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NOTES

THE JOBS ACT: INVESTOR PROTECTION, CAPITAL FORMATION, AND EMPLOYMENT IN AN INCREASINGLY POLITICAL ECONOMY

INTRODUCTION

On April 5, 2012, President Obama signed the Jumpstart Our Business Startups Act (the JOBS Act or Act).¹ The purpose of the Act was “[t]o increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.”² The Act sought to lower the cost of raising capital by deregulating current securities laws.³ It was passed against the backdrop of a classic struggle of balancing free markets with investor protection,⁴ a debate that was exacerbated by the financial crisis and ensuing recession.⁵

The main criticism of the Act alleged that decreased regulation would lead to decreased investor protection and thus to increased fraud.⁶ The purpose of this Note is to show that this criticism is misplaced. A more legitimate criticism of the Act should question the effect it will have on job creation. The Note will accomplish this by arguing that (1) the JOBS Act, by deregulating certain securities offerings, will have a positive impact on capital formation without significantly impairing investor protection, and (2) the Act, as drafted and sold to the public, may not actually increase employment.

Part I of this Note provides an overview of the federal securities laws as well as the JOBS Act as a whole. Part II examines the background and legislative history of three provisions that seem to have caused the most

1. Jumpstart Our Business Startups Act (JOBS Act), Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified in scattered sections of 15 U.S.C. (2012)).

2. *Id.*

3. *See id.*

4. J. WILLIAM HICKS, INTERNATIONAL DIMENSIONS OF U.S. SECURITIES LAW § 4:2 (2012).

5. *See, e.g., Enhanced Investor Protection After the Financial Crisis: Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs*, 112th Cong. 3 (2011) (statement of David Massey, President, North American Securities Administrators Association; Deputy Securities Administrator of North Carolina) (discussing the necessity of the investor protection provisions of the Dodd-Frank Act).

6. *See, e.g.,* Letter from Mary L. Schapiro, Chairman, SEC, to U.S. Senators Tim Johnson & Richard C. Shelby 1 (Mar. 13, 2012), available at http://www.aicpa.org/advocacy/issues/downloadabledocuments/404b/3-13-12_sec_chm_schapiro_letter_to_johnson.pdf (addressing the JOBS Act and explaining how “[t]oo often, investors are the target of fraudulent schemes disguised as investment opportunities”); Matt Taibbi, *Why Obama’s JOBS Act Couldn’t Suck Worse*, ROLLING STONE (Apr. 9, 2012, 11:53 AM), <http://www.rollingstone.com/politics/blogs/taibblog/why-obamas-jobs-act-couldnt-suck-worse-20120409> (“The ‘Jumpstart Our Business Startups Act’ . . . will very nearly legalize fraud in the stock market.”).

commentary and controversy. This Part also analyzes the investor protection mechanisms the Act provides. Part III discusses additional investor protections outside the JOBS Act. In Part IV, this Note evaluates the effect the Act will have on job creation and argues that deregulation will not lead to a significant increase in employment. Finally, Part V reviews the political climate surrounding the JOBS Act and provides some alternative explanations of the Act's true purpose.

I. OVERVIEW OF THE FEDERAL SECURITIES LAWS AND THE JOBS ACT

A. THE SECURITIES ACT OF 1933 AND THE SECURITIES AND EXCHANGE ACT OF 1934

The Securities Act of 1933 (the Securities Act) requires that all securities offered or sold must be registered with the U.S. Securities and Exchange Commission (the SEC) or must fall under an exemption.⁷ The cost of registration can be prohibitively expensive, especially for small businesses.⁸ The theory behind the registration process under the Securities Act is to provide investors with disclosure, which grants investors access to all material information required to make an informed decision.⁹ While the Securities Act governs a one-time disclosure for initial offerings, the Securities and Exchange Act of 1934 (the Exchange Act) requires continued disclosure for companies with securities that trade in the secondary market and have a certain number of shareholders and assets.¹⁰ As with the Securities Act, the goal of the reporting requirements of the Exchange Act is to allow investors to accurately value a company's shares.¹¹

B. OVERVIEW OF THE JOBS ACT

The JOBS Act expanded many existing exemptions and created several new ones, thereby increasing access to capital for small businesses. Title I of the JOBS Act scaled down the reporting requirements of Securities Act registration statements for any entity that qualifies as an "emerging growth company."¹² This category was defined in extremely broad terms, which

7. 15 U.S.C. §§ 77c–77e (2012). For an overview of the registration process, see *Registration Under the Securities Act of 1933*, SEC, <http://www.sec.gov/answers/regis33.htm> (last modified Sept. 2, 2011).

8. See, e.g., *infra* note 103 and accompanying text.

9. *The Laws That Govern the Securities Industry*, SEC, <http://www.sec.gov/about/laws.shtml> (last modified Oct. 1, 2013).

10. 15 U.S.C. § 78m.

11. See, e.g., Bruce A. Hiler, *The SEC and the Courts' Approach to Disclosure of Earnings Projections, Asset Appraisals, and Other Soft Information: Old Problems, Changing Views*, 46 MD. L. REV. 1114, 1118 (1987).

12. JOBS Act § 102 (codified as amended at 15 U.S.C. §§ 77g(a), 78m(a), 78n(i), 78n-1(e); 17 C.F.R. § 229.402 (2013)).

includes any issuer with “total annual gross revenue” of under \$1 billion.¹³ The continued reporting requirements of the Exchange Act and Sarbanes-Oxley Act (SOX) are also scaled down as long as the company keeps its status as an emerging growth company.¹⁴ In addition, such entities are allowed to “test the waters” by communicating with qualified institutional buyers and institutional accredited investors before a registration statement is filed.¹⁵ Draft versions of registration statements can also be submitted to the SEC confidentially.¹⁶

Title II of the JOBS Act changed the way private funds, including hedge funds,¹⁷ private equity funds,¹⁸ and venture capital funds,¹⁹ will be able to offer securities by lifting the previous ban on general solicitation and advertising.²⁰ These funds rely on an exemption to the Securities Act under Rule 506 of Regulation D.²¹ In order to claim the exemption, the securities must only be sold to accredited investors.²²

13. *Id.* § 101(a) (codified as amended at 15 U.S.C. § 77b(a)(19)).

14. *Id.* §§ 102–04 (codified as amended at 15 U.S.C. §§ 77g(a), 78m(a), 78n(i), 78n-1(e), 7213(a)(3), 7262(b)). “Emerging growth company” is defined in the Securities Act at 15 U.S.C. § 77b(a)(19) and in the Exchange Act at 15 U.S.C. § 78c(a)(80).

15. JOBS Act § 105(c) (codified as amended at 15 U.S.C. § 77e(d)).

16. *Id.* § 106(a) (codified as amended at 15 U.S.C. § 77f(e)).

17. The President’s Working Group on Financial Markets explains:

The term “hedge fund” is commonly used to describe a variety of different types of investment vehicles that share some common characteristics. Although it is not statutorily defined, the term encompasses any pooled investment vehicle that is privately organized, administered by professional money managers, and not widely available to the public.

PRESIDENT’S WORKING GRP. ON FIN. MKTS., HEDGE FUNDS, LEVERAGE, AND THE LESSONS OF LONG-TERM CAPITAL MANAGEMENT 1 (1999) [hereinafter PRESIDENT’S WORKING GRP.], available at <http://www.treasury.gov/resource-center/fin-mkts/Documents/hedgfund.pdf>.

18. Private equity funds invest in, by definition, private equity. These are

[e]quity securities of companies that have not “gone public” (are not listed on a public exchange). Private equities are generally illiquid and thought of as a long-term investment. As they are not listed on an exchange, any investor wishing to sell securities in private companies must find a buyer in the absence of a marketplace.

Private Equity, VCEXPERS, <https://vcexperts.com/encyclopedia/glossary/private-equity> (last visited Nov. 17, 2013).

19. “An investment fund that manages money from investors seeking private equity stakes in startup and small- and medium-size enterprises with strong growth potential. These investments are generally characterized as high-risk/high-return opportunities.” *Venture Capital Funds*, INVESTOPEDIA, <http://www.investopedia.com/terms/v/vcfund.asp#axzz297tOK0an> (last visited Nov. 17, 2013).

20. JOBS Act § 201 (codified as amended at 15 U.S.C. § 77d; 17 C.F.R. §§ 230.144A(d)(1), .506(2013)).

21. See 17 C.F.R. § 230.506. This Note will focus mainly on hedge funds rather than all private funds.

22. *Id.*; see *infra* note 40 (defining “accredited investor”).

