

## Venture Capital & Emerging Companies Alert

MARCH 27, 2012

### Crowdfunding: One Step Closer to Reality

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On Tuesday, March 27, the House of Representatives passed the JOBS (Jumpstart Our Business Startups) Act (H.R. 3606) by an overwhelming majority of 380-41. With this vote, the JOBS Act has passed the final congressional hurdle before going to the President to be signed into law, which is expected to occur as early as the end of the week. Among the various elements of the bill, which is actually a package of bills aimed at easing the regulatory burdens on private and newly public businesses, the JOBS Act contains a crowdfunding provision that may be transformative in the way entrepreneurs and early-stage companies raise small amounts of first round capital.

While crowdfunding will eventually provide a new method for early-stage businesses to raise their initial capital, it will not be as frictionless to use as initially intended by its proponents. First, the SEC will have 270 days to issue rules before crowdfunding becomes available for companies. Second, the Senate amendments to the initial House bill have added significant regulatory and disclosure requirements that are likely to inhibit the rapid and widespread use of this new capital raising tool.

Title III of the JOBS Act will amend the Securities Act of 1933 to provide a new exemption from securities registration for private companies raising capital in a “crowdfunding” – a private financing comprised of the pooled investments of many small investors. The bill allows companies to raise up to \$1,000,000 within a 12-month period without registering the securities offered in the financing(s) with the SEC, subject to certain restrictions. Companies raising between \$100,000 and \$500,000 will have to engage an auditor to “review” their financial statements, and companies raising over \$500,000 up to \$1,000,000 will need audited financials. Because of these auditor requirements, the new crowdfunding tool may be most useful for companies raising only \$100,000 or less, because for offerings up to that amount, only CEO-certified financial statements will be necessary. New app developers in particular, who often need only small amounts of capital to get started, may find the crowdfunding tool very useful.

Investors in these crowdfunded financings with less than \$100,000 in net worth or annual income will be limited to investing the greater of \$2,000 or 5% of their annual income or net worth in any company per 12-month period, and investors with \$100,000 or more in net worth or annual income will be limited to 10% of their annual income or net worth, with a limit of \$100,000. Investors purchasing securities in crowdfunding will be prohibited from reselling their securities for one year (except back to the company, or to accredited investors or family members).

One major limitation imposed on crowdfunding is that it must be conducted by a broker or “funding portal” (essentially a website designed specifically to handle these offