

The Intrastate Crowdfunding Movement

Title III of the JOBS Act creates an exemption from federal registration requirements for equity crowdfunding and requires that the Securities & Exchange Commission ("SEC") adopt and implement rules for crowdfunding. More than a year has passed since Title III was adopted. Even though the SEC has not adopted the required rules; until it does so, companies cannot rely upon the federal equity crowdfunding exemption. Despite this, 14 states have enacted their own crowdfunding exemptions for companies domiciled and conducting business within their state. This means that companies must rely upon Rule 147 of the Securities Act also known as the "Intrastate Exemption" to crowdfund a securities offering in their individual state.

Intrastate Crowdfunding Q&A

Q: What is an Intrastate Crowdfunded Offering?

A: Intrastate Crowdfunding allows a company organized and operating within a single state to make offers and sales of its securities within that state, if certain conditions are met.

Q: Can a Company advertise its Intrastate Crowdfunded offering on its website?

A: Yes, Rule 147 does not prohibit general advertising or general solicitation in intrastate offerings. However, advertising must be conducted in a manner consistent with the requirement that offers made in reliance on the intrastate exemption be made only to persons resident in the state or territory of which the issuer is a resident. Using a website to advertise an offer would likely involve offers to residents in more than one state. As such, companies must take steps to ensure that only residents of their respective state can view their offering materials.



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Small companies are using Intrastate Crowdfunding to offset the costs of going public and fast track their going public transactions by using Equity Crowdfunding to obtain the shareholder base that FINRA requires to assign a stock trading or ticker symbol.



What is a Sponsoring Market Maker?

A sponsoring market maker is a FINRA registered broker-dealer firm that accepts the risk of holding certain number of shares of a particular security in order to facilitate trading in that security. Broker-dealers must register with FINRA to act as a market maker.

It should be noted that sponsoring market makers have become one of the most important players in the going public process because they are the only ones who can apply for a ticker symbol.

For the first 30 days after a ticker symbol assignment in a going public transaction, only the sponsoring market maker who filed the Form 211 can publish quotes of the company's securities. Thereafter, other market makers can publish their own quotes.

Market maker activities are regulated by the SEC as well as by FINRA. FINRA oversees registration, education and testing of market makers, broker-dealers and registered representatives.

Texas Adopts Intrastate Crowdfunding

Texas is the latest state to embrace Equity Crowdfunding. The Texas Board approved Rule 139.25 which exempts intrastate securities offerings using Crowdfunding if certain conditions are met.

What is a Crowdfunding Portal?

According to the SEC, a Crowdfunding Portal means "any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others." A Crowdfunding Portal does not offer investment advice, solicit purchases or offers to buy the securities, compensate employees based on the sale of the securities, hold or manage investor funds, or engage in other activities described by the SEC.

Crowdfunding Portals and the Internet

A company may use crowdfunding internet portals to promote an offering to residents of a single state in accordance with state laws intended to enable crowdfunding within that state if the crowdfunding portal implements safeguards to ensure that offers of securities are made only to persons who reside in the relevant state. These safeguards must include, at a minimum

- disclaimers and restrictive legends which clearly state that the offering is limited to residents of the relevant state under applicable law; and
- steps to limit access to information about the offering to persons who confirm that they are residents of the relevant state.

Crowdfunding a Going Public Transaction

A company domiciled in a state that has an intrastate crowdfunding exemption can crowdfund its going public transaction, so long as the company discloses this as a use of proceeds in its offering materials.



The Role of the Crowdfunding Lawyer

The SEC doesn't regulate concepts, but it does have jurisdiction over companies that choose to apply those concepts, and to those who participate in their application. As such, it is critical that companies engage a skilled crowdfunding lawyer to ensure compliance with the new rules.

The following 13 states have passed Intrastate Crowdfunding: Alabama, Colorado, Georgia, Idaho, Indiana, Kansas, Maine, Maryland, Michigan, Tennessee, Texas, Washington and Wisconsin.

Fourteen states have Intrastate legislation pending: Alaska, Arkansas, California, Connecticut, District of Columbia, Illinois, Kentucky, Missouri, New Jersey, New Mexico, Pennsylvania, South Carolina, Utah and Virginia.



Crowdfunding Confusion

Although Title III of the JOBS Act provides for equity-based crowdfunding, the SEC has not completed its rule making. As such, companies cannot rely on the federal crowdfunding exemption. The Intrastate Crowdfunding exemption varies from state to state and to rely upon the exemption, companies must comply with both federal and state law requirements.

Section 3(a)(11) of the Securities Act ("Section 3(a)(11)") provides the federal exemption from registration for intrastate offerings. Rule 147 under the Securities Act provides a safe harbor for offerings conducted pursuant to Section 3(a)(11), which requires that the issuer must be a resident of, and doing business in, the same state in which all offers and sales are made, and the offering may not be offered or sold to non-residents.

Section 3(a)(11) of the Securities Act is generally known as the "federal intrastate offering exemption." This exemption facilitates the financing of local business operations within a single state. To qualify for the intrastate offering exemption, a company must:

- be organized in the state where it is offering the securities;
- carry out a significant amount of its business in that state; and
- make offers and sales only to residents of that state.

The intrastate offering exemption does not limit the size of the offering or the number of purchasers. A company must determine the residence of each offeree and purchaser. If any of the securities are offered or sold to even one out-of-state person, the exemption may be lost. Without the exemption, the company could be in violation of the Securities Act.

If an investor resells any of the securities to a person who resides outside the state within a short period of time after the company's offering is complete (the usual test is nine months), the entire transaction, including the original sales made within the required state, might violate the Securities Act.

Don't Forget the Technical Requirements!

The SEC requires companies relying upon Rule 506 of Regulation D file a Form D through its EDGAR database when conducting an accredited crowdfunding offering. Similarly, States that have adopted intrastate crowdfunding require a notice filing be filed with their securities regulatory body. Failure to timely file the required documents with regulators could negatively impact your securities offering and going public transaction.

Companies conducting intrastate offerings should remember that even one sale to a resident outside their home state would cause the exemption to no longer be available for their offering. If this happens, the company must locate another exemption from the SEC's registration statement requirements. Failure to do so could lead to SEC or state enforcement proceedings and/or civil actions by investors for rescission of their investment.

It's Called Going Public For a Reason...

Companies using crowdfunding to go public going public should be prepared to provide full disclosure and transparency to their shareholders and investors. These disclosures are often provided in private placement memorandums and state required information statements. Transparency is the key to a successful crowdfunding offering and going public transaction.

Contact Us

Give us a call for more information about Periodic Reporting, Going Public, Crowdfunding, SEC Registration statements, direct public offerings or securities law!

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