Title III of the Act created a brand new exemption to securities laws by allowing companies to raise money through “crowdfunding” platforms.²³ This is accomplished through websites that allow businesses to raise up to \$1 million from a large number of investors.²⁴ Although each contribution may be small, the Internet allows a business owner to reach an unlimited number of investors, and thus crowdfunding may revolutionize the way small businesses raise capital. The website must register with the SEC as either a broker-dealer or a “funding portal.”²⁵

Title IV of the Act amended section 3(b) of the Securities Act by creating a new class of exempted securities for small businesses that are raising a limited amount of capital.²⁶ Prior to the Act, a similar exemption existed under Regulation A.²⁷ The new exemption created under the JOBS Act, dubbed Regulation A+,²⁸ has been viewed as an expansion of Regulation A, although it is technically a new exemption.²⁹ The JOBS Act increased the amount of money that may be raised in these offerings from \$5 million to \$50 million.³⁰ The issuer may rely on general solicitation, and the securities may be freely resold, but the issuer must comply with several requirements, which include providing investors with a simplified offering circular and simplified financial statements.³¹

Titles V and VI amended sections 12(g) and 15(d) of the Exchange Act by raising the threshold of shareholders for mandatory registration.³² Registration with the SEC is required from companies with over \$10 million in assets and over 2000 shareholders, increased from 500.³³ Lastly, Title VII simply instructs the SEC to make information regarding the JOBS

23. JOBS Act §§ 301–05 (codified as amended at 15 U.S.C. §§ 77d(6), 77d-1, 77r(b)(4), (c)(1), (c)(2)(F), 78c(a)(80), (h), 78l(g)(6), 78o(i)(2)).

24. *Id.* § 302 (codified as amended at 15 U.S.C. § 77d(6)).

25. Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure*, 90 N.C. L. REV. 1735, 1753–54 (2012). *See infra* note 90 (defining “funding portal”).

26. JOBS Act § 401 (codified as amended at 15 U.S.C. § 77c(b)).

27. *See* 17 C.F.R. §§ 230.251–63 (2013).

28. Louis A. Bevilacqua et al., *JOBS Act Targets Smaller Business Capital Raising*, PILLSBURY WINTHROP SHAW PITTMAN LLP 4 (Apr. 5, 2012), http://www.pillsburylaw.com/siteFiles/Publications/CSAlertJumpstartOurBusinessesAct040512_final.pdf.

29. *See, e.g.*, Rob Kaplan & Tom Voekler, *Beyond Crowdfunding: Why Regulation A Reform Is the Most Vital Piece of the JOBS Act*, WASH. POST (June 13, 2012), http://articles.washingtonpost.com/2012-06-13/business/35459353_1_initial-public-offerings-investors-jobs-act (“The JOBS Act expands Regulation A’s annual dollar limit tenfold—from \$5 million to \$50 million.”).

30. JOBS Act § 401 (codified as amended at 15 U.S.C. § 77c(b)(2)(A)).

31. *Id.* *See also* *Small Business and the SEC*, SEC, <http://www.sec.gov/info/smallbus/qasbsec.htm> (last modified Oct. 10, 2013) (providing an overview of Regulation A).

32. JOBS Act §§ 501, 601 (codified as amended at 15 U.S.C. §§ 78l(g)(1), (4), (5)(A), 78o(d)).

33. *Id.* Title VI and section 15(d) apply to banks and bank holding companies; Title V and section 12(g) apply to companies other than banks and bank holding companies. *Id.*

Act available online and to direct this information towards small businesses and those owned by minorities, women, and veterans.³⁴

II. BACKGROUND OF THE JOBS ACT'S PROVISIONS AND RESULTANT INVESTOR PROTECTION MECHANISMS

The three provisions of the JOBS Act analyzed here came about for slightly different reasons, but all were passed with the general intent of increasing small businesses' access to capital and increasing employment.³⁵ Although these provisions seek to ease the requirements for certain companies issuing equity, several of the Act's requirements seek to limit the scope of each provision and safeguard investors.³⁶

A. TITLE II: PRIVATE FUNDS AND THE LIFTING OF THE BAN ON GENERAL SOLICITATIONS

i. Background and Legislative History

Hedge funds, although not a new concept, have seen substantial growth in recent years.³⁷ This growth, combined with the government's lack of information regarding their operations,³⁸ led to several proposals in the last decade to regulate the industry.³⁹ For many years hedge funds have been able to avoid registration under the Securities Act by not offering their securities publicly, not advertising or engaging in general solicitation, and only selling to accredited investors.⁴⁰ Funds can also avoid the requirements of the Investment Company Act of 1940 and the Investment Advisers Act of 1940 by limiting the number of beneficial owners and requiring investors to meet investment minimums and the definition of a "qualified purchaser."⁴¹

Although much of the commentary on Title II of the JOBS Act focuses on hedge funds, the original legislative intent does not appear to consider

34. *Id.* § 701.

35. *See infra* Part II.A–C.

36. *Id.*

37. PRESIDENT'S WORKING GRP., *supra* note 17, at 1.

38. STAFF OF SEC, IMPLICATIONS OF THE GROWTH OF HEDGE FUNDS vii (2003) [hereinafter STAFF REPORT], available at <http://www.sec.gov/news/studies/hedgefunds0903.pdf>.

39. Pallavi Gogoi & Barbara Hagenbaugh, *Geithner Seeks More Hedge Fund Regulations*, USA TODAY (Mar. 27, 2009, 11:26 AM), http://usatoday30.usatoday.com/money/companies/regulation/2009-03-26-hedge-funds-regulation-geithner_N.htm; Registration Under the Advisers Act of Certain Hedge Fund Advisers, Advisers Act Release No. 2266, 69 Fed. Reg. 72,054 (Dec. 10, 2004).

40. STAFF REPORT, *supra* note 38, at x. "Accredited investor" is defined by Rule 501(a) of the Securities Act. Besides certain institutional investors and insiders of the issuer, a natural person may be accredited if he has a net worth of more than \$1 million or has income of more than \$200,000 in each of the previous two years and a reasonable expectation of the same income level for the current year. 17 C.F.R. § 230.501(a) (2013).

41. STAFF REPORT, *supra* note 38, at x.

this sector of the financial industry. The bill was introduced by Representative Kevin McCarthy as the Access to Capital for Job Creators Act, which “would improve capital formation by expanding financing options”⁴²—a purpose couched in general terms not unlike the JOBS Act as a whole. The justification for the bill was that, due to the heightened lending standards resulting from the financial crisis, traditional commercial bank loans were increasingly difficult to obtain by small businesses.⁴³ Congressional testimony of industry experts favored the proposal, asserting that raising capital under the current regulation was too burdensome, as a ban on general solicitation meant that investors needed a preexisting relationship with the issuer.⁴⁴ Furthermore, because these investors were required to qualify as accredited, they typically had a bigger appetite for risk and needed fewer protections than less wealthy or sophisticated investors.⁴⁵

Still, a problem remained—although purchasers would need accreditation status, allowing advertising and general solicitation would result in offers being extended to unaccredited investors, who might then mislead the issuer as to their true level of wealth or sophistication.⁴⁶ To assuage these concerns, the bill was amended to include a provision directing the SEC to adopt rules requiring “the issuer to take reasonable steps to verify that purchasers of the securities are accredited investors.”⁴⁷

ii. Investor Protection Mechanisms

Despite these safeguards, critics warned that the proposed SEC rules threatened to undermine investor protection.⁴⁸ These new rules for hedge funds come at a time when, for many years, proposals have been made to

42. Access to Capital for Job Creators Act, H.R. 2940, 112th Cong. (2012); *Digest for H.R. 2940*, HOUSE REPUBLICAN CONF., <http://www.gop.gov/bill/112/1/hr2940> (last visited Nov. 17, 2013).

43. H.R. REP. NO. 112-263, at 2 (2011).

44. *Legislative Proposals to Facilitate Small Business Capital Formation and Job Creation: Hearing Before the Subcomm. on Capital Mkts. & Gov't Sponsored Enters. of the H. Comm. on Fin. Servs.*, 112th Cong. 35–36 (2011) [hereinafter *Legislative Proposals Hearing*] (statement of Barry E. Silbert, Founder & CEO, SecondMarket).

45. *Id.* at 123; but see Pat Huddleson, *Keeping Vigilant for Investment Fraud*, PHYSICIAN'S MONEY DIG. (Oct. 18, 2011), <http://www.physiciansmoneydigest.com/personal-finance/Keeping-Vigilant-for-Investment-Fraud> (noting that doctors are often targets of investment fraud because of their high wealth levels and lack of financial expertise).

46. *Legislative Proposals Hearing*, *supra* note 44, at 64 (statement of Heath Abshire, Arkansas Securities Commissioner and Chairman of the Corporation Finance Committee of the North American Securities Administration Association).

