Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

JOBS Act's Lift Of Ad Ban Gains Traction With Small Cos.

By **Tom Zanki**

Law360, New York (April 4, 2016, 11:56 PM ET) -- Four years since Congress passed the Jumpstart Our Business Startups Act, a work in progress that aims to expand capital-raising options for smaller companies, attorneys says the law's lifting of advertising bans for certain private placements is finally beginning to gain traction with issuers, while changes under the law's Regulation A-Plus have yet to make much of an impact.

Despite a slow initial reception, lawyers say clients are warming up to what are known as 506(c) offerings, named after a rule that lets issuers publicly market private placements that can raise unlimited funds as long as such offerings are limited to accredited investors, a class that includes wealthy individuals. The 506(c) provision, now in effect for nearly three years, was one of several key parts of the JOBS Act, passed April 5, 2012, on the premise of modernizing capital markets.

The law's noted easing of access to initial public offerings took effect instantly, but options for private companies have been phased in more slowly, depending on when the U.S. Securities and Exchange Commission implemented rules. For instance, the JOBS Act’s enlarged Regulation A offerings took effect in June of last year, while equity crowdfunding doesn’t go into force until May.

As the new landscape gradually begins to crystallize, attorneys say that 506(c) offerings are showing potential now that the market is becoming more familiar with them. They say that's largely because issuers want to use modern technology to spread word about their offerings while being subjected to as few strings as possible.

“Right now, my personal experience is, 506(c) is gaining a lot of traction and seems to be the one that is going to be the most popular,” said Rutan & Tucker LLP partner Gregg Amber.

The JOBS Act’s removal of the ban on “general solicitation” — or advertising — took effect in September 2013. The 506(c) deals come under Regulation D, which sets the ground rules for private offerings that are exempt from formal registration requirements.

By letting companies publicly advertise their offerings, the change is meant to give smaller companies that lack an existing investor base or connections to brokers the opportunity to use the Internet to tap a wider pool of backers. But 506(c) offerings also require both that issuers verify their investors are accredited and that investors demonstrate they are accredited — additional mandates not required under traditional 506(b) offerings, which existed before the JOBS Act and bar general solicitation.

Attorneys say issuers were initially tripped up by the added requirements of 506(c) offerings, contributing to their soft start. The SEC and trade group the Securities Industry and Financial Markets Association later issued guidance on how issuers can verify investors' accreditation, and the SEC issued guidance on what exactly constitutes “general solicitation,” attempting to provide clarity and allay fears.

“Those things, along with the general passage of time, have eased some of the concerns people had about relying on 506(c),” said Covington & Burling LLP partner Keir Gumbs. “Whereas in the beginning, at least in my experience, very few institutions wanted to rely on it, now it seems very commonplace.”

Gumbs said 506(c) has had the “biggest impact” to date among the various avenues for private companies the JOBS Act created, noting that it's drawing interest from both startups and established companies. Amber said real estate firms have shown the most interest in Rule 506(c) offerings among his clients.

In other industries, Noble Environmental Technologies Corp., a San Diego-based environmental technology and manufacturing company, filed for a $10.5 million 506(c) offering, while oil and gas producer Del Mar Energy Inc. filed for a $10 million raise. Still, data show that 506(c) offerings represent only a tiny fraction of private placements when compared with traditional 506(b) offerings, which remain the preferred route and can serve as a bridge to an IPO.

An SEC Division of Economic and Risk Analysis report revealed that 2,946 companies raised $26.7 million under the new rule from when it took effect in 2013 until the end of 2015, compared with 32,461 operating companies that raised $310.1 million under the traditional 506(b) format, or more than 11 times as much. The 506(b) offerings also allow up to 35 unaccredited investors provided that the companies accept additional regulation.

But SEC data also show that 506(c) offerings began to rise last fall, posting consecutive year-over-year increases in funding levels last November and December. The same SEC report showed no spike in fraud since 506(c) offerings came into effect as critics had feared.

Eliza S. Fromberg, counsel at Day Pitney LLP, said she expects 506(c) offerings to pick up as methods of verifying accredited investors become more standard and the use of Internet platforms, which allow smaller companies to bypass intermediaries, become more accepted.

“I think it is inevitable,” Fromberg said. “Investors are excited about private placements because they offer an opportunity to get in on the ground floor on an exciting company."

While investors explore 506(c) offerings, the SEC’s expanded Regulation A offerings, also known as Regulation A-Plus, are newer to the fold and have yet to make a splash. Regulation A-Plus allows issuers to raise up to $50 million through a process exempt from registration requirements, sometimes dubbed a “mini-IPO.”

An SEC study through Feb. 15 showed that 68 Regulation A-Plus filings were submitted since rules became effective last June, of which 19 offerings were qualified by the SEC and three sales were completed. The filings sought $1.3 billion, of which $290 million has been qualified, the study said.

Covington & Burling partner Donald Murray said Regulation A-Plus offerings could struggle to gain traction because they fall between the private and public realms into an area that is “neither fish nor fowl.” He noted that Regulation A-Plus filing requirements are not significantly less than what is required for a full-blown IPO while the fundraising caps and other restrictions limit their appeal.

“You don't have the glamour of being a public company, but you don't have anonymity of being private,” Murray said.

Regulation A-Plus offerings contain two tiers of offerings, one capped at $20 million and one at $50 million, in order to give issuers flexibility. The higher offering, called Tier 2, requires more extensive disclosures but also relieves issuers from obtaining approval from state securities regulators for deals that cross state lines, though regulators in Massachusetts and Montana are challenging that waiver. Tier 1 offerings require approval from state securities regulators.

The hope behind Regulation A-Plus — which raised a prior $5 million limit that was widely considered obsolete — is that such offerings can serve as a bridge to a full-fledged IPO. Attorneys say that has yet to happen.

“Unfortunately, I have not seen a strong tendency to consider A-Plus in connection with the financing plan toward an IPO,” said Olshan Frome Wolosky LLP partner Spencer Feldman.

Dechert LLP partner David Rosenthal said because Regulation A-Plus offerings are only marginally less costly, companies might opt for IPOs regardless. He noted that smaller life sciences companies continue to pursue IPOs, even though many in recent months have raised $50 million or less.

“I don't see it having a tremendous amount of utility,” Rosenthal said of Regulation A-Plus. “I would love to be proven wrong and see whether it actually takes off.”

Regulation A-Plus offerings got a boost last month when Generation Income Properties Inc., a Florida-based real estate investment trust, became the first REIT to take advantage of the new option, raising $20 million.

Even with the slow start, Gumbs said, Regulation A-Plus is getting far more looks from issuers than it did under the old $5 million standard, which often attracted lower-quality companies.

“Reputationally, it has improved a ton from how it used to be,” Gumbs said.

Amber said the jury is still out on which option is best, and much depends on what stage a company’s in and what its capital-raising needs are. But he said many clients tend to prefer 506(c), largely because of less extensive SEC disclosures compared with the sizable Form 1-A required of Regulation A-Plus filings.

“There are so many things about it that look like a full registration that most of the clients I speak to end up going back to 506(c) and saying, 'We think we can do it with accredited investors only as long as we can do general solicitation,’ which in this age means they are able to use the Internet," Amber said.

--Editing by Mark Lebetkin and Philip Shea.