Jumpstarting the next JOBS Act

By Sean Donahue, Esq., and Lauren Visek, Esq., Goodwin

JULY 11, 2022

Given current increased stock market volatility and the decreased number of IPOs in 2022, a discussion draft of proposed legislation by Senate Banking Committee Republicans aimed at facilitating capital formation may gain traction. The draft, referred to as JOBS Act 4.0, is intended to build on the success of the 2012 Jumpstart Our Business Startups (JOBS) Act.

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The 2012 JOBS Act encouraged smaller companies called "emerging growth companies" (EGC) to go public and supported capital formation in the private market through deregulation. For example, the 2012 JOBS Act reduced the disclosure and compliance requirements for EGCs for up to five years after going public. It also permits smaller companies to submit confidential draft IPO registration statements and to "test the waters" with investors prior to the IPO roadshow.

In the private market, the 2012 JOBS Act lifted the ban on general solicitation under Rule 506 of Regulation D, increased the number of shareholders before a company is required to become a reporting company and created a crowdfunding exemption. While the 2012 JOBS Act encouraged private investments and the number of IPOs initially increased, proponents of the JOBS Act 4.0 believe further deregulation is needed. Below is an overview of some of the key JOBS Act 4.0 proposals.

Reduce disclosure burdens

The JOBS Act 4.0 wants to reduce disclosure burdens for reporting companies. One proposal suggests making quarterly reporting voluntary and only requiring Exchange Act reports on a semi-annual basis. Republicans advocate for reduced reporting obligations to encourage longer term thinking and reduce expenses. Counterarguments include the importance of keeping investors informed and the lower cost of capital for companies seeking to raise funds.

Less surprising proposals in the JOBS Act 4.0 include removing the requirements to disclose the ratio of the CEO's pay to the median company employee in proxy statements and removing requirements under the Exchange Act to disclose information related to conflict minerals, coal or mine safety and payments by resource extraction issuers. Both CEO pay ratio and conflict minerals disclosure requirements have been unpopular with companies. Some have argued pay ratio disclosures are misleading, costly, of limited utility because they are not comparable and do not encourage pay reform. Critics also argue conflict mineral disclosures are static and difficult to report.

Another proposal in JOBS Act 4.0 includes a provision to modify the definition of EGC, which was introduced in the 2012 JOBS Act, so that status as an EGC would expire up to 10, instead of five, years following a company's IPO. The proposed change would not eliminate the loss of EGC status before such date once a company: hits annual gross revenues of $1.07 billion; issues more than $1 billion in non-convertible debt over three years; or when it becomes a large accelerated filer. Extension of the time period during which a company will remain an EGC, with reduced reporting requirements, would reduce the disclosure burden on smaller companies, but is unlikely to encourage more companies to go public.

Encourage capital formation of smaller companies

A number of additional proposals have been included to encourage capital formation. For example, the JOBS Act 4.0 includes language for the creation of venture exchanges to allow for the trading of: securities of early-stage growth companies exempt from registration under the small issues exemption; the securities of EGCs and securities registered under section 12(b) if the issuer is not a large accelerated filer; or if the average daily trade volume is below a certain threshold.

The proposed legislation also instructs the Securities and Exchange Commission ("SEC") to issue regulations to provide sufficient disclosures to investors, allows the SEC to limit transactions as appropriate and authorizes the SEC to create a Venture Exchanges Office. The proposal aims to allow small issuers to concentrate trading on one exchange.

An additional proposal is focused on adding a micro-offering exemption to exempt transactions that would assist small

companies in raising capital. The proposal would include transactions involving the sale of securities where the aggregate amount sold by the issuer during the year preceding the transaction does not exceed $500,000 (subject to adjustment for inflation).

Additional proposals aim to assist capital formation by making it easier for brokers to assist smaller companies. One suggestion would require the SEC to promulgate regulations for private placement brokers that:

- are no more stringent than those imposed on funding portals,
- require the SEC to pass rules allowing a private placement broker to become a member of a national securities association with reduced membership requirements, and
- remove private placement brokers from the definitions of broker.

A second proposal includes provisions for M&A brokers to be exempt from registration as a broker dealer. This proposed legislation is intended to help small companies find investors and sell or purchase companies.

