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JOBS Act
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Is This a Game Changer?

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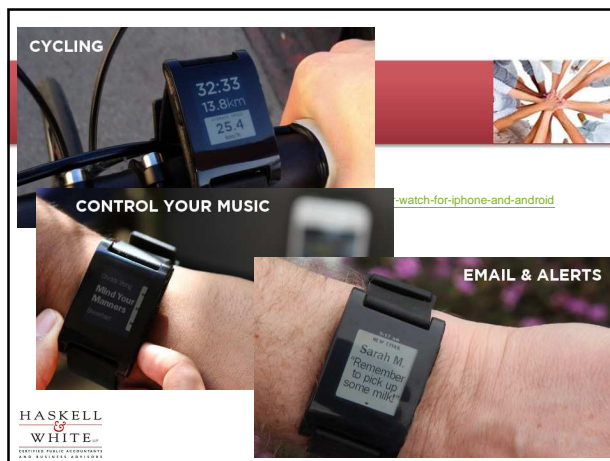
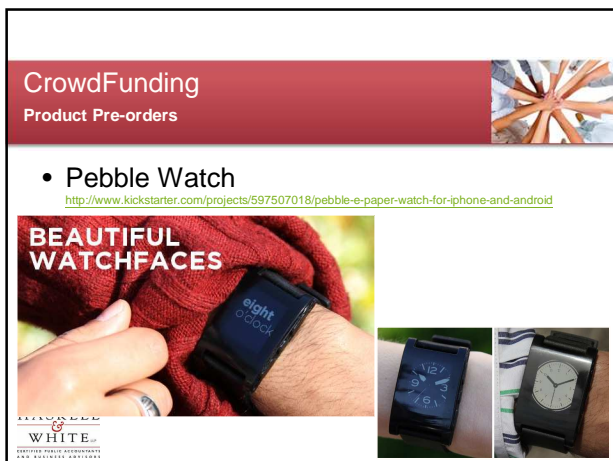
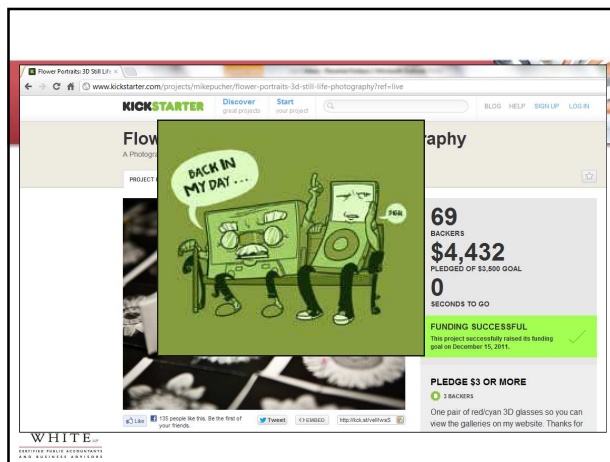
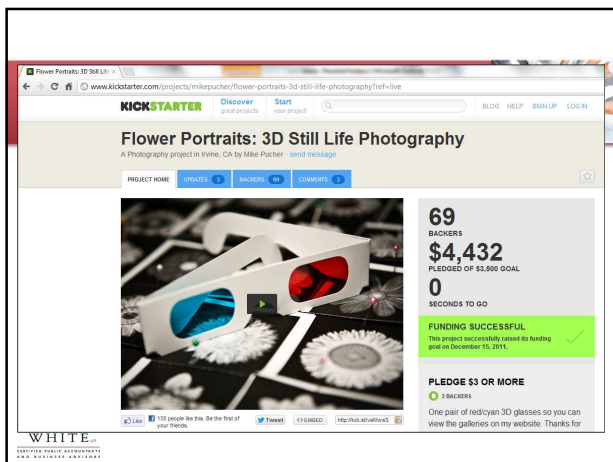
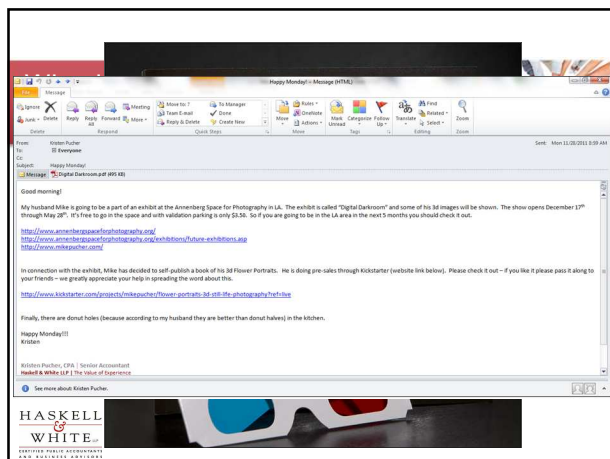
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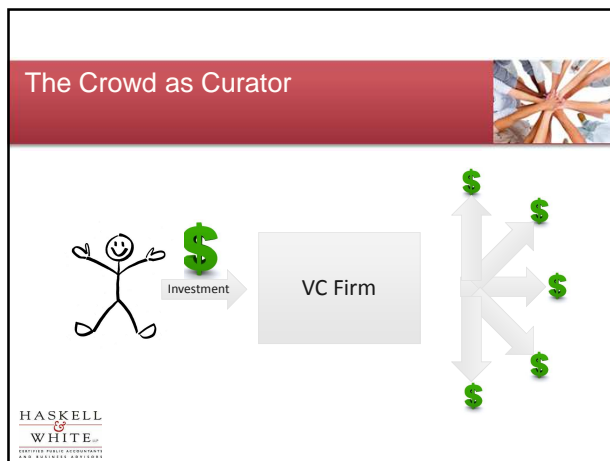
