

# Angel Capital Association & VC Experts

## Understanding the JOBS Act

May 4, 2012

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## Today's Panel::



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## JOBS Act: Overview for Angels

- **IPO On-Ramp – Joe Bartlett**
- **General Solicitation – Dan Hansen**
- **Regulation A – Joe Bartlett**
- **Shareholder Thresholds – Dan Hansen**
- **Crowdfunding – Bill Carleton**



## IPO On-Ramp: Impact for Angels?

- Realistic exit opportunities on occasion
- Effective now ... at least two filings are in process
- Upward influence on valuations if the Conveyor Belt\* finish line is (or might be) a “portfolio maker,” i.e., On-Ramp IPO

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\* See, Bartlett, “From the Embryo to the IPO, Courtesy of the Conveyor Belt (Plus a Tax-Efficient Alternative to the Carried Interest),” *JPE*, Winter 2011

J. Bartlett

Companies less than \$1B in revenue (an “*Emerging Growth Company*”); for earlier of: 5 years or \$1 billion in gross revenue; large accelerated filer (\$700 million in market cap)

- 2 years audited financials, not 3; more limited MD&A
- S-1 confidential until 3 weeks before road show
- SEC to modernize S-K

J. Bartlett

- No auditor report on internal controls for up to 5 years, SOX 404(b) but, internal controls over financial reporting; CEO and CFO provide SOX-compliant certifications
- No audit firm rotation rules
- No ‘say on pay’
- Test the waters, a “road show” (by any other name) with QIBs and institutional (Rule 506(a)(1)) accrediteds; discussion of pricing
- Discuss draft registration statement with SEC (in advance)

J. Bartlett

- Sell side analysts can issue research reports before, during or immediately after the offering; no quiet period
- More relaxed restrictions on communications with management and sell-side analysts

J. Bartlett

## IPO On-Ramp: Selected Practical Issue

- Consistency of test the waters material with registration statement disclosures
- Underwriters may require representations and warranties with respect to test the waters information
- Registrant and advisers (and the market) may require some items be revised upwards ... 3 years of audited statements
- Qualify for listing on a National Exchange

See Bartlett & Shulman, "IPO Reform: Some Immodest Proposals," *JPE*, Summer 2003.

J. Bartlett

## General Solicitation

- Current requirement: A company cannot generally solicit or generally advertise a private securities offering.
- Part of Rule 506 under Section 4(2):  
    "Transactions by an issuer not involving any public offering."
- Includes: Newspapers, TV, magazines, radio and generally solicited meetings.

D. Hansen

## Core Rule Changes

- Remove general solicitation and advertising prohibition provided all purchasers are accredited.
- Require company to “take reasonable steps” to verify purchasers are accredited.

D. Hansen

## New Platform Protection

Act creates a safe harbor from federal broker dealer laws for persons who maintain a “platform or mechanism” that permits Rule 506 offerings and sales, whether online, in person or through other means.

D. Hansen

## Conditions on Platform

Platform cannot:

- Receive compensation in connection with the purchase or sale.
- Control customer funds or securities.
- Be disqualified.

Platform can:

- Provide ancillary services (due diligence and standardized docs) and co-invest in the securities.

D. Hansen

## When Effective?

- SEC to adopt rules for new 506 within 90 days (July 4, 2012).
- Platform safe harbor effective now.

D. Hansen

## General Solicitation: FAQs

- Does this mean I can advertise the sale of my stock?
- What are “reasonable steps” for accredited?
- If below the exemption is it a public offering?
- How will state law treat platforms?

D. Hansen

## Impact to Angels?

- More deal opportunities.
- Investment opportunities in new platforms and mechanisms.
- More competition for deals.
- Increased cost of transactions and privacy risk.

D. Hansen

## Impact to Angel Portfolio Companies?

- Increased means for companies to get funding.
- Possibly more risk to directors and officers due to uncertainty in securities compliance.
- May help expand secondary markets.

D. Hansen

## \$50,000,000 Regulation A: Impact for Angels?

- Depends on SEC rules, e.g., definition of “Qualified Purchasers” or list on NASDAQ Capital or NYSE AMEX
- State Law Pre-emption a “must”
- Market acceptance?
- Question of expense: How much cheaper and faster than the On-Ramp?

