The JOBS Act: Investor Protection, Capital Formation, and Employment in an Increasingly Political Economy

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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). 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.” The Act sought to lower the cost of raising capital by deregulating current securities laws. It was passed against the backdrop of a classic struggle of balancing free markets with investor protection, a debate that was exacerbated by the financial crisis and ensuing recession.

The main criticism of the Act alleged that decreased regulation would lead to decreased investor protection and thus to increased fraud. 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

2. Id.
3. See id.
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. The cost of registration can be prohibitively expensive, especially for small businesses. 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. 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. 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.

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.” This category was defined in extremely broad terms, which

8. See, e.g., infra note 103 and accompanying text.
12. JOBS Act § 102 (codified as amended at 15 U.S.C. §§ 77g(a), 78m(a), 78m(i), 78n-l(c); 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)).
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.


18. Private equity funds invest in, by definition, private equity. These are equity securities of companies that have not "gone public" (are not listed on a public exchange). Private equity is 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.


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. This is accomplished through websites that allow businesses to raise up to $1 million from a large number of investors. 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.”

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. Prior to the Act, a similar exemption existed under Regulation A. The new exemption created under the JOBS Act, dubbed Regulation A+, has been viewed as an expansion of Regulation A, although it is technically a new exemption. The JOBS Act increased the amount of money that may be raised in these offerings from $5 million to $50 million. 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.

Titles V and VI amended sections 12(g) and 15(d) of the Exchange Act by raising the threshold of shareholders for mandatory registration. Registration with the SEC is required from companies with over $10 million in assets and over 2000 shareholders, increased from 500. Lastly, Title VII simply instructs the SEC to make information regarding the JOBS Act available to the public.
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 WORKINGGRP., supra note 17, at 1.
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”\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{47}

\textbf{ii. Investor Protection Mechanisms}

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

\begin{footnotesize}
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\item 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).
\item Legislative Proposals Hearing, supra note 44, at 64 (statement of Heath Abshure, Arkansas Securities Commissioner and Chairman of the Corporation Finance Committee of the North American Securities Administration Association).
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increase, not decrease, regulation of the hedge fund industry.\textsuperscript{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.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{52} This is not to say that hedge funds can never pose systemic risk to the financial system.\textsuperscript{53} In 1998, a hedge fund run by Long Term Capital Management nearly collapsed.\textsuperscript{54} A failure of the fund could have had a broader impact on the already fragile financial markets.\textsuperscript{55} Nine years later, the subprime mortgage crisis led to the near collapse of two hedge funds at Bear Stearns,\textsuperscript{56} which was one factor that led to the firm’s fire sale to JPMorgan eight months later.\textsuperscript{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.\textsuperscript{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 opaqueness would allow for a more tailored oversight regime. However, hedge funds are notoriously secretive,\textsuperscript{59} and by making more information publicly available, the effect

\textsuperscript{49} See, e.g., Gogoi & Hagenbaugh, \textit{supra} note 39.
\textsuperscript{50} \textit{President’s Working Grp.}, \textit{supra} note 17, at 1.
\textsuperscript{52} Id.
\textsuperscript{53} \textit{President’s Working Grp.}, \textit{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.”).
\textsuperscript{54} Id. at 12–14.
\textsuperscript{55} Id. at 20.
may be to decrease funds’ competitive advantage, which again would distort the current laissez-faire environment. 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. However, as mentioned, hedge funds prefer to remain out of the public eye. 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. For this reason, some commentators have speculated that private funds may not wish to advertise.

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. 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. However, many hedge funds already have more than enough capital and often must turn away new investors. 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?”).
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.
67. Niles, supra note 62.
investors, 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. 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. The Act also allows the SEC to conduct audits and collect information on systemic risk.

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. 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.