47. H.R. REP. NO. 112-263, at 1 (2011); 157 CONG. REC. H7290 (daily ed. Nov. 3, 2011) (statement of Rep. Waters).

48. See, e.g., Press Release, U.S. Senator Carl Levin, Levin Statement on SEC's Proposed General Solicitation Rule (Aug. 29, 2012), available at <http://www.levin.senate.gov/newsroom/press/release/levin-statement-on-secs-proposed-general-solicitation-rule>.

increase, not decrease, regulation of the hedge fund industry.⁴⁹ There are several valid reasons why regulating hedge funds is not a high priority. First, despite their recent growth, hedge funds remain a relatively small part of the financial sector.⁵⁰ In a 2007 speech, Federal Reserve Chairman Ben Bernanke disagreed with these proposals for increased regulation and argued that the invisible hand of the market would regulate itself.⁵¹ He noted that “[t]hus far, the market-based approach to the regulation of hedge funds seems to have worked well, although many improvements can still be made.”⁵² This is not to say that hedge funds can never pose systemic risk to the financial system.⁵³ In 1998, a hedge fund run by Long Term Capital Management nearly collapsed.⁵⁴ A failure of the fund could have had a broader impact on the already fragile financial markets.⁵⁵ Nine years later, the subprime mortgage crisis led to the near collapse of two hedge funds at Bear Stearns,⁵⁶ which was one factor that led to the firm’s fire sale to JPMorgan eight months later.⁵⁷

Even if regulators agreed that hedge funds posed too great a risk, increased regulation would pose several problems. First, it is not clear that increased regulation would even be able to contain risk in the industry, or whether it would disrupt the existing market-based discipline.⁵⁸ A balanced proposal is that while highly burdensome regulations may not be in the economy’s best interest, regulations should, at a minimum, try to understand the industry better. This decrease in opacity would allow for a more tailored oversight regime. However, hedge funds are notoriously secretive,⁵⁹ and by making more information publicly available, the effect

49. See, e.g., Gogoi & Hagenbaugh, *supra* note 39.

50. PRESIDENT’S WORKING GRP., *supra* note 17, at 1.

51. Ben S. Bernanke, Chairman, Fed. Reserve, Speech at New York University Law School: Financial Regulation and the Invisible Hand (Apr. 11, 2007), available at <http://www.federalreserve.gov/newsevents/speech/bernanke20070411a.htm>.

52. *Id.*

53. PRESIDENT’S WORKING GRP., *supra* note 17, at 2 (“Although individually and as an industry, hedge funds represent a relatively small segment of the market, their impact is greatly magnified by their highly active trading strategies and by the leverage obtained through their use of repurchase agreements and derivative contracts.”).

54. *Id.* at 12–14.

55. *Id.* at 20.

56. Julie Creswell & Vikas Bajaj, *\$3.2 Billion Move by Bear Stearns to Rescue Fund*, N.Y. TIMES (June 23, 2007), <http://www.nytimes.com/2007/06/23/business/23bond.html>.

57. Yalman Onaran, *JPMorgan Chase to Buy Bear Stearns for \$240 Million*, BLOOMBERG (Mar. 17, 2008, 12:54 AM), <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a4qrSYRFeOgl>.

58. Ben S. Bernanke, Chairman, Fed. Reserve, Speech at the Federal Reserve Bank of Atlanta’s 2006 Financial Markets Conference: Hedge Funds and Systemic Risk (May 16, 2006), available at <http://www.federalreserve.gov/newsevents/speech/bernanke20060516a.htm> (“A risk of any prescriptive regulatory regime is that, by creating moral hazard in the marketplace, it leaves the system less rather than more stable.”).

59. Michael S. Schmidt, *A Trader’s Train to Wall Street*, Conn., N.Y. TIMES (Aug. 4, 2006), <http://www.nytimes.com/2006/08/04/business/04reverse.html>.

may be to decrease funds' competitive advantage, which again would distort the current laissez-faire environment.⁶⁰ Thus, the benefits of hedge funds would be reduced.

Once the disadvantages of increased regulation are understood, the next step is to focus on determining the effects of decreased regulation. Critics to the Act contend that allowing private funds to solicit to the general public will cause unsophisticated investors to be inundated with advertisements and offers for funds, which will lead to increased fraud.⁶¹ However, as mentioned, hedge funds prefer to remain out of the public eye.⁶² This aspect of the industry is even more evident as the financial crisis has brought negative attention to the financial sector and the "one percent" of wealthy Americans.⁶³ For this reason, some commentators have speculated that private funds may not wish to advertise.⁶⁴

Another concern is whether increasing the solicitation opportunities of these private funds will result in larger numbers of investments in such funds as investors divert funds that ordinarily would have been invested in safer vehicles such as mutual funds or tax-qualified accounts such as IRAs or 401(k)s.⁶⁵ Private funds are often riskier than traditional funds and have much less liquidity, making it more difficult for investors to access their funds for extended periods of time.⁶⁶ However, many hedge funds already have more than enough capital and often must turn away new investors.⁶⁷ Additionally, hedge funds are typically only available to accredited

60. See Bernanke, *supra* note 58 ("If several funds had similar positions, how would authorities avoid giving a competitive advantage to one fund over another in using the information from the database?").

61. See, e.g., Ronald D. Orol, *Regulator Fears Fraud from Hedge-Fund Ad Rules*, WALL ST. J. MARKETWATCH, (Nov. 15, 2012, 1:42 PM), http://articles.marketwatch.com/2012-11-15/economy/35126471_1_angel-investors-angel-capital-association-hedge-fund.

62. See, e.g., Phil Niles, *The JOBS Act: Why It May Mean Nothing for Hedge Funds*, FINALTERNATIVES (June 11, 2012, 8:05 AM), <http://www.finalalternatives.com/node/20741>; see also Schmidt, *supra* note 59.

63. See, e.g., *Talking About a Revolution: Occupy Wall Street and the Media*, ECONOMIST, Apr. 7, 2012, at 92, available at <http://www.economist.com/node/21552179>.

64. See, e.g., *Hedge Fund Industry Cautious on JOBS Act*, COOCONNECT (July 12, 2013), <http://cooconnect.com/news/hedge-fund-industry-cautious-jobs-act> (quoting Charlie Nightingale, senior counsel and head of legal and investment structuring at PAAMCO).

65. See, e.g., Steven M. Davidoff, *The Risks of Tapping Your Retirement Fund for Alternative Investments*, N.Y. TIMES, Oct. 31, 2012, at B10, available at <http://dealbook.nytimes.com/2012/10/30/the-risks-of-tapping-a-retirement-fund-for-an-alternative-use/>.

66. PRESIDENT'S WORKING GRP., *supra* note 17, at 3 (noting that hedge funds offer greater returns, but also greater risk, than other investment benchmarks). Hedge funds frequently limit redemptions by investors, a practice referred to as putting up a "gate." See, e.g., Juliet Chung & Gregory Zuckerman, *Salient Says Fund Halts Investor Withdrawals*, WALL ST. J. (Oct. 27, 2012, 2:07 PM), available at <http://online.wsj.com/article/SB10001424052970204098704578081262215522792.html>.

67. Niles, *supra* note 62.

investors,⁶⁸ making it unlikely that the average person would have access to these investments.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Dodd-Frank Act) is an additional safeguard on the hedge fund industry.⁶⁹ As part of the overall effort to regulate hedge funds, or at least to increase their transparency, Dodd-Frank requires that hedge funds now register with the SEC and increases the amount of information reported to the agency.⁷⁰ The Act also allows the SEC to conduct audits and collect information on systemic risk.⁷¹

B. TITLE III: USING CROWDFUNDING PORTALS TO RAISE CAPITAL THROUGH THE INTERNET

i. Background and Legislative History

The JOBS Act, by improving access to capital, addressed a problem present in many small businesses. That is, when raising capital, the cost of compliance with securities regulations may outweigh the benefit of the financing.⁷² One proposed solution was crowdfunding:

The concept of crowdfunding finds its root in the broader concept of crowdsourcing, which uses the “crowd” to obtain ideas, feedback and solutions in order to develop corporate activities. In the case of crowdfunding, the objective is to collect money for investment; this is generally done by using social networks, in particular through the Internet (Twitter, Facebook, LinkedIn and different other specialized blogs). . . . In other words, instead of raising the money from a very small group of sophisticated investors, the idea of crowdfunding is to obtain it from a large audience (the “crowd”), where each individual will provide a very small amount.⁷³

Although crowdsourcing is attractive to small business startups, the securities laws prior to the JOBS Act did not contain an exemption for such a financing method.⁷⁴ Rule 506 of Regulation D, discussed in Part II.A, was not a possibility before the JOBS Act because of the ban on general

68. See *supra* note 40 (defining “accredited investor”).

69. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified in scattered sections of the U.S.C. (2012)).