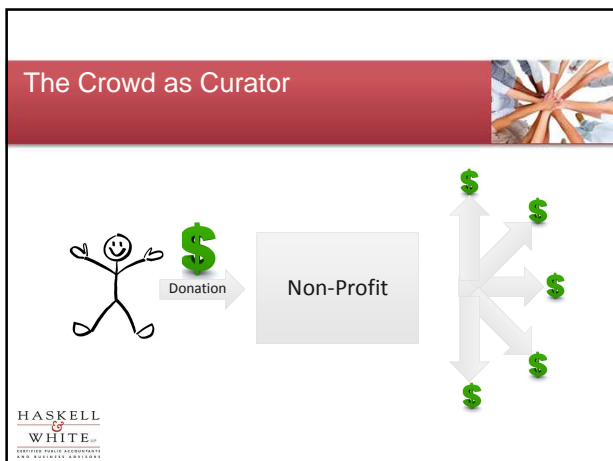
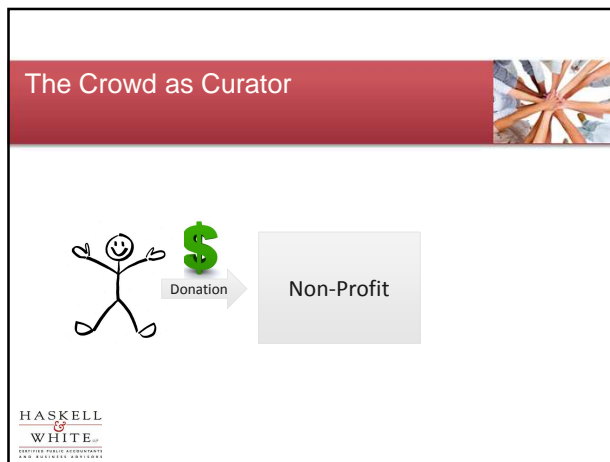
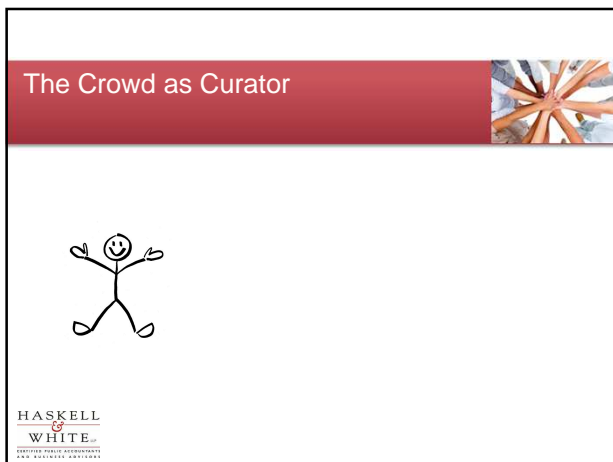
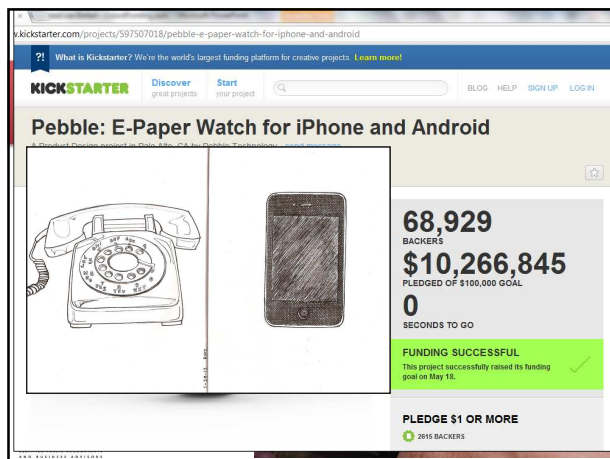
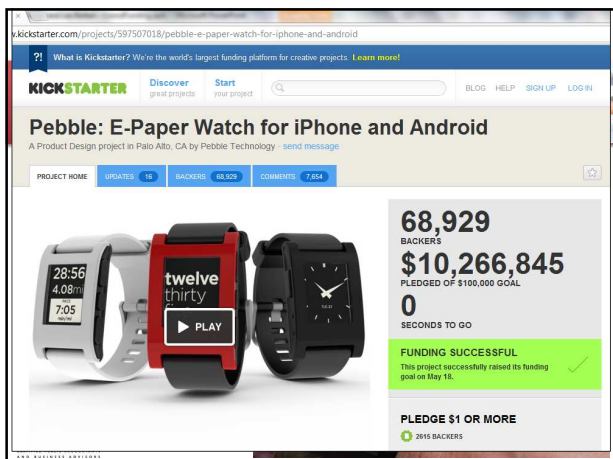
What is CrowdFunding?