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. Rule 506 of Regulation D, discussed in Part II.A, was not a possibility before the JOBS Act because of the ban on general

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68. See supra note 40 (defining “accredited investor”).
70. 15 U.S.C. §§ 80b-2(a), -3(b), -4(b).
71. Id. § 80b-4.
74. Hazen, supra note 25, at 1744–49.
solicitation and advertising.\textsuperscript{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.\textsuperscript{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.\textsuperscript{77} Regulation A, discussed in Part II.C, is another exemption for small businesses that allows for general solicitation.\textsuperscript{78} Although the exemption does not require issuers to complete the full registration process, some financial statements and offering circulars must be filed,\textsuperscript{79} the cost of which may not be conducive for a small startup seeking limited funding.\textsuperscript{80}

\textbf{ii. Investor Protection Mechanisms}

Crowdfunding became explicitly legal through Title III of the JOBS Act.\textsuperscript{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.\textsuperscript{82} The Act also limits the amount that may be sold to any one investor.\textsuperscript{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.\textsuperscript{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.\textsuperscript{85}

Congress had at least two purposes in drafting the investment limits.\textsuperscript{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.\textsuperscript{87} By allowing these companies to seek funding from the “wisdom of the crowd,” businesses could seek small investments

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  \item \textsuperscript{75} 17 C.F.R. \textsection 230.502(c) (2013) (to be amended by JOBS Act \textsection 201, Pub. L. No. 112-106, 126 Stat. 306, 313 (2012)).
  \item \textsuperscript{77} 17 C.F.R. \textsection 230.504–05.
  \item \textsuperscript{78} Id. \textsection 230.251–63.
  \item \textsuperscript{79} Id. \textsection 230.252–53.
  \item \textsuperscript{80} See infra Part II.C.
  \item \textsuperscript{81} JOBS Act \textsection 301–05 (codified as amended at 15 U.S.C. \textsection 77d(a)(6), 77d-1, 77r(b)(4), (c)(1), (c)(2)(F), 78a(a)(80), (h), 78l(g)(6), 78o(ii)(2)).
  \item \textsuperscript{82} 15 U.S.C. \textsection 77d(a)(6)(A).
  \item \textsuperscript{83} See id. \textsection 77d(a)(6)(B).
  \item \textsuperscript{84} Id. \textsection 77d(a)(6)(B)(i).
  \item \textsuperscript{85} Id. \textsection 77d(a)(6)(B)(ii).
  \item \textsuperscript{87} Id.
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from a large number of investors. Second, by explicitly limiting the
investment amount, Congress limited the exposure and thus the risk borne
by any individual investor.

A further condition requires that the transactions take place through an
intermediary designated as a broker or “funding portal,” either of which
must be registered with the SEC. Both the issuer and intermediary are
subject to additional requirements. For example, an intermediary may not
compensate promoters or lead generators for providing identifying
information of any potential investor. 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, the financial condition of the company, and a description of the
nature and purpose of the offering; this information must be made
available to investors as well. 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.

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. One of the main reasons
for increasing this ceiling was that very few companies were actually using

98. Id.
99. Id.
100. See id.
102. Id. § 77d-1.
103. Id. § 77d-1(a)(10).
104. Id. § 77d-1(b)(1)(A)–(C).
105. Id. § 77d-1(b)(1)(D).
106. Id. § 77d-1(b)(1)(E).
107. Id. § 77d-1(b)(1).
108. Id. § 77d-1(c).
109. Id. § 77c(b)(2)(A).
the exemption. 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. Because of this, the process is sometimes referred to as a “mini-registration.” However, this results in an offering cost which, when combined with the $5 million limit, becomes prohibitively expensive. By some estimates, between three and seven companies completed Regulation A offerings in 2010. Indeed, Congress had this issue in mind previously and has raised the initial exemption of $100,000 several times. The ceiling was raised to $300,000 in 1945, $500,000 in 1972, $2 million in 1978, and $5 million in 1980. 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.

The purpose behind the original Regulation A exemption, like the purpose behind the JOBS Act, was to grant small businesses easier access to capital. Small businesses are an integral part of the economy, but the current state of the credit markets makes it difficult for many to obtain financing. Regulation A+ lowers many of the barriers to capital raising that were present in its predecessor. The Act raises the cap of the offering from $5 million to $50 million. 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.”

