

## JOBS Act: Is it the answer for startups and small businesses looking for funding? *By Nathaniel Roland*

Many small business and startup business owners are familiar with the broad strokes of the Jumpstart Our Business Startups (JOBS) Act signed by President Obama in early April. One of the stated goals of the JOBS Act is to reduce securities law burdens on startups and small businesses and to make capital more accessible to them.

“Crowdfunding” is a term that generally describes a group of unaffiliated people who pool their money, usually via the internet, to support the financing needs of another person or organization. Prior to the JOBS Act, a company could not promote its stock publicly or raise money from a large number of “unaccredited” (i.e., not wealthy) investors without first registering its stock with the Securities and Exchange Commission (SEC) and becoming a publicly-traded company – that is, without “going public.” And, because the costs of going and remaining public are prohibitively high for most small companies, they were effectively barred from raising investment dollars from the public at large.

Enter the JOBS Act, and, in particular, Congress’s directive to the SEC to draft a set of rules and regulations to permit companies to raise money via crowdfunding: that is, allow companies to advertise that they are selling their stock, and take lots of small investments from a large group of people, including unaccredited investors.. With crowdfunding, a company will no longer be confined to raising funds quietly among wealthy friends and acquaintances (or hiring a registered broker-dealer to do so on its behalf).

However, while the general concept of crowdfunding sounds like a win for both entrepreneurs and start-ups, it is untested territory and the “devil is in the details.” The Securities and Exchange Commission still needs to develop and finalize regulations to govern

crowdfunding before companies may utilize crowdfunding to raise investment capital (the soonest these regulations are expected is in early 2013). Nonetheless, the JOBS Act provides some general rules and limitations for crowdfunding, and these general rules will form the structure around which the SEC's more detailed regulations will be built. What we can already see from these general rules and limitations is that qualifying for and complying with the requirements of crowdfunding could limit the usefulness of this capital raising mechanism.

These are some of the more important restrictions in the law:

1. A company cannot raise more than \$1 million annually from crowdfunding.
2. A company can only accept certain amounts from investors. The amount that an investor can allocate across *all* crowdfunding investments that he makes in a given year cannot exceed (i) \$2,000 or five percent of his annual income if his annual income or net worth is less than \$100,000, or (ii) ten percent of his annual income if his net worth or annual income is \$100,000 or more.
3. All sales of stock or other equity and advertising for the offering must be conducted through a registered broker-dealer or an authorized funding portal. The company cannot conduct the crowdfunding on its own.
4. The company must comply with disclosure requirements, which include providing basic financial information before seeking funding.

In addition to the restrictions above, there is uncertainty about how crowdfunding will work in practice, although it is possible that the SEC will address these uncertainties in the regulations. For instance, it is still unclear whether and to what extent a company that utilizes crowdfunding will, within twelve months of concluding its crowdfunding offering, be able to use other methods to raise additional funds from investors without going public. Also, companies

that utilize crowdfunding will need to file certain financial reports with the SEC on an ongoing basis, and we do not yet know if these reports will be made available to the public. Small companies trying to enter a competitive market space could be at a substantial disadvantage if they are required to make their financial information public, especially if they are trying to win big jobs or contracts against larger, more established competitors.

Moreover, although the JOBS Act requires crowdfunding investors to demonstrate that they understand the risks of investing in small businesses, managing a large group of possibly unsophisticated stockholders, none of whom has put in a large sum of money, could be an unhelpful distraction for management of a start-up company. These small-dollar investors may be quicker to file lawsuits or complain to the SEC if their investments are unsuccessful. The presence of a large group of small-dollar investors could also discourage venture capitalists and other institutional investors from investing in a company when the company is in need of more funding down the road.

Despite these potential challenges, crowdfunding may prove to be an innovative and viable way to give startups and small businesses more access to investors and capital. Early-stage businesses that have a good invention or idea, do not need to raise more than \$1 million a year to launch their product or service, and are having difficulty finding wealthy individuals or venture capital firms to invest in them may find crowdfunding helpful. However, it will not be the best solution for all companies. For example, for businesses requiring more than \$1 million in a 12-month period, such as drug development companies, raising funds the old-fashioned way through wealthy individuals who can invest as much money as they like will generally prove to be the better route.

The details of how crowdfunding will work, including its benefits and drawbacks, will remain unclear until the SEC moves further along in its rulemaking process. Right now, it is probably best to consider more traditional fundraising methods if investment capital is necessary within the next year. In the meantime, it remains a good idea to get company paperwork in order because, no matter how funds are raised, investors can be expected to be ask for access to information concerning all material aspects of a business before writing a check.

*Nathaniel Roland is a shareholder at [Trenam Kemker](http://www.trenam.com) (www.trenam.com), and focuses his practice primarily on mergers and acquisitions, corporate formation and structuring matters, capital raising, private placements, lending transactions and commercial contracts. He can be reached at [ncroland@trenam.com](mailto:ncroland@trenam.com).*