

Embracing Crowdfunding

There are many forms of crowdfunding. “Retail crowdfunding” or “equity crowdfunding” refers to crowdfunding under Sections 4(a)(6) and 4A of the Securities Act which was created by Title III of the JOBS Act and related SEC rules.

The JOBS Act requires the Securities and Exchange Commission’s (“SEC”) to finalize its rules for crowdfunding, and until it does so, companies cannot rely upon the equity crowdfunding exemption.

Because of this, companies are turning to other types of crowdfunding to raise capital. Accredited crowdfunding is based upon the private placement exemption found in Rule 506 of Regulation D. The JOBS Act created rule 506(c) known as the “accredited crowdfunding” exemption. The exemption provides a viable capital-raising alternative to equity crowdfunding.

The Rule 506(c) exemption became available in September 2013. Since then, there have been almost 900 new Rule 506(c) offerings which have raised more than \$10 billion in new capital as of March 2014.

Q. How did the JOBS Act change Rule 506 offerings?

A. The JOBS Act eliminated the prior prohibition against general solicitation and advertising in Rule 506 securities offerings, provided that the securities offered are sold only to accredited investors; however, the issuer is required to take “reasonable steps” to verify that all investors are accredited. Since September 23, 2013, Rule 506 offerings being conducted without general solicitation or advertising have been conducted pursuant to Rule 506(b).

Q. Can an issuer conduct offerings under 506(b) and Rule 506(c) at the same time?

A. Probably not. If the securities are of the same class because it would be difficult if not impossible to prevent the general solicitation used in connection with a Rule 506(c) offering from impacting the simultaneous Rule 506(b) offering.

In This Issue

- Embracing Equity Crowdfunding
- Accredited Crowdfunding—Rule 506(c) Highlights
- General Solicitation and Crowdfunding
- What Is An Accredited Investor?
- Rule 506 Bad Boy Provisions
- State Blue Sky Laws After Rule 506(c)

Because of the JOBS Act, issuers are now able to use general solicitation and advertising in Rule 506 (c) offerings so long as sales are only made to accredited investors. This streamlines the going public process by making it easier for issuers to raise capital and obtain the necessary shareholders for their going public transaction.





General Solicitation and Crowdfunding

General solicitation and crowdfunding will provide new ways for small businesses to attract investors; with luck, they will help them grow more quickly and easily than before. But the rules are complicated, and a failure to understand them could result in securities laws violations.

For issuers seeking to go public, both crowdfunding and Rule 506(c) ease the burden of obtaining the shareholder base required by FINRA for a ticker symbol assignment. Companies should seek advice from a qualified securities attorney before embarking upon the unknown.

Accredited Crowdfunding—Rule 506(c) Highlights

Securities offerings made under Rule 506 can be advertised including, but not limited to, on the internet, television and through social media.

Both SEC Reporting and Non-Reporting companies can use the Rule 506(c) Equity Crowdfunding Exemption. Although investors can receive advertisements and solicitations for the offering, only accredited investors can actually invest.

Companies must take reasonable steps to “verify” the accredited status of investors. The SEC has provided a non-exclusive list that may be relied on as meeting the requirements for verification of accredited investor status under Rule 506:

- No minimum offering, dollar limit or limits on the size of an offering
- Private Placement Memorandums are typically used, but not required.
- Filing requirements—Form D with the SEC within 15 days after the first sale.
- The anti-fraud provisions of Rule 10b-5 and state laws apply to any untrue statements.
- The resale of equity crowdfunded securities are “restricted”
- Intermediaries are not required. If an intermediary is used, it must be registered as a broker-dealer or be an entity exempt from broker-dealer registration.

Beware of Bad Actors!

The accredited crowdfunding exemption cannot be relied upon on if a “Bad Actor” is involved with the issuer. The issuer must take “reasonable care” to exclude Bad Actors.



What Is An Accredited Investor?