J. Bartlett

- Exempt public offerings by U.S. and Canadian issuers of \$50 million or less over 12 month period; equity, debt and convertible debt freely transferable except sales by affiliates
- Start Date: SEC to adopt rules to implement; no time limit on how soon

J. Bartlett

- State law is preempted for offerings on a national securities exchange or offered or sold to “qualified purchasers” as defined by SEC. No definition as yet
- **Existing Reg A:**
  - \$5 million limit.
  - 1994 to 2004 only 78 Reg As; 2010 only 3

J. Bartlett

- Financial statements in Form 1-A to be audited in accordance with GAAP but only from issuers with audited financials prepared for other purposes
- Pre filing “test the waters,” soliciting investor interest
- No limits on types of investors; non-accrediteds O.K. except to the extent imposed under State laws

J. Bartlett

- Registrants file an offering statement on Form 1-A including an offering circular and exhibits; a standard registration-type or a question-and-answer format;
- Form 1-A topics include: risk factors; how the issue was priced; projections; use of proceeds; management CVs;\* conflicts; MD&A

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\*The SEC is highly alert to managers' 'resume creep'

J. Bartlett

- Periodic disclosures regarding the issuer, its business operations, its financial condition, its corporate governance principles, its use of investor funds and “other appropriate” matters

J. Bartlett

## Regulation A: Practical Issues

- Easier than conventional IPO?
- As a practical matter, Godspell filed its 1-A in March 2010 and its final response to SEC comments was in July 2010;
  - There were a grand total of 6 SEC letters of comment, 102 comments in all and 5 letters of response (total of 30 pages)

J. Bartlett

## Shareholder Thresholds

- Prior rule: Private company must register with SEC when:
  - \$1,000,000 in assets and
  - More than 500 stockholders.

D. Hansen

## New Rule

Private company must register with SEC when:

- Over \$10 million in assets and
- More than either: (a) 2,000 stockholders or (b) 500 stockholders who are not accredited.
- Excluding: stockholders who acquired securities from employee plans and crowdfunding exemptions.

D. Hansen

## When Effective?

Now! But:

- SEC to adopt rules for implementing employee plan exception. No deadline.
- SEC to adopt rules for implementing crowdfunding exception in 270 days.

D. Hansen

## Shareholder Thresholds: Impact on Angels

- More large private companies. Fewer IPOs?
- Increased secondary market activities.
- Watch the transfer restrictions.

D. Hansen

## Fun Facts About Crowdfunding

- Crowdfunding is the ONLY portion of the JOBS Act drafted in the Senate; all other titles are EXACTLY as first passed by the House
- Crowdfunding exists today (e.g., Kickstarter); but existing crowdfunding can't be used to sell stock
- General solicitation will NOT be ok for equity crowdfunding (but WILL be a-ok for angel investing!)
- Equity crowdfunding is STILL ILLEGAL (SEC has 8 more months to write rules)

## Equity Crowdfunding: Rules for Companies

- May raise up to \$1M, LESS amounts raised in prior 12 months
- Must conduct the transaction through a broker or registered “funding portal”
- May not advertise, except to direct prospects to the broker or funding portal

B. Carleton

## Crowdfunders Subject to (*Complex!*) Individual Investment Caps

- Income or net worth, \$40,000 or less, cap = \$2,000
- Income or net worth between \$40,000 and \$100,000, cap = 5%
- Income or net worth = or > \$100,000, cap = 10%, up to max. of \$100,000

<<Caps measured looking back 12 mos.>>

B. Carleton

## Last but not least – Funding Portals

- Must register with the SEC
- Must register with the SRO
- Must educate and quiz prospective investors
- Must perform background checks on each officer, director and > 20% shareholder
- Tasked to ensure no investor exceeds her annual investment limit (across all deals!)
- Must protect “privacy of information collected from investors”
- Must give SEC 21 days advance notice of issuer disclosures
- Must not release proceeds until target met, subject to investor right to cancel
- Must prohibit its officers, directors and partners from having an interest in its listed issuers
- May eventually be turned over to state regulatory oversight . . .

B. Carleton

## Quandaries & Hidden “Gotcha’s”

- Stock restricted one year (except for transfers to company, angels & family) – but where is liquidity?
- Personal liability of directors and officers for “material omissions” in disclosure
- Impact on valuations?
- How does an angel round follow a crowdfunded round?

B. Carleton

## Additional Resources:

- [Final JOBS Act \(html\)](#)
- [Final JOBS Act \(pdf\)](#)
- [President's remarks before signing the JOBS Act](#)
- [Crowdfunding Leadership Group April 5 letter to President Obama \(pdf\)](#)
- [MoFo summary and analysis \(pdf\)](#)
- [WSG&R summary and analysis \(pdf\)](#)
- [NASAA Model Crowdfunding Exemption \(initial draft submitted to members\)](#)
- [VC Experts Information & Contact](#)

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# Q/A

More Questions?

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