70. 15 U.S.C. §§ 80b-2(a), -3(b), -4(b).

71. *Id.* § 80b-4.

72. Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 880 (2011).

73. *Id.* at 881 (quoting Paul Belleflamme et. al, *Crowdfunding: Tapping the Right Crowd 2* (CORE Discussion Paper No. 2011/32, 2011), available at http://www2.dse.uni-bo.it/dsa/seminari/610/Crowdfunding_BLS_13Feb2011.pdf).

74. Hazen, *supra* note 25, at 1744–49.

solicitation and advertising.⁷⁵ Even after the Act lifted this ban, the rule requires that all purchasers be accredited investors, and issuers must take reasonable steps to verify such accreditation.⁷⁶ Rules 504 and 505 have similar problems, which include bans on general solicitation, accreditation standards, and a restricted securities status, meaning the securities may not be freely resold by purchasers.⁷⁷ Regulation A, discussed in Part II.C, is another exemption for small businesses that allows for general solicitation.⁷⁸ Although the exemption does not require issuers to complete the full registration process, some financial statements and offering circulars must be filed,⁷⁹ the cost of which may not be conducive for a small startup seeking limited funding.⁸⁰

ii. Investor Protection Mechanisms

Crowdfunding became explicitly legal through Title III of the JOBS Act.⁸¹ Several requirements pertaining to funding amounts must be met in order to rely on this exemption. The Act limits the aggregate amount of capital raised through the offering during any twelve-month period to \$1 million.⁸² The Act also limits the amount that may be sold to any one investor.⁸³ If either the annual income or net worth of the investor is less than \$100,000, that investor may only invest up to the greater of \$2000 or five percent of his annual income or net worth.⁸⁴ If either the annual income or net worth is greater than \$100,000, the investor may not invest more than ten percent of his annual income or net worth, and in no instance may he invest more than \$100,000.⁸⁵

Congress had at least two purposes in drafting the investment limits.⁸⁶ First, the general concept of crowdfunding was a response to the demand of startups and small businesses for which the traditional methods of capital raising were not accessible.⁸⁷ By allowing these companies to seek funding from the “wisdom of the crowd,” businesses could seek small investments

75. 17 C.F.R. § 230.502(c) (2013) (to be amended by JOBS Act § 201, Pub. L. No. 112-106, 126 Stat. 306, 313 (2012)).

76. JOBS Act § 201(a)(1), Pub. L. No. 112-106, 126 Stat. 306, 313 (2012) (codified as amended at 17 C.F.R. § 230.506).

77. 17 C.F.R. §§ 230.504–05.

78. *Id.* §§ 230.251–63.

79. *Id.* §§ 230.252–53.

80. *See infra* Part II.C.

81. JOBS Act §§ 301–05 (codified as amended at 15 U.S.C. §§ 77d(a)(6), 77d-1, 77r(b)(4), (c)(1), (c)(2)(F), 78c(a)(80), (h), 78l(g)(6), 78o(i)(2)).

82. 15 U.S.C. § 77d(a)(6)(A).

83. *See id.* § 77d(a)(6)(B).

84. *Id.* § 77d(a)(6)(B)(i).

85. *Id.* § 77d(a)(6)(B)(ii).

86. *See* 157 CONG. REC. S8458 (daily ed. Dec. 8, 2011) (statement of Sen. Jeff Merkley).

87. *Id.*

from a large number of investors.⁸⁸ Second, by explicitly limiting the investment amount, Congress limited the exposure and thus the risk borne by any individual investor.⁸⁹

A further condition requires that the transactions take place through an intermediary designated as a broker or “funding portal,”⁹⁰ either of which must be registered with the SEC.⁹¹ Both the issuer and intermediary are subject to additional requirements.⁹² For example, an intermediary may not compensate promoters or lead generators for providing identifying information of any potential investor.⁹³ The issuer, in keeping with the overall goal of disclosure and transparency, must register certain information with the SEC pertaining to the identity of the issuer and its officers,⁹⁴ the financial condition of the company,⁹⁵ and a description of the nature and purpose of the offering;⁹⁶ this information must be made available to investors as well.⁹⁷ The importance of these registrations becomes more apparent due to a private cause of action created by the statute: issuers are liable to investors for any material misstatements or omissions.⁹⁸

C. TITLE IV: REGULATION A+ OFFERINGS FOR SMALL BUSINESSES

i. Background and Legislative History

Regulation A+ increased the amount of capital available through a limited offering from \$5 million to \$50 million.⁹⁹ One of the main reasons for increasing this ceiling was that very few companies were actually using

88. *Id.*

89. *See id.*

90. “Funding portal” is a new term defined by section 3(a)(80) of the Exchange Act:

The term “funding portal” means any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to section 4(6) of the Securities Act of 1933 (15 U.S.C. 77d(6)) that does not— (A) offer investment advice or recommendations; (B) solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; (C) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (D) hold, manage, possess, or otherwise handle investor funds or securities; or (E) engage in such other activities as the Commission, by rule, determines appropriate.

15 U.S.C. § 77c(a)(80) (2012).

91. 15 U.S.C. § 77d-1(a)(1). The broker or funding portal must be registered, not the securities themselves.

92. *Id.* § 77d-1.

93. *Id.* § 77d-1(a)(10).

94. *Id.* § 77d-1(b)(1)(A)–(C).

95. *Id.* § 77d-1(b)(1)(D).

96. *Id.* § 77d-1(b)(1)(E).

97. *Id.* § 77d-1(b)(1).

98. *Id.* § 77d-1(c).

99. *Id.* § 77c(b)(2)(A).

the exemption.¹⁰⁰ Although Regulation A is an exemption to the traditional registration process, it still requires that some financial statements and offering circulars be prepared and filed with the SEC, albeit a much less rigorous process than a full public offering.¹⁰¹ Because of this, the process is sometimes referred to as a “mini-registration.”¹⁰² However, this results in an offering cost which, when combined with the \$5 million limit, becomes prohibitively expensive.¹⁰³ By some estimates, between three and seven companies completed Regulation A offerings in 2010.¹⁰⁴ Indeed, Congress had this issue in mind previously and has raised the initial exemption of \$100,000 several times.¹⁰⁵ The ceiling was raised to \$300,000 in 1945, \$500,000 in 1972, \$2 million in 1978, and \$5 million in 1980.¹⁰⁶ The new Regulation A+ contains a similar provision that allows the SEC to review the amount every two years and raise the maximum if necessary.¹⁰⁷

The purpose behind the original Regulation A exemption, like the purpose behind the JOBS Act, was to grant small businesses easier access to capital.¹⁰⁸ Small businesses are an integral part of the economy,¹⁰⁹ but the current state of the credit markets makes it difficult for many to obtain financing.¹¹⁰ Regulation A+ lowers many of the barriers to capital raising that were present in its predecessor.¹¹¹ The Act raises the cap of the offering from \$5 million to \$50 million.¹¹² Further, Regulation A+ securities will be treated as “covered” securities, meaning they will be exempt from state blue sky laws if they are listed on a national exchange or if offers and sales are made to “qualified purchasers.”¹¹³

100. See SEC Advisory Comm. on Small & Emerging Buss., Presentation Slides (Oct. 31, 2011), available at <http://www.sec.gov/info/smallbus/acsec/acsec103111presentation.pdf>.

101. 17 C.F.R. § 230.251–63 (2013).

102. Harvey Frank, *The Processing of Small Issues of Securities Under Regulation A*, 1962 DUKE L.J. 507, 508.

103. *Id.* at 507.

104. H.R. REP. NO. 112-206, at 3 (2011); SEC Advisory Comm. on Small & Emerging Buss., *supra* note 100.

105. H.R. REP. NO. 112-206, at 3.

106. *Id.* Although Congress authorized the SEC to use the \$5 million maximum in 1980, the SEC did not actually raise it to this level until 1992. *Id.*

107. 15 U.S.C. § 77c(b)(5).

108. Frank, *supra* note 102, at 507.

109. H.R. REP. NO. 112-206, at 4 (2011); see also Council of Econ. Advisers, *Annual Report of the Council of Economic Advisers*, in ECONOMIC REPORT OF THE PRESIDENT 7, 67 (2012) [hereinafter Council of Econ. Advisers], available at http://www.whitehouse.gov/sites/default/files/microsites/ERP_2012_Complete.pdf.

110. *Small Business Lending: Field Hearing Before the Cong. Oversight Panel*, 111th Cong. 19 (2010) (statement of Robert Blaney, Arizona District Director, U.S. Small Business Administration).

111. See JOBS Act § 401; 17 C.F.R. § 251–63 (2013).

112. JOBS Act § 401.

113. 15 U.S.C. § 77r(b)(4)(D). “Qualified purchasers” is a term to be defined by the SEC. *Id.* § 77r(b)(4)(D)(ii).

