

The Growing Public Market for Private Company Shares

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The Jumpstart Our Business Startups Act, or JOBS Act, was designed to facilitate capital-raising transactions by smaller companies, including private companies. A likely but less heralded consequence of the JOBS Act is that it will also increase the number of private company shares available for sale by investors in essentially public online markets available to accredited investors. The development of these markets may prove to be helpful to some investors and may provide liquidity for employees who receive equity compensation from private company employers. Yet the rules for these markets, and for companies whose shares are or will be traded on them, are currently less than clear. Moreover, private companies and their principal investors should consider the impact of potential market transfers when planning their companies' capitalization structure and transferability restrictions.

Where will the shares come from? As is now the case, some shares may come from grants to employees. Once the SEC adopts the regulations required under the JOBS Act, the shares may also come from crowdfunding transactions by early stage companies. More shares are likely to come from investors who acquired their interests in private financing transactions. These might be traditional private placements or online offerings of private company shares to accredited investors, a form of financing that will be facilitated by the JOBS Act removal of the ban on general solicitation in certain offerings limited to accredited investors. The SEC has proposed, but not yet adopted, final rules relating to these JOBS Act provisions.

Of course, companies may (and generally do) restrict the transfer of shares issued privately, but there is always a pressure to let shareholders, particularly minority shareholders, gain some liquidity. This has resulted in the development of the existing secondary markets for private company shares. What the JOBS Act does is make it easier for companies to stay private longer, while issuing shares to employees and investors. The JOBS Act revisions to Section 12(g) of the Securities Exchange Act of 1934, as amended, make it possible to avoid SEC registration for a class of equity securities until there are 2,000 record holders, so long as no more than 500 of such record holders are unaccredited investors. This contrasts with the 500 total record holders permitted under prior law.

Key issues for the secondary markets and the companies whose shares are traded on them include:

- Disclosure obligations of the companies, brokers and investors when shares are traded and in the event of elections of directors and other shareholder votes, buybacks, acquisitions and other transactions;
- Market transparency as to pricing, insider transactions and other matters;

- Maintaining continuing contractual controls over the transferability of shares; and
- Recordkeeping (how will companies determine whether their record holders are accredited?).

Without a doubt some of these issues will be resolved over time. In the near term, however, growing private companies and other market participants face a challenge in adapting to new conditions without clear guidance.

About the Author

Bonnie J Roe is a partner in the Corporate Group of Cohen & Gresser LLP, where she represents publicly and privately held companies and investment funds. Ms. Roe has thirty years of experience advising public companies on disclosure, securities law compliance and corporate governance. She has served as counsel for issuers, underwriters and placement agents in connection with public and private offerings, including PIPE transactions and cross-border offerings. Ms. Roe was named as one of New York's *Super Lawyers* for Securities & Corporate Finance in 2011 and 2012 and is mentioned in *Who's Who in America* and *Who's Who in American Law*.

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