The Securities Act provides companies with a number of exemptions from the SEC's registration requirements. For some of the exemptions, such as Rule 506 (c) of Regulation D, a company may sell its securities to what are known as "accredited investors." The term accredited investor is defined in Rule 501 of Regulation D.

Generally, Rule 501 of Regulation D defines "accredited investors" as: (A) individuals with net worth of at least \$1 million or annual income of at least \$200,000 and (B) entities with total assets of at least \$5 million. Married couples may aggregate their net worth and income for purposes of the net worth test and the income test, provided that the income requirement is increased to \$300,000 annually if relying on the joint income of a married couple.

Rule 506 Bad Boy Provisions

The individuals below are "covered persons" and considered bad actors who are disqualified from offering securities under Rule 506 (c):

- The issuer and any predecessor of the issuer or affiliated issuer;
- Any director, general partner or managing member of the issuer;
- Any executive officer and officers participating in the offering;
- Any 20 percent beneficial owner of the issuer;
- Any promoter—that is, any person or entity that directly or indirectly takes initiative in founding the issuer, or in connection with the founding of the issuer, receives 10% or more of any class of the issuer's securities, or 10% of the proceeds from the sale of any class of the issuer's securities;
- Any investment manager or principal of pooled investment funds offering securities;
- Any person that has been or will be compensated for solicitation of purchasers in connection with sales of securities in the offering ("compensated solicitor"); and
- Any director, officer, general partner or managing member of any such compensated solicitor.

Disqualifying Events

The disqualifying events cover eight classes of court and administrative orders that relate to a person's or entity's history of financial and securities fraud. The different events require different look-back periods and generally include:

- Criminal Convictions
- Court Injunctions and Restraining Orders
- Final Orders of Certain Regulators
- SEC Disciplinary Orders
- Certain Commission Cease-and-Desist Orders of the SEC
- Suspension of Expulsion from SRO Membership or Association with an SRO Member
- Registration Statement Stop Orders and Orders Suspending the Regulation A Offerings
- False Representation Orders



State Blue Sky Laws After Rule 506(c)

Issuers are often unaware of the state laws that apply to their private placements prior to completion of their going public transactions. Federal securities laws require that the purchase or sale of a security be subject to a registration statement under the Securities Act of 1933 (the "Securities Act") or exempt from registration. Rule 506(c) of Regulation D provides an exemption for accredited crowdfunding.

Issuers conducting any offer or sale of securities must consider state blue sky laws that may be relevant to their offering. Securities offerings under Rule 506 are deemed to be covered securities under the federal law, which preempts the states from substantively regulating Rule 506 offerings under state securities or blue sky laws. Despite this federal preemption, states may require the filing of a Form D, Consent to Service of Process and the payment of a filing fee. Securities offerings under new Rule 506(c) are "covered securities". As such, State securities commissioners and regulators are precluded from applying their blue sky laws to offerings of securities that involve general solicitation or general advertisement under Rule 506(c), provided that the issuer complies with the requirements of the exemption and notice filing and fee payment requirements in their state.

Some states have existing laws prohibiting issuers from making unregistered offerings to residents of their state using the Internet. Because Rule 506(c) offerings constitute covered securities, states cannot prohibit the use of the Internet in connection with an offering that complies with the requirements of Rule 506(c).

It should be noted that issuers that have previously relied on state limited offering exemptions rather than federal preemption as covered securities will no longer be able to utilize a limited offering exemptions if they conduct a Rule 506(c) offering.

States remain authorized to enforce anti-fraud provisions and regulate financial intermediaries even after Rule 506(c), so it is critical that issuers provide investors with accurate and complete disclosures, where applicable.

Contact Us

Give us a call for more information about periodic reporting, securities law and going public!

Hamilton & Associates Law Group, P.A.
101 Plaza Real South, Suite 202 North
Boca Raton, FL 33432

Phone: (561) 416-8956

Fax: (561) 416-2855

Email: info@securitieslawyer101.com

Visit us on the web at

www.securitieslawyer101.com

www.jobsact101.com

www.gopublic101.com