As with the old Regulation A, the securities may be publicly sold.¹¹⁴ The securities may also be resold freely by the purchaser.¹¹⁵ Another provision included from the old Regulation A allows issuers to “test the waters” by soliciting interest before filing the offering statement.¹¹⁶

ii. Investor Protection Mechanisms

The increased availability of the exemption has led to criticism that fewer requirements for raising capital will lead to an increase in fraud.¹¹⁷ Although many provisions favor issuers, the Act also includes some protections for investors. First, issuers must provide audited financial statements with the offering circulars and must file updated audited financial statements with the SEC annually.¹¹⁸ The SEC can also require the issuers to file and disseminate non-financial information such as a discussion of business operations and corporate governance principals.¹¹⁹ Regulation A only requires unaudited financial statements, and those statements need to be filed once, rather than continuously.¹²⁰

Second, although the JOBS Act grants certain Regulation A+ offerings an exemption from blue sky laws, the exemption only applies if the securities are listed on a national exchange or sold only to qualified investors;¹²¹ therefore, many Regulation A+ offerings will still be subject to state securities laws. The Act also requires that a study be performed on the effect of blue sky laws on Regulation A+ offerings,¹²² which may affect SEC rulemaking in the future.¹²³

Third, a disqualification rule exists for certain “bad actors.”¹²⁴ Regulation A has a similar provision under Rule 262, which bars issuers, affiliates, or underwriters who are subject to administrative orders or injunctions involving certain securities laws from utilizing the exemption.¹²⁵ Certain criminal convictions also prevent a party from using the exemption.¹²⁶ Regulation A+ directs the SEC to promulgate a rule substantially similar to regulations found in the Dodd-Frank Act, which

114. *Id.* § 77c(b)(2)(B).

115. *Id.* § 77c(b)(2)(C).

116. *Id.* § 77c(b)(2)(E).

117. H.R. REP. NO. 112-206, at 13 (2011).

118. 15 U.S.C. § 77c(b)(2)(F).

119. *Id.* § 77c(b)(2)(G)(i).

120. 17 C.F.R. § 230.251-63 (2013).

121. 15 U.S.C. § 77r(b)(4)(D).

122. JOBS Act, Pub. L. No. 112-106, § 402, 126 Stat. 306, 325 (2012).

123. Benjamin M. Hron, *JOBS Act May Make It Easier for Emerging Companies to Raise Capital*, MCCARTER & ENGLISH, LLP (Apr. 2012), http://www.mccarter.com/files/Uploads/Images/EmergingBusinessAlert_Apr2012.pdf.

124. 15 U.S.C. § 77c(b)(2)(G)(ii).

125. 17 C.F.R. § 230.262.

126. *Id.*

prohibit certain actors from using Rule 506.¹²⁷ Practitioners have recommended that the SEC amend Rule 262, which applies to Regulation A offerings, to conform to the new rule concerning Regulation A+ offerings.¹²⁸

III. INVESTOR PROTECTIONS OUTSIDE THE JOBS ACT COMMON TO ALL EXEMPTIONS

A. EXTRA-STATUTORY MECHANISMS: NEGOTIATION AND VALUATION IN SMALL BUSINESS INVESTMENTS

In addition to the investor protections built into the JOBS Act, the current investing environment provides several other safeguards. Investing in a small business is usually done through an arm's-length transaction; investors will do their own due diligence and understand the risks.¹²⁹ Indeed, investing in small businesses is inherently risky—a majority of small businesses fail within a few years.¹³⁰ However, risk is valued into investment: the riskier the proposition, the less investors will be willing to pay for it (through lower share prices for equity investments), and the more protections they will demand (through higher interest rates and other covenants for loans).¹³¹ As a result, some companies are choosing to go beyond what the JOBS Act requires.¹³² Unlike Titles II, III, and IV, which still require SEC rulemaking in order to be implemented, Title I of the JOBS Act went into effect immediately.¹³³ From the time that the Act was

127. 15 U.S.C. § 77c(b)(2)(G)(ii); 17 C.F.R. § 230.506(d).

128. Letter from Catherine T. Dixon, Chair, Fed. Regulation of Sec. Comm., Bus. Law Section, Am. Bar Ass'n, to SEC 10–11 (Sept. 7, 2012), available at <http://www.sec.gov/comments/jobs-title-iv/jobstitleiv-13.pdf>.

129. See Claudia Ling-Yun Zhang, *How to Solve the Dilemma of Small Business Finance: A Proposal for Creditors' Statutory Information Right*, 13 U.C. DAVIS BUS. L.J. 129, 145 (2012) (analyzing the “corporate obligations to creditors, particularly how variations on statutory protection depend on bargaining between contracting parties”); Ronald J. Gilson, *Engineering a Venture Capital Market: Lessons from the American Experience*, 55 STAN. L. REV. 1067, 1068–76 (2003) (noting that venture capital firms are uniquely situated to take on the risk of start-up financing and observing how venture capital contracting addresses the problems of uncertainty, information asymmetry, and agency costs).

130. *A Consumer's Guide to Small Business Investments*, WASH. ST. DEP'T FIN. INSTITUTIONS, <http://dfi.wa.gov/sd/sbinvestments.htm> (last updated Jan. 29, 2010).

131. The Capital Asset Pricing Model (CAPM) is a theory of modern finance which uses risk and expected return to value an investment. For a discussion of this theory and others, see Samuel C. Thompson, Jr., *A Lawyer's Guide to Modern Valuation Techniques in Mergers and Acquisitions*, 21 J. CORP. L. 457, 460 (1996).

132. See Jessica Holzer, *Some Firms Shun Looser IPO Rules*, WALL ST. J. (Nov. 14, 2012), <http://online.wsj.com/article/SB10001424127887324595904578117322881014396.html>. Fifty-five eligible companies were used in the calculation. *Id.*

133. JOBS Act, Pub. L. No. 112-106, §§ 101–08, 126 Stat. 306, 307 (2012) (codified in scattered sections of 15 U.S.C.); *JOBS Act Implementation Update: Hearing Before the Subcomm. on Investigations, Oversight and Regulations of the H. Comm. on Small Bus.*, 113th Cong. 35 (2013) (statements of Lona Nallengara, Acting Director, Division of Corporation Finance, and John Ramsay, Acting Director, Division of Trading & Markets, SEC).

passed in April 2012 until November of the same year, eighty-five percent of companies who were eligible to qualify as an “emerging growth company” chose not to use the less demanding reporting requirements because the cost savings did not outweigh the negative perception from investors, who would attach a lower valuation to the security.¹³⁴ If investors lack confidence because of a perception of increased fraud, then the cost of capital would actually increase, which in turn would hurt job growth.¹³⁵ Interestingly, this suggests that the JOBS Act may not achieve its intended purpose.

B. STATUTORY MECHANISMS UNDER EXISTING SECURITIES LAWS

Existing securities laws provide some potential protections for investors that remain in effect after the passage of the JOBS Act. Even if a securities offering is exempt from registration requirements, the anti-fraud provisions of the securities laws still apply.¹³⁶ However, such protections are not without limitation. The SEC is authorized to bring civil actions seeking injunctions or damages for violations of the securities laws.¹³⁷ However, the resources of the agency are limited, and enforcement actions may not uncover all ongoing violations or deter future offenses.¹³⁸ The Securities Act also provides investors with private causes of action under certain circumstances.¹³⁹ However, the Private Securities Litigation Reform Act of 1995 heightened the pleading standard for some such claimants.¹⁴⁰ One private action arises in section 11 of the Securities Act, under which an issuer is liable for an untrue statement or omission of a material fact in a registration statement.¹⁴¹ Purchasers are required to prove neither reliance

134. Holzer, *supra* note 132.

135. *Id.* (“[T]he law would have the perverse effect of hurting job growth because it would cause investors to place a lower value on companies that cut back on disclosures. That would, in turn, raise their cost of capital.”).

136. See, e.g., Harry S. Gerla, *Issuers Raising Capital Directly from Investors: What Disclosure Does Rule 10b-5 Require?*, 28 J. CORP. L. 111, 112 (2002).

137. 15 U.S.C. § 78u(d) (2012).

138. Troy A. Paredes, Commissioner, SEC, Remarks at “The SEC Speaks in 2009” (Feb. 6, 2009), available at <http://www.sec.gov/news/speech/2009/spch020609tap.htm>.

[A]s an agency, the SEC has limited resources. Even if the agency’s budget increases, we still will be faced with the challenge of allocating a finite number of people and funds. . . . [W]e must consider how the consequent allocation of resources compromises our ability to do other things that may more effectively advance our mission of protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation.

Id.