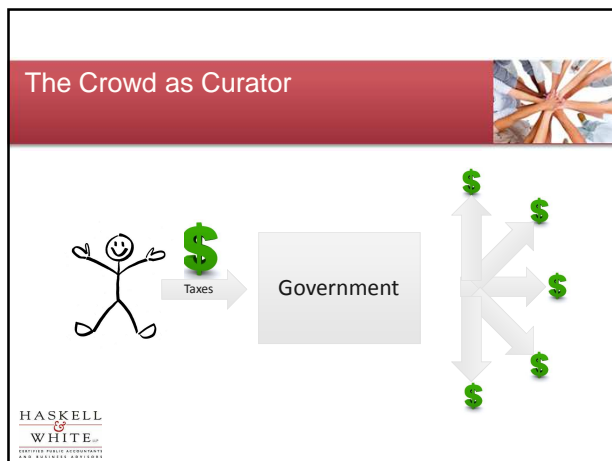
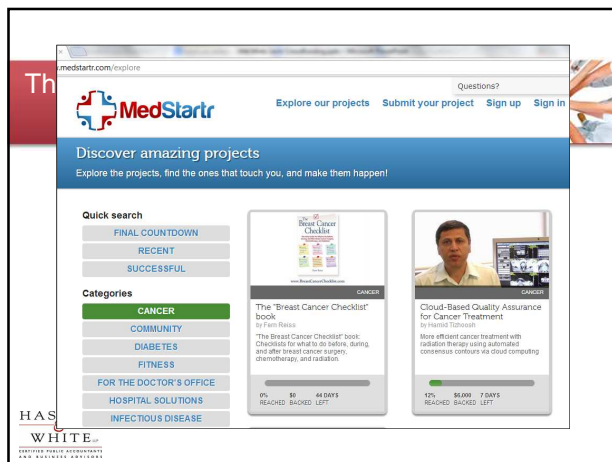
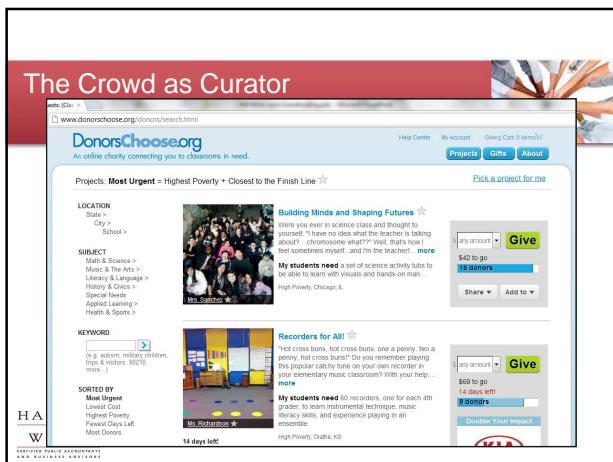
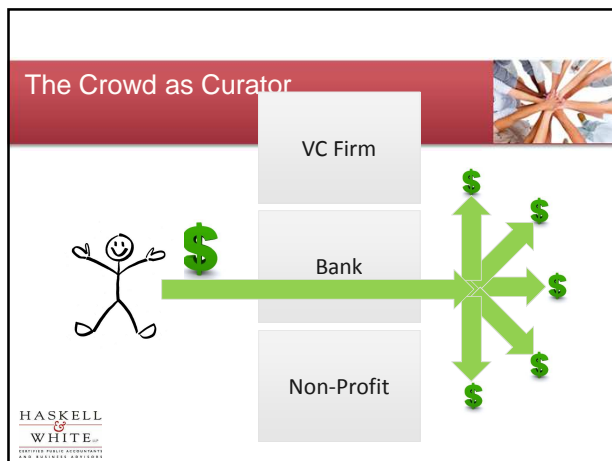
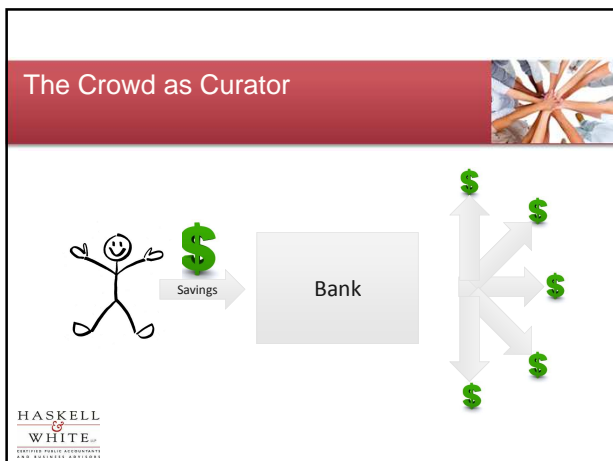
Product Pre-orders