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In order to raise capital under certain private placement exemptions, investors have to be considered accredited investors. An accredited investor, under the current rules, is determined in reference to the investor meeting certain income or net worth requirements. A proposal under the JOBS Act 4.0 would make it easier for companies to verify investors meet the applicable requirements and expands the number of investors that could be considered accredited investors by:

- permitting an investor to be certified as an accredited investor through an examination established or approved by the SEC, any state securities commission or any self-regulatory organization without being subject to income requirements,
- allowing anyone to invest in Regulation D securities up to 10% of their inc
- adding additional categories of individuals that would be considered accredited investors, including any person having at least $500,000 in investments.

The legislation also permits the SEC to undertake a review of the definition of accredited investor and to make adjustments after such review. The proposed revisions are aimed at allowing more investors to buy private stock, which would increase the number of investors from which smaller companies could seek capital.

An additional proposal worth noting requires the SEC to regularly evaluate and revise the definition of "small entity." The proposal requires, within one year of passing the legislation and every five years thereafter, the SEC to conduct a study of the definition of "small entity" for purposes of chapter 6 of title 5, United States Code and submit to Congress a report with detailed recommendations on amendments to the definition of "small entity." The SEC is then required to issue a proposed rule within 270 days of the submission of the report to Congress. The primary purpose of the proposal is to regularly update the low asset size limits in the definitions and require the SEC to consider regulatory impacts on small companies.

Increase the burden of shareholders bringing proposals

Additional proposals under JOBS Act 4.0 would restrict the ability of shareholders to submit proposals. One such proposal would remove the requirement that a company has to include a shareholder's proposal in its proxy statement if the shareholder meets certain eligibility requirements and follows certain procedures. Instead, companies would be required to opt-in to Rule 14a-8. This proposed change would decrease the success rate of shareholder proposals as proposals that are included in the proxy statement have a higher chance of passing.

A second proposal would allow companies to exclude shareholder proposals under §240.14a-8(i) regardless of whether the proposal relates to a significant policy issue. The SEC came out with guidance in November 2021 (https://bit.ly/3bttJQk) that makes it more difficult for companies to exclude certain shareholder proposals which will, for example, make it easier for environmental, social and governance related proposals to be included and passed. If the proposed legislative changes were made, this guidance would be overruled and companies will be able to exclude a larger number of shareholder proposals.

An additional proposal that would restrict shareholder access suggests changes to the requirements for shareholders to submit proposals under §240.14a-8. Currently, to be eligible to submit a shareholder proposal, a shareholder has to have continuously held either (i) $2,000 or more in securities for at least three years, (ii) $15,000 or more in securities for at least two years or (iii) $25,000 or more in securities for at least one year.

Under the proposed revisions, shareholders would be required to hold 1% of the market securities of a company but would be permitted to aggregate their holdings with other shareholders in order to meet the eligibility threshold. The proposed revisions would make shareholder proposals only available to large shareholders or shareholders who are able to organize enough smaller shareholders in order to meet the 1% threshold. Republicans argue decreasing shareholder proposal access will help cut down on frivolous submissions, but the proposed legislation would limit shareholder access.

While some of the JOBS Act 4.0 proposals will likely receive resistance from Democrats, the proposals give a sense of issues that are top of mind for companies and certain changes that may be on the horizon given the current economic and political climate.

About the authors

Sean Donahue (L) is a partner in **Goodwin** Capital Markets practice and Shareholder Activism & Takeover Defense practice, chair of the firm's Public Company Advisory Practice, and co-chair of the firm's ESG & Impact Practice. Based in the firm's Washington, D.C., office, he counsels public companies and their Boards of Directors on securities regulation, shareholder activism defense, and corporate governance matters. He can be reached at SDonahue@goodwinlaw.com. **Lauren Visek** (R) is an associate in the firm's Business Law Department and a member of the Technology and Life Sciences groups, as well as the Capital Markets and Public Company Advisory practices. Based in the firm's Washington, D.C., office, she counsels public companies and their Boards of Directors on securities regulation, capital market transactions, and corporate governance matters. She can be reached at LVisek@goodwinlaw.com.

This article was first published on Reuters Legal News and Westlaw Today on July 11, 2022.