139. See, e.g., 15 U.S.C. §§ 77k, 77l.

140. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.).

141. 15 U.S.C. § 77k. Section 11(a) provides:

on the omission or misstatement nor intent of the issuer.¹⁴² Damages are limited to the difference between the offering price and the price of the securities at the time of the suit.¹⁴³ Purchasers also have a cause of action against the underwriter or any other parties who signed the registration statement,¹⁴⁴ though these parties can claim a “due diligence” defense that they had no reason to believe the registration statement had a misstatement or omission.¹⁴⁵ A clear limitation on this cause of action is that only purchasers who acquired a security sold pursuant to a registration statement may bring claims.

Although a registration statement is required for section 11, issuers who sell securities without registering them in violation of the securities laws may face liability under sections 5 and 12(a)(1).¹⁴⁶ Purchasers have a cause of action against a seller who issues a non-exempt security without registering it.¹⁴⁷ Section 12(a)(2) of the Securities Act creates liability for anyone who sells a security through a prospectus containing a material misrepresentation or omission.¹⁴⁸ The definition of “prospectus” is

In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue . . .

enumerated parties, including those who signed the registration statement, directors of the issuer, accountants, and underwriters. *Id.* § 77k(a).

142. *See id.* § 77k. An exception is that the presumption of reliance is rebutted if the plaintiff acquired the security more than twelve months after the effective date of the registration statement. *Id.* § 77k(a); *see also* Todd R. David et al., *Heightened Pleading Requirements, Due Diligence, Reliance, Loss Causation, and Truth-On-The-Market—Available Defenses To Claims Under Sections 11 and 12 of the Securities Act of 1933*, 11 *TRANSACTIONS: TENN. J. BUS. L.* 53, 68 (2010).

143. *Id.* § 77k(g).

144. *Id.* § 77k(a).

145. *Id.* § 77k(b)(3).

146. *Id.* §§ 77e, 77l(a)(1).

147. *Id.*

148. Section 12(a)(2) of the Securities Act provides:

Any person who—offers or sells a security, whether or not exempted by the provisions of section 3, other than paragraphs (2) and (14) of subsection (a) thereof, by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable, subject to subsection (b), to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the securities.

extremely broad and includes nearly any communication that offers a security for sale.¹⁴⁹ The purchaser must not know of the misstatement or omission at the time of the transaction.¹⁵⁰

Section 17(a) of the Securities Act is a key antifraud provision making it unlawful “to employ any device, scheme, or artifice to defraud,” “obtain money or property” through misstatements or omissions, or “engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.”¹⁵¹ Although courts previously found an implied private right of action in section 17(a), that position has become more disfavored.¹⁵² The SEC, however, continues to use this provision.¹⁵³

While the Securities Act and Exchange Act provide a backbone, more recent legislation has added to this body of law. In response to the accounting scandals at Enron and several other companies, the Sarbanes-Oxley Act of 2002 (SOX Act) was passed with the goal of protecting investors by “improving the accuracy and reliability of corporate disclosures.”¹⁵⁴ This law primarily concerns public companies, their board of directors and management, and their accounting firms;¹⁵⁵ thus many small businesses would not be affected. The Dodd-Frank Act, however, affords a more recent and sweeping change of the legal landscape. Dodd-Frank, signed just two years before the JOBS Act,¹⁵⁶ ushered in a new era of financial regulation and undoubtedly increased government oversight of, and regulatory requirements for, companies that affect the financial stability of the United States.¹⁵⁷ These changes include the consolidation and creation of regulatory agencies, consumer protection reforms, and an increased availability of tools for financial crises.¹⁵⁸ Perhaps the JOBS Act was a way to ensure that smaller companies would not be overburdened by the increased regulations of Dodd-Frank. When viewed in this light, the amount of regulation as a whole for capital raisers has increased, not decreased.

Id. § 771(a)(2).

149. *Id.* § 77b(a)(10).

150. *Id.* § 771(a)(2).

151. *Id.* § 77q(a).

152. 4 THOMAS LEE HAZEN, THE LAW OF SECURITIES REGULATION § 12.22 (6th ed. 2009).

153. *See, e.g.*, SEC v. Stoker, 865 F. Supp. 2d 457 (S.D.N.Y. 2012).

154. Sarbanes-Oxley Act, Pub. L. No. 107-204, pmb1., 116 Stat. 745 (2002).

155. *See* 15 U.S.C. §§ 7211–20 (establishing the Public Company Accounting Oversight Board); *id.* §§ 78j-1(g)–(l) (regarding auditors); *id.* §§ 7241–44 (imposing obligations of corporate responsibility on officers and directors).

156. JOBS Act, Pub. L. No. 112-106, 126 Stat. 306 (2012); Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

157. *See* Dodd-Frank Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

158. *Id.*

In addition to using federal securities laws, purchasers may be able to state a fraud claim under common law.¹⁵⁹ This cause of action differs from state to state and often requires a plaintiff to prove eight or nine elements.¹⁶⁰ However, certain class action securities lawsuits may be preempted by federal law under the Securities Litigation Uniform Standards Act (SLUSA).¹⁶¹

IV. THE EFFECT OF THE JOBS ACT AND SUPPLY-SIDE ECONOMICS ON EMPLOYMENT

A. THE EMPLOYMENT SITUATION LEADING UP TO THE JOBS ACT

The American unemployment rate¹⁶² hit 4.4% in October of 2006—the lowest point in a decade.¹⁶³ However, the recession officially began on December 1, 2007,¹⁶⁴ and in the spring of 2008, rising unemployment began to shed light on this fact.¹⁶⁵ In October 2008, President Bush signed a \$700 billion bailout of the financial system through the Emergency Economic Stabilization Act of 2008, which established the Troubled Asset Relief Program (TARP).¹⁶⁶ President Obama then signed an \$831 billion

159. Joshua D. Ratner, *Stockholders' Holding Claim Class Actions Under State Law After the Uniform Standards Act Of 1998*, 68 U. CHI. L. REV. 1035, 1037 (2001).

160. Douglas M. Branson, *Securities Litigation In State Courts— Something Old, Something New, Something Borrowed . . .*, 76 WASH. U. L.Q. 509, 512 (1998); see also RESTATEMENT (SECOND) OF TORTS § 531 (1977) (“One who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation, for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced.”).

161. 15 U.S.C. § 78bb(f) (2012); see also *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71 (2006) (addressing the issue of the scope of SLUSA’s “in connection with” language); Elizabeth C. Schaubert, Note, *Developing a Precise Definition: The Fifth Circuit Addresses the Scope of the “In Connection With” Requirement Under SLUSA*, 7 BROOK. J. CORP. FIN. & COM. L. 561 (2013) (exploring and endorsing the Fifth Circuit’s adoption of the Ninth Circuit’s *more than tangentially related* SLUSA standard in *Roland v. Green*, 675 F.3d 503 (5th Cir. 2012), cert. granted, 133 S. Ct. 978 (Jan. 18, 2013) (No. 12-88), which is currently before the Supreme Court on appeal).

162. Persons are considered unemployed “if they do not have a job, have actively looked for work in the prior 4 weeks, and are currently available for work.” *Labor Force Statistics from the Current Population Survey*, U.S. BUREAU LAB. STAT. <http://data.bls.gov/timeseries/LNS14000000> (last visited Nov. 17, 2013) [hereinafter *Labor Force Statistics*]. As a result, the category does not include those who are underemployed or not currently seeking employment.

163. *Id.* The unemployment rate reached 4.4% again in December 2006, March 2007, and May 2007. *Id.*

164. *Determination of the December 2007 Peak in Economic Activity*, NAT’L BUREAU ECON. RES., <http://www.nber.org/dec2008.pdf> (last modified Dec. 11, 2008).

165. Michael M. Grynbaum, *Unemployment Rate Rises After 80,000 Jobs Cut*, N.Y. TIMES (Apr. 4, 2008), <http://www.nytimes.com/2008/04/04/business/04cnd-econ.html>.

166. Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (codified as amended at 12 U.S.C. §§ 5201–61) (2012)). As of May 2013, the Congressional Budget Office estimated that \$428 billion of the originally authorized \$700 billion would be paid to TARP. CONG. BUDGET OFFICE, REPORT ON THE TROUBLED ASSET RELIEF PROGRAM—MAY

stimulus package known as the American Recovery and Reinvestment Act of 2009.¹⁶⁷ The stimulus included tax cuts, extended unemployment benefits, and direct investments in infrastructure.¹⁶⁸ Despite these efforts, the unemployment rate reached 10% in October 2009 and was 8.1% in April 2012 when the JOBS Act was passed.¹⁶⁹

B. DEREGULATION AS A TOOL AGAINST UNEMPLOYMENT

The stated purpose of passing the JOBS Act, as the title suggests, was to create jobs.¹⁷⁰ The sponsors of the Act contended that allowing small businesses to avoid regulations while raising capital would have the effect of those enterprisers hiring a larger workforce.¹⁷¹ The assertion that businesses need access to capital is not subject to much debate. A report to the President noted that “[e]conomists have modeled a link between the supply of credit and macroeconomic activity” and that “[c]redit conditions have been shown to affect a variety of specific macroeconomic outcomes, including investment spending, inventories, and economic growth and development.”¹⁷² However, another link in the chain is needed to get from general economic growth to increased employment.