<http://www.kickstarter.com/projects/mikepucher/flower-portraits-3d-still-life-photography>

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The Crowd as Curator

<http://en.imakerotterdam.nl/>

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International Crowdfunding

<http://player.vimeo.com/video/42372905>

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The JOBS Act: Leveraging the JOBS Act to Raise Capital

Jeremy Glaser, Esq.
Member & Co-chair of Venture Capital & Emerging
Companies Practice Group
Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.
October 4, 2012

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The Jumpstart Our Business Startups Act (JOBS Act): A “Game Changer”

- “This is a country that has always been on the cutting edge and the reason is because America has always had the most daring entrepreneurs in the world... When their ideas take root we get inventions that can change the way we live. And when their businesses take off, more people become employed because, overall, new businesses account for almost every new job that’s created in America.” – President Barack Obama on the JOBS Act, April 5, 2012
- What does the new game really look like?

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Traditional Public versus Private Offering Considerations (The Old Rules)

Public	Private
<ul style="list-style-type: none"> • Deal Cost: High • Ongoing Cost: High; ongoing reporting and Sarbanes Oxley requirements • Speed: Slow; SEC review required • Market: Liquid public market; unrestricted securities • General solicitation permitted 	<ul style="list-style-type: none"> • Deal Cost: Low • Ongoing Cost: Low • Speed: Relatively fast; SEC review not required • Market: None or secondary; restricted securities • General solicitation <i>not</i> permitted; finding accredited investors often very challenging

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Post JOBS Act: General Solicitation Permitted

What is General Solicitation?

- Depends on the facts and circumstances
- Substantial pre-existing relationship a key factor for traditional private placements
- Definitely includes:
 - Newspapers, magazines, mass mailings
 - Radio, television spots, cold calling, public seminars
 - Public, unrestricted websites, social media (Facebook, Twitter etc.)
- Once regulations adopted, issuers may use all of the above to solicit accredited investors without the traditional costs of going public.

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The Way it is Now

- All securities publicly offered and sold in the United States must be either registered or exempt at both the federal and state level.
- Two commonly used federal exemptions:
 - Section 4(2)
 - Rule 506 of Regulation D
- A state exemption is also required, but Rule 506 partially preempts state law. Section 4(2) does not.
- Other federal and state exemptions exist, but are not as useful when raising large amounts of private capital.

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<h4>Section 4(2)</h4> <ul style="list-style-type: none"> • Statutory Exemption-no filing required • State Securities Law Compliance Required • Restricted Securities • Available for “Private Offerings” as determined by case law • Private Offering <u>Factors</u> <ul style="list-style-type: none"> – Number of Offerees – Number of Securities/Size of Offering – Investor Intent – Investor Access to Information – Sophistication of ALL Investors – Manner of Offering-No General Solicitation • Lack of certainty makes Section 4(2) a fallback position in most financings. 	<h4>Rule 506, Regulation D</h4> <ul style="list-style-type: none"> • Issuer files an informational notice filing-Form D • Unlimited Offering Amount • State Securities Laws Preempted • Restricted Securities • Unlimited Number of Accredited Investors • Up to 35 Non-Accredited Investors <u>with Disclosure</u> • Accredited Status <ul style="list-style-type: none"> – Varies with type of investor – Must have a “reasonable belief” an investor is accredited • No General Solicitation Permitted • Section 4(2) Defense
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The Current Market: Changes in Liquidity

- Traditionally, Rule 506 and private offerings had no or a very limited secondary market. This prevented many investors from investing and reduced pricing for issuers.
- Mandatory holding period still required.
 - One year for non-reporting issuers
 - Six months if reporting issuer
- But, secondary market makers (e.g. SharesPost, SecondMarket) now increasing liquidity once applicable holding periods expire

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Title II of the JOBS Act – Rule 506
Additional Requirements for General Solicitation

- Issuer files Form D and checks box indicating general solicitation will be used
- ALL Investors must be accredited (Two requirements)
 - Reasonable Belief
 - Reasonable Steps used to verify accreditation
- Section 4(2) is not available as a fall back position if general solicitation is used.