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103. Id. at 507.
104. H.R. REP. NO. 112-206, at 3 (2011); SEC Advisory Comm. on Small & Emerging Buss., supra note 100.
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.
108. Frank, supra note 102, at 507.
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. Another provision included from the old Regulation A allows issuers to “test the waters” by soliciting interest before filing the offering statement.

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. 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. 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. Regulation A only requires unaudited financial statements, and those statements need to be filed once, rather than continuously.

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; 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, which may affect SEC rulemaking in the future.

Third, a disqualification rule exists for certain “bad actors.” 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. Certain criminal convictions also prevent a party from using the exemption. Regulation A+ directs the SEC to promulgate a rule substantially similar to regulations found in the Dodd-Frank Act, which

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114. *Id.* § 77c(b)(2)(B).
115. *Id.* § 77c(b)(2)(C).
116. *Id.* § 77c(b)(2)(E).
119. *Id.* § 77c(b)(2)(G)(i).
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

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.
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.\(^\text{134}\) 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.\(^\text{135}\) 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.\(^\text{136}\) 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.\(^\text{137}\) However, the resources of the agency are limited, and enforcement actions may not uncover all ongoing violations or deter future offenses.\(^\text{138}\) The Securities Act also provides investors with private causes of action under certain circumstances.\(^\text{139}\) However, the Private Securities Litigation Reform Act of 1995 heightened the pleading standard for some such claimants.\(^\text{140}\) 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.\(^\text{141}\) Purchasers are required to prove neither reliance

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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.").


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


141. 15 U.S.C. § 77k. Section 11(a) provides:
on the omission or misstatement nor intent of the issuer.\textsuperscript{142} Damages are limited to the difference between the offering price and the price of the securities at the time of the suit.\textsuperscript{143} Purchasers also have a cause of action against the underwriter or any other parties who signed the registration statement,\textsuperscript{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.\textsuperscript{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).\textsuperscript{146} Purchasers have a cause of action against a seller who issues a non-exempt security without registering it.\textsuperscript{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.\textsuperscript{148} The definition of "prospectus" is

\begin{quote}
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 . . .
\end{quote}

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

\textsuperscript{142} See \textit{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. \textit{Id.} § 77k(a); see also Todd R. David et al., \textit{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 \textit{TRANSACTIONS: TENN. J. BUS. L.} 53, 68 (2010).

\textsuperscript{143} \textit{Id.} § 77k(g).

\textsuperscript{144} \textit{Id.} § 77k(a).

\textsuperscript{145} \textit{Id.} § 77k(b)(3).

\textsuperscript{146} \textit{Id.} §§ 77e, 77k(a)(1).

\textsuperscript{147} \textit{Id.}

\textsuperscript{148} Section 12(a)(2) of the Securities Act provides:

\begin{quote}
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.
\end{quote}
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. § 77l(a)(2).
149. Id. § 77b(a)(10).
150. Id. § 77l(a)(2).
151. Id. § 77q(a).
Board); id. §§ 78j-1(g)–(l) (regarding auditors); id. §§ 7241–44 (imposing obligations of corporate
responsibility on officers and directors).
158. Id.
In addition to using federal securities laws, purchasers may be able to state a fraud claim under common law. This cause of action differs from state to state and often requires a plaintiff to prove eight or nine elements. However, certain class action securities lawsuits may be preempted by federal law under the Securities Litigation Uniform Standards Act (SLUSA).

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


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.”).


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.


stimulus package known as the American Recovery and Reinvestment Act of 2009.\textsuperscript{167} The stimulus included tax cuts, extended unemployment benefits, and direct investments in infrastructure.\textsuperscript{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.\textsuperscript{169}

\section*{B. Deregulation as a Tool Against Unemployment}

The stated purpose of passing the JOBS Act, as the title suggests, was to create jobs.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{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.\textsuperscript{173} Instituting deregulation in an attempt to increase economic activity is part of a strategy known as supply-side economics.\textsuperscript{174} This approach is achieved mainly through lower marginal tax rates, which in turn increases after-tax returns