Proponents of the JOBS Act assert that decreasing the amount of regulations that companies face will increase hiring.¹⁷³ Instituting deregulation in an attempt to increase economic activity is part of a strategy known as supply-side economics.¹⁷⁴ This approach is achieved mainly through lower marginal tax rates, which in turn increases after-tax returns

2013, at 1 (2013), available at http://www.cbo.gov/sites/default/files/cbofiles/attachments/44256_TARP.pdf.

167. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2012) (codified in scattered sections of the U.S.C.). In February 2012, the Congressional Budget Office revised the estimated impact of the law from \$787 billion to \$831 billion. CONG. BUDGET OFFICE, PUB. NO. 4435, ESTIMATED IMPACT OF THE AMERICAN RECOVERY AND REINVESTMENT ACT ON EMPLOYMENT AND ECONOMIC OUTPUT FROM OCTOBER 2011 THROUGH DECEMBER 2011, at 1 (2012), available at <http://www.cbo.gov/sites/default/files/cbofile/attachments/02-22-ARRA.pdf>.

168. See American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115 (2012).

169. *Labor Force Statistics*, supra note 162.

170. “An Act [t]o increase American job creation and economic growth.” JOBS Act, Pub. L. No. 112-106, pmbll., 126 Stat. 306, 306 (2012).

171. See Jim Abrams, *House Passes Bipartisan JOBS Act to Help Startups and Small Businesses*, OFF. MAJORITY LEADER (Mar. 8, 2012), <http://majorityleader.gov/blog/2012/03/house-passes-bipartisan-jobs-act-to-help-startups-and-small-businesses.html> (quoting Representative Stephen Fincher, who said, “Reducing these regulations will help small companies raise capital, grow their business and create private jobs for Americans”).

172. Council of Econ. Advisers, supra note 109, at 68.

173. Press Release, Rep. Eric Cantor, Leader Cantor Statement on the President Signing the JOBS Act (Apr. 5, 2012), available at <http://majorityleader.gov/newsroom/2012/04/leader-cantor-statement-on-the-president-signing-the-jobs-act.html>.

174. See *Supply-Side Economics*, LAFFER CENTER, <http://www.laffercenter.com/supply-side-economics/> (last visited Nov. 17, 2013).

on labor and investment.¹⁷⁵ The increased supply is thought to have a “trickle down” effect.¹⁷⁶ The broader policy mix of supply-side economic theory asserts that, besides lower tax rates, free trade and decreased regulation are key to economic growth.¹⁷⁷ Many economists, however, disagree with the ability of a deregulatory policy to increase economic growth in general and doubt it can create a positive effect on employment specifically.¹⁷⁸

While it is true that securities regulations create barriers to capital access for small businesses, these enterprises frequently cite to other problems as having a higher priority.¹⁷⁹ In a 2012 survey, small business owners ranked “cost of health insurance” and “uncertainty over economic conditions” as their top two problems, with “unreasonable government regulations” ranked fifth.¹⁸⁰ As a category, tax concerns ranked higher than regulatory concerns,¹⁸¹ suggesting that taxes are increasingly complex and more costly to deal with than regulations. But lowering taxes may not have the impact on employment that some policy makers expect. The Center on Budget and Policy Priorities noted that “[s]mall business employment rose by an average of 2.3 percent (756,000 jobs) per year during the Clinton years, when tax rates for high-income filers were set at very similar levels to those that would be reinstated under President Obama’s budget.”¹⁸² However, during the Bush administration, when the tax rates were lower, “employment rose by just 1.0 percent (367,000 jobs).”¹⁸³

Admittedly, while these responses suggest that taxes are more of a priority than regulations, government intrusion clearly still plays a role in decision-making and attempts at growth in small businesses. One reason is that it costs small businesses more per employee to comply with federal regulations than larger firms.¹⁸⁴ Although regulations are a concern of small

175. *Id.*

176. *Trickle Down Theory*, INVESTOPEDIA, <http://www.investopedia.com/termst/trickledowntheory.asp> (last visited Nov. 17, 2013).

177. *Supply-Side Economics*, *supra* note 174.

178. *See, e.g.*, PAUL KRUGMAN, THE RETURN OF DEPRESSION ECONOMICS AND THE CRISIS OF 2008, at 182 (2009) (“The specific set of foolish ideas that has laid claim to the name ‘supply-side economics’ is a crank doctrine that would have had little influence if it did not appeal to the prejudices of editors and wealthy men.”); Richard Butrick, *The Trickle-Down Hoax*, AM. THINKER (July 15, 2012), http://www.americanthinker.com/2012/07/the_trickle-down_hoax.html.

179. *See* HOLLY WADE, SMALL BUSINESS PROBLEMS AND PRIORITIES 5 (2012), available at <http://www.nfib.com/Portals/0/PDF/AllUsers/research/studies/small-business-problems-priorities-2012-nfib.pdf>.

180. “Uncertainty over Government Actions” was fourth. *Id.*

181. *See id.* at 6.

182. Jason Levitis & Chuck Marr, *History Contradicts Claim That President’s Budget Would Harm Small Business Job Creation*, CENTER ON BUDGET & POL’Y PRIORITIES 1 (Mar. 26, 2009), available at <http://www.cbpp.org/files/3-26-09tax2.pdf>.

183. *Id.*

184. *See* NICOLE V. CRAIN & W. MARK CRAIN, THE IMPACT OF REGULATORY COSTS ON SMALL FIRMS iv (2010), available at [http://www.sba.gov/sites/default/files/The%20Impact%20of%20Regulatory%20Costs%20on%20Small%20Firms%20\(Full\).pdf](http://www.sba.gov/sites/default/files/The%20Impact%20of%20Regulatory%20Costs%20on%20Small%20Firms%20(Full).pdf).

business owners, statistical analysis suggests that government regulation does not have the effect on employment that the Act's sponsors claimed.¹⁸⁵ Numbers from the Congressional Budget Office estimate that in 2011, only 0.4% of jobs lost were due to "government regulation/intervention."¹⁸⁶ Moreover, economists and policy makers, even those who once championed deregulation, have begun to reverse position. Bruce Bartlett, a former economist to the Reagan administration, recently claimed the idea that deregulation would lead to significant job growth is "just nonsense. It's just made up."¹⁸⁷

V. THE POLITICAL ECONOMY: THE RELATIONSHIP BETWEEN SPECIAL INTERESTS AND ECONOMIC THEORY

In the first presidential debate of 2012, President Obama stood by his position that the financial system lacked sufficient control prior to the recession: "Does anybody out there think that the big problem we had is that there was too much oversight and regulation of Wall Street? Because if you do, then Governor Romney is your candidate. But that's not what I believe."¹⁸⁸ Yet just six months prior to making this statement, the President signed a JOBS Act that was described as one which was "premised on the dangerous and discredited notion that the way to create jobs is to weaken regulatory protections."¹⁸⁹ This conundrum can be partially understood by analyzing the various interests that went into the JOBS Act. Although the surface of this analysis seems to point to a balance between access to capital, job creation, and investor protection, several other interests came into play with the passage of the JOBS Act. The Act was as much a creature of politics as economic theory.

185. See David Edwards, *Study Proves Regulations Killed Practically No Jobs*, RAW STORY (Nov. 14, 2011, 11:53 AM), <http://www.rawstory.com/rs/2011/11/14/study-proves-regulations-killed-practically-no-jobs/> (discussing environmental regulations).

186. *Id.* (citing News Release, U.S. Bureau of Labor Statistics, Extended Mass Layoffs—Third Quarter 2011 tbl. 2 (Nov. 9, 2011), available at http://www.bls.gov/news.release/archives/mslo_11092011.pdf).

187. Charles Babington, *Bruce Bartlett, Ex-Reagan Economist: Idea That Deregulation Leads To Jobs 'Just Made Up,'* HUFFINGTON POST (Oct. 30, 2011, 1:07 PM), http://www.huffingtonpost.com/2011/10/31/gop-candidates-plans-on-economy-housing_n_1066949.html.