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Title II of the JOBS Act – Rule 506
What are Reasonable Steps to Verify an Investor's Accredited Status?

- SEC Answer: Whatever is reasonable under the circumstances!
- Factors from the SEC's proposed rules:
 - Nature of the investor and the type of accredited investor the investor claims to be
 - Individual investors generally subject to greater scrutiny
 - Individuals—Obtain a W2, bank statement or third party CPA letter
 - Amount and type of information available about the investor
 - For regulated entities status should be verified with regulator (i.e. FINRA's Broker Check)
 - Manner of solicitation (Wider the net, greater the diligence)
 - Internet Solicitation is very broad, more diligence required
 - Offering terms such as high minimum investment amounts
- Investor representations and questionnaires alone probably not sufficient if general solicitation is used. Third party/additional verification likely required.
- Overall Theme: *No bright line test for compliance. Absent Actual Knowledge - Actual Due Diligence Required.*

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The Result: A New Type of Financing Created

- Public Private Placement?
- Public Accredited Placement?
- Public Offering to Accredited Investors?
- Really *not* a private placement – whole new set of implications

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The Recent Market: Lack of Smaller IPO's as an Exit Strategy

Source: "Where Have All the IPOs Gone?" By Xiaohui Gao, Jay R. Ritter, Zhongyan Zhuo (April 3, 2012).

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VC's Shift to Later Stage Investing

Source: PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ Report; Data: Thome on Reuters.

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Let's Have Some Fun
What are the implications on fundraising?

- What will be the impact on angel and super angel investors?
- Will venture funds continue/accelerate their trend toward more later stage investing?
- What new opportunities may be created for local and regional investment banking firms?
- What role do venture funds play in the new environment?

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Title III of the JOBS Act - Crowdfunding

- **Crowdfunding Defined:** a private financing comprised of the pooled investments of many small investors
- **Crowdfunding History:** evolved from non-securities type transactions (e.g. Kickstarter) into more traditional securities-type offerings
- **Before the JOBS Act:** No federal exemption from securities registration for private companies raising capital from large groups of unaccredited investors
- **After the JOBS Act:** Subject to future regulations, private companies raising capital from large groups of unaccredited investors through a qualified intermediary will be exempt from securities registration at *both* the state and federal level.

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Title III of the JOBS Act - Crowdfunding

Conditions for Crowdfunding Financing:

- Companies can raise up to \$1,000,000 within a 12-month period without registering the securities offered with the SEC, subject to certain restrictions.
- Companies raising between \$100,000 and \$500,000 will have to engage an auditor to review their financial statements.
- Companies raising over \$500,000 and up to \$1,000,000 will need to provide investors with audited financials.
- **Resale Restrictions:** One year holding period unless sold to issuer, accredited investor, registered or an estate/family transfer; additional restrictions under consideration by the SEC.

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Title III of the JOBS Act - Crowdfunding

Conditions for Crowdfunding Financing:

- Investors with annual income or net worth below \$100,000 = annual investment is capped at the greater of \$2,000 or 5% of annual income or net worth.
- Investors with annual income or net worth above \$100,000 = annual investment is capped at 10% of annual income or net worth.
- Qualified intermediaries must be used (e.g. funding portals).
- Funding portals and brokers must register with the SEC and comply with numerous restrictions which have not yet been implemented or proposed in their final form.

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Title III of the JOBS Act - Crowdfunding

Conditions for Crowdfunding Financing:

- Issuers may not advertise the offering outside the funding portal or broker engaged.
- Intermediaries must take steps to ensure individual investor limits maintained for *all* of an investor's crowdfunding investments and that investors have read and understand investment materials.
- Issuers must file a disclosure document with the SEC including a business description, financial statements, and description of ownership and capital structure. Likely a public filing, but awaiting final rules.
- Subject to rulemaking by the SEC within 270 days. No rules yet proposed.

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