

# Supporting Startups

## Will the JOBS Act expand the crowdfunding crowd?



PATRICK J. FRANKE



JESSICA F. HOERSCHELMANN



MATTHEW D. VIERS

Congress's passage last year of the popular and bipartisan Jumpstart Our Business Startups (JOBS) Act was met with expectations of imminent and fundamental changes to the financing environment for early-stage businesses. Those who saw the JOBS Act as a game changer focused on the act's "crowdfunding for the masses" provisions. Specifically, Title III amends existing law to exempt certain crowdfunding activities—that is, the use of internet and social media to raise relatively small individual investments from a large number of investors—from registration with the U.S. Securities and Exchange Commission (SEC). While these provisions potentially create a much larger pool of startup investors, Title III also significantly restricts the scope of lawful crowdfunding and establishes new disclosure and other compliance requirements for crowdfunding issuers and intermediaries. Notably, Title III:

- Limits the total amount raised via crowdfunding to \$1 million per issuer, per year;
- Limits the total amount sold to any individual investor to a percentage of the investor's net worth or annual income (for example, an investor with an annual income of \$50,000 and a net worth of \$100,000 may only be issued \$5,000 worth of securities during any 12-month period);

### Title III significantly restricts the scope of lawful crowdfunding and establishes new disclosure and compliance requirements.

- Requires that crowdfunding transactions be conducted through a qualified broker or funding portal that complies with new disclosure, investor education, anti-fraud and privacy regulations; and
- Requires crowdfunding issuers to disclose detailed information about their finances, operations and uses of capital.

It is important to note that the registration exemption created by Title III takes effect only upon the SEC's issuance of definitive crowdfunding regulations. Because the SEC has not yet issued these rules, *crowdfunding from the general public remains illegal*. This is not to say, however, that startups are not already using online networks and resources to raise capital. Earlier this year, the SEC sanctioned the business models of two online crowdfunding platforms, ruling that the companies' targeted crowdfunding activities comply with existing securities laws. These platforms, which pool money in investment funds, which in turn invest in startups, are only open to

so-called "accredited investors," or those individuals that either have: (a) a net worth of at least \$1 million or (b) consistent annual income of at least \$200,000 (individual) or \$300,000 (joint). Such accredited investor or Regulation D crowdfunding (that is, the existing SEC rule establishing private placement exemptions) does not rely on the JOBS Act exemptions and, therefore, avoids the requirements and limitations listed above. In addition, the SEC's recent elimination of the longstanding ban on general solicitation or advertising for securities (a less-publicized JOBS Act provision) may allow these platforms to significantly expand their operations by targeting the approximately 7.5 million accredited investors in the United States who do not currently participate in private placements.

Once the SEC adopts rules implementing Title III of the JOBS Act, startups seeking crowdfunded capital will have the option to seek funds from the general public and/or, as they would have prior to the JOBS Act, solicit investment from high-income or high-net-worth individuals. These startups will weigh the benefit of a greatly expanded pool of investors against the resources required to comply with the new JOBS Act reporting requirements. These reporting requirements are extensive and ongoing, and any misstatement or omission (even if there was no intent by the issuer to mislead investors) will expose the company to liability similar to that associated with full-fledged SEC-registered offerings. As such, well-advised startups will expend significant time as well as incur legal and accounting expenses in compiling these disclosures. Given the modest amounts that can be raised through Title III crowdfunding, many startups may conclude that their scarce funding resources are best directed toward the traditional startup investor crowd. If this is the case, the JOBS Act may not, in fact, expand the crowdfunding crowd much at all.

—The information contained in this article pertaining to the JOBS Act and its related SEC regulations was current as of the date of its writing, July 15, 2013. Up-to-date information regarding JOBS Act regulations and implementation may be located at [www.sec.gov/spotlight/jobs-act.shtml](http://www.sec.gov/spotlight/jobs-act.shtml).

**PATRICK J. FRANKE** is a shareholder and corporate lawyer at Lane Powell. He can be reached at 206.223.7100 or [frankep@lanepowell.com](mailto:frankep@lanepowell.com). **JESSICA F. HOERSCHELMANN** and **MATTHEW D. VIERS** are attorneys at Lane Powell focusing on corporate and transactional matters. Hoerschmann can be reached at 206.223.7055 or [hoerschmannj@lanepowell.com](mailto:hoerschmannj@lanepowell.com). Viers can be reached at 206.223.7117 or [viersm@lanepowell.com](mailto:viersm@lanepowell.com).