188. President Barack Obama & Former Governor Mitt Romney, Presidential Debate at the University of Denver 29 (Oct. 3, 2012), available at <http://www.debates.org/modules/Printing/createpdf.php?pageid=111&returnid=111>. Governor Romney's position was that certain regulations needed to be rolled back in order to help small business. In the same debate he stated one part of his five-point plan was to "champion small business. It's small business that creates the jobs in America, and over the last four years, small business people have decided that America may not be the place to open a new business because new business startups are down to a 30-year low." *Id.* at 4.

189. Letter from Am. Fed'n of State, Cnty. & Mun. Emps. et al. to U.S. Senators Timothy Johnson & Richard Shelby (Mar. 5, 2012), available at <http://www.consumerfed.org/news/467>.

“Political economy” is defined as “[t]he study and use of how economic theory and methods influences political ideology.”¹⁹⁰ This discipline covers a broad group of competing interests because various individuals and groups are often competing for a finite number of resources.¹⁹¹ Because competing groups have different interests and yield influence in various ways, there often seems to be a disconnect between economic theory and politics.¹⁹² So what explanations account for the Act’s passage, and which groups benefited?

One possible explanation is that Republicans simply pushed a bill through to further their goal of deregulation. Jesse Rothstein, an economics professor at the University of California, Berkeley, believed that “[i]t’s game playing to try to pretend like they’re doing something” and “they know they have to put up something that has the label ‘job creation’ on it, whether or not it would work.”¹⁹³ Republicans pushed a similar package of jobs bills in the months leading up to the 2012 election, and many of these were aimed at reducing environmental regulations, analogous to the securities regulations that were relaxed through the JOBS Act.¹⁹⁴ This suggests that the JOBS Act may have been part of a broader partisan strategy of deregulation.

However, this view may be too cynical and even hints at deceptiveness on the part of politicians. While the two-party system of the American legislative branch often leads to partisan conflict,¹⁹⁵ the role of politics and of special interests is to allow for the representation of parties who hold differing views on the role of government and the extent of free-market capitalism. At the same time, politicians understand the give-and-take nature of negotiations and must often compromise to further their ultimate goals.¹⁹⁶ An inquiry into the different groups served by the JOBS Act and the overall political landscape provides more clues.

190. *Political Economy*, INVESTOPEDIA, <http://www.investopedia.com/terms/p/political-economy.asp#axzz2EWIW46oY> (last visited Nov. 17, 2013).

191. *See id.*

192. *See* Jonathan Baron et al., *Citizens’ Perceptions and the Disconnect Between Economics and Regulatory Policy*, in *REGULATORY BREAKDOWN: THE CRISIS OF CONFIDENCE IN U.S. REGULATION 143* (Cary Coglianese ed., 2012) (suggesting that public perceptions, by influencing legislation, are the cause of inefficient regulations); *see also* Theo Francis, *Six Policies Economists Love (And Politicians Hate)*, NPR (July 19, 2012, 2:15 PM), <http://www.npr.org/blogs/money/2012/07/19/157047211/six-policies-economists-love-and-politicians-hate>.

193. Erin Mershon, *Republican Jobs Bill Won’t Actually Create Jobs, Say Economists*, HUFFINGTON POST (July 24, 2012, 10:11 AM), http://www.huffingtonpost.com/2012/07/24/republican-jobs-bills_n_1687647.html.

194. *See id.*

195. *See, e.g.*, Richard Rubin, *Republicans Reprise 2011 Debt-Limit Threat in Cliff Talks*, BLOOMBERG (Dec. 3, 2012, 5:57 PM), <http://www.bloomberg.com/news/2012-12-03/republicans-reprise-2011-debt-limit-threat-in-cliff-talks.html>.

196. *See, e.g.*, Donald J. Boudreaux & Dwight R. Lee, *Politics as the Art of Confined Compromise*, 16 CATO J. 365 (1997).

One such party-in-interest was the labor movement, which—one would think—ordinarily favors laws aimed at increasing employment. However, the nation’s largest labor organizations were opposed to the Act’s passage.¹⁹⁷ The American Federation of Labor asked Congress “to set aside the politics of the 1%, the old game of special favors for Wall Street, and turn to the business of real job creation. The labor movement strongly opposes the JOBS Act and any other effort to weaken the Dodd-Frank Act.”¹⁹⁸

And deceptiveness does not seem present as Republican politicians, for their part, made no effort to disguise their agenda of rolling back regulations imposed by Dodd-Frank.¹⁹⁹ Thus, as mentioned in Part III.B, perhaps the purpose of this deregulation was to assist small businesses that may be overburdened by costly laws and rules. As outlined in Part IV.B, federal regulations are usually more costly for small businesses because of the economies of scale.²⁰⁰

One particularly noteworthy subset of small businesses is technology startups. As manufacturing jobs continue to be outsourced to emerging economies,²⁰¹ Silicon Valley continues to play an increasingly important role in U.S. economic growth.²⁰² But after the recessions of 2001 and 2008, increased regulations that were perhaps unwarranted may have impacted the industry.²⁰³ The JOBS Act, therefore, may have been an attempt for Congress and Obama to win back the technology sector, which is driven in large part by small start-ups. Even larger technology companies like Google welcomed the new law.²⁰⁴

197. *The Jobs Act—A Cynical and Dangerous Return to the Politics of Financial Deregulation*, AFL-CIO (Mar. 14, 2012), <http://www.aflcio.org/About/Exec-Council/EC-Statements/The-Jobs-Act-A-Cynical-and-Dangerous-Return-to-the-Politics-of-Financial-Deregulation>.

198. *Id.*

199. Peter Schroeder, *House GOP Advances Measure Rolling Back Dodd-Frank Provisions*, HILL (Apr. 18, 2012), <http://thehill.com/blogs/on-the-money/banking-financial-institutions/222385-house-gop-advances-measure-rolling-back-dodd-frank>.

200. See *supra* note 184.

201. See, e.g., Peter Dizikes, *The High Price of Losing Manufacturing Jobs*, FISCAL TIMES (Feb. 26, 2012), <http://www.thefiscaltimes.com/Articles/2012.02/26/The-High-Price-of-Losing-Manufacturing-Jobs.aspx>.

202. For example, Silicon Valley attracted nearly one-third of all venture capital investments in the United States in the first quarter of 2010. PRICEWATERHOUSECOOPERS, MONEYTREE REPORT: Q1 2010 US RESULTS 5 (2010), available at <http://findcapital.files.wordpress.com/2010/05/moneytree-report-executive-summary.pdf>; see also Zvika Krieger, *So What If Tech Start-Ups Are Small? Their Job-Creation Impact Is Big*, ATLANTIC (Oct. 8, 2012, 9:07 AM), <http://www.theatlantic.com/business/archive/2012/10/so-what-if-tech-start-ups-are-small-their-job-creation-impact-is-big/263332/>.

203. Eric Alden, *Primum Non Nocere: The Impact of Dodd-Frank on Silicon Valley*, 8 BERKELEY BUS. L.J. 107, 127 (2011).

204. Pablo Chavez, *Bipartisanship, New Businesses and New Jobs, with a Little Help from Your Friends*, GOOGLE PUB. POL’Y BLOG (Mar. 15, 2012), <http://googlepublicpolicy.blogspot.com/2012/03/bipartisanship-new-businesses-and-new.html>.

A reason for this attempt at “winning back” certain sectors of business has to do with the negotiation aspect of politics mentioned above.²⁰⁵ These events all transpired during an election year. In effect, Obama and his Democratic supporters may also be a beneficiary of the JOBS Act, albeit indirectly.

CONCLUSION

Employment has been at the forefront of political and economic debate as a result of the recent recession. The JOBS Act was passed with the express purpose of increasing employment. As commentators and representatives of various industries assailed the new legislation as dangerous to investor protection, many did not see the simple truth directly in front of them: the act may not fulfill its purpose of creating jobs.²⁰⁶ Some other areas of the law seem not to add up as well. One example discussed was that while many think allowing hedge funds to no longer face a ban on general solicitation will harm investors, others think the industry will not be affected.²⁰⁷ Additionally, companies are choosing to go beyond what is necessary when disclosing to investors because they know the entity’s value will increase.²⁰⁸

While safeguarding investors is important, it must be balanced against other policy interests. The SEC, in its own mission statement, declares that its purpose is to “protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”²⁰⁹ On top of these public policy concerns, unemployment continues to hurt many citizens. As a result, the government should continue efforts to increase employment. However, having too many interests involved with the passage of this law has turned it into what will amount to an unsuccessful attempt at job creation. At the same time, the JOBS Act will likely not harm investors to the extent many commentators believed.

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205. See *supra* note 196.

206. See *supra* Part IV.

207. See *supra* Part II.A.

208. See *supra* Part III.A.

209. *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC, <http://www.sec.gov/about/whatwedo.shtml> (last modified June 10, 2013).

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