



# Proposed Crowdfunding Rules

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## ABOUT THIS CLIENT ALERT:

As mandated by the Jumpstart Our Business Startups Act of 2012 (commonly called the JOBS Act), on October 23, 2013, the Securities and Exchange Commission released proposed “crowdfunding” rules. This Client Alert provides an overview of the proposal, which remains subject to public comment through February 3, 2014.



On October 23, 2013, the Securities and Exchange Commission released proposed “crowdfunding” rules, as mandated by the Jumpstart Our Business Startups Act of 2012 (commonly called the JOBS Act). Once final, these regulations will permit U.S. companies to raise up to \$1 million in any 12-month period through a registered intermediary – either a registered broker or an online funding portal – from a large number of investors, without registering the offering with the SEC. The proposed rules are subject to a 90-day comment period, currently set to expire February 3, 2014, following which the SEC will issue final rules.

## Issuer Qualifications

To qualify for the proposed crowdfunding exemption from registration, the offering must meet the following requirements:

- The issuer must be organized under the laws of a U.S. state or territory or the District of Columbia.
- The issuer and its affiliates may raise no more than \$1,000,000 through all crowdfunding offerings during any twelve-month period.
- The issuer may not be a public company, an investment company, or a hedge fund.
- The issuer must have a business plan and the business plan may not be to engage in a merger or acquisition with an unidentified company.
- The issuer may not violate the “bad actor” provisions of the crowdfunding rules, which generally prohibit individuals who have been subject to injunctions or restraining orders under the securities laws or other regulatory orders from participating in key roles with the issuer or in the offering.

The terms of the offering must include both (1) a target amount and (2) a deadline for the target to be raised. If the target amount is not raised by the deadline, the offering must be cancelled and the intermediary must return all money to the investors. Additionally, investors have the right to terminate their investment commitment (and receive a full refund) any time up to 48 hours prior to the deadline.



### **Investor Limitations**

Unlike traditional private placements under the SEC's Regulation D, the proposed crowdfunding rules do not require an investor to be an accredited investor or to meet other sophistication requirements. Instead the rules limit the amount any investor may invest in crowdfunding offerings. In any twelve-month period, an investor may make purchases in crowdfunding offerings up to no more than either (a) \$2,000, or 5% of annual income or net worth, whichever is greater, if the investor's income and net worth are both less than \$100,000; or (b) 10% of income or net worth, whichever is greater, if the investor's income or net worth is greater than \$100,000, but not to exceed \$100,000 in total purchases in crowdfunding offerings in any twelve-month period.

### **New Form C Filing Requirements**

For each offering, issuers must file an offering statement with the SEC on the new Form C, with information that is similar, though narrower in scope, to the disclosures required in a registered public offering. This information includes two years of financial information; a description of the issuer's ownership, capital structure, and securities; a discussion of the issuer's financial condition; and disclosures of compensation paid to the intermediary, the number of employees, risk factors, related-party transactions, and exempt offerings in the past three years. Notably, the financial statements required to be included in the Form C must be certified by the issuer's CEO if the offering is under \$100,000, must be reviewed by a public accountant if the offering is greater than \$100,000 but under \$500,000, or must be audited by an independent auditor if the offering is greater than \$500,000. If the offering is completed, the issuer must file annual reports with the SEC to update portions of the information on the Form C offering statement. Given the size of the offerings contemplated under the crowdfunding exemption, many issuers may find the Form C requirements prohibitively burdensome.

### **Intermediaries**

Intermediaries stand between companies issuing securities and the general public. Their role is to run the funding platform websites and provide a certain amount of vetting of both the issuers and investors. All intermediaries must be registered with the SEC as either a broker or as a "funding portal" under the new crowdfunding regulations. Neither an intermediary nor its officers, directors, or partners may have any financial interest in any issuer selling securities through its website.

An intermediary will have a duty to exclude issuers or terminate offerings when it has a reasonable basis to believe a potential for fraud exists or investor protection is otherwise implicated. At a minimum, an intermediary must obtain a background check and securities enforcement regulatory history of each officer, director, and 20% holder of an issuer.

Furthermore, an intermediary must provide “communication channels” for investors to communicate with the issuer and with one another (e.g., an online forum). These forums must be accessible to the public, but only the issuer and investors who have opened an account with the intermediary may post in the forum.

### **Final Rules**

The much-anticipated crowdfunding rule proposal was issued over a year after the deadline under the JOBS Act, and is certain to elicit a substantial number of comments and an array of opinions and suggestions. At Freeborn & Peters, we expect a further delay between the expiration of the comment period on February 3, 2014 and the issuance of final rules as the SEC sorts through these comments. If adopted as proposed, the crowdfunding rules will provide a new exemption that will require issuers to consider whether the amount of money being raised will be worth the burden of (a) a large shareholder base and (b) the Form C offering statement and ongoing updates. Until final rules are adopted, the crowdfunding contemplated by the JOBS Act will have to wait. We will continue to keep our clients updated of any significant developments in these rules.

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