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on labor and investment.\footnote{175} The increased supply is thought to have a “trickle down” effect.\footnote{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.\footnote{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.\footnote{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.\footnote{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.\footnote{180} As a category, tax concerns ranked higher than regulatory concerns,\footnote{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.”\footnote{182} However, during the Bush administration, when the tax rates were lower, “employment rose by just 1.0 percent (367,000 jobs).”\footnote{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.\footnote{184} Although regulations are a concern of small

\footnotesize{\begin{itemize}
\item \footnote{175} Id.
\item \footnote{176} \textit{Trickle Down Theory}, \textsc{Investopedia}, \url{http://www.investopedia.com/terms/t/trickledowtheory.asp} (last visited Nov. 17, 2013).
\item \footnote{177} Supply-Side Economics, supra note 174.
\item \footnote{178} See, e.g., \textsc{Paul Krugman}, \textsc{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, \textit{The Trickle-Down Hoax}, \textsc{Am. Thinker} (July 15, 2012), \url{http://www.americanthinker.com/2012/07/the_trickle_down_hoax.html}.
\item \footnote{179} See \textsc{Holly Wade}, \textsc{Small Business Problems and Priorities} 5 (2012), available at \url{http://www.nfib.com/Portals/0/PDF/AllUsers/research/studies/small-business-problems-priorities-2012-nfib.pdf}.
\item \footnote{180} “Uncertainty over Government Actions” was fourth. \textit{Id}.
\item \footnote{181} See id. at 6.
\item \footnote{182} Jason Levitis & Chuck Marr, \textsc{History Contradicts Claim That President’s Budget Would Harm Small Business Job Creation}, \textsc{Center on Budget & Pol’y Priorities} 1 (Mar. 26, 2009), available at \url{http://www.cbpp.org/files/3-26-09tax2.pdf}.
\item \footnote{183} Id.
\item \footnote{184} See \textsc{Nicole V. Crain & W. Mark Crain}, \textsc{The Impact of Regulatory Costs on Small Firms} iv (2010), available at \url{http://www.sba.gov/sites/default/files/The%20Impact%20of%20Regulatory%20Costs%20on%20Small%20Firms%20(Full).pdf}.
\end{itemize}}
business owners, statistical analysis suggests that government regulation
does not have the effect on employment that the Act’s sponsors claimed. Numbers from the Congressional Budget Office estimate that in 2011, only 0.4% of jobs lost were due to “government regulation/intervention.” 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.”

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.” 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.” 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.

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.
“Political economy” is defined as “[t]he study and use of how economic theory and methods influences political ideology.”\textsuperscript{190} This discipline covers a broad group of competing interests because various individuals and groups are often competing for a finite number of resources.\textsuperscript{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.\textsuperscript{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.”\textsuperscript{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.\textsuperscript{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,\textsuperscript{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.\textsuperscript{196} An inquiry into the different groups served by the JOBS Act and the overall political landscape provides more clues.

\begin{footnotesize}
\textsuperscript{191}. See id.
\textsuperscript{194}. See id.
\textsuperscript{196}. See, e.g., Donald J. Boudreaux & Dwight R. Lee, \textit{Politics as the Art of Confined Compromise}, 16 CATO J. 365 (1997).
\end{footnotesize}
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. 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.”

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. 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.

One particularly noteworthy subset of small businesses is technology startups. As manufacturing jobs continue to be outsourced to emerging economies, Silicon Valley continues to play an increasingly important role in U.S. economic growth. But after the recessions of 2001 and 2008, increased regulations that were perhaps unwarranted may have impacted the industry. 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.

198. Id.
200. See supra note 184.
A reason for this attempt at “winning back” certain sectors of business has to do with the negotiation aspect of politics mentioned above. 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. 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. Additionally, companies are choosing to go beyond what is necessary when disclosing to investors because they know the entity’s value will increase.

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.” 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.
* B.A., Gettysburg College, 2008; J.D. Candidate, Brooklyn Law School, 2014. I would like to thank the editors and staff of the Journal for their efforts, as well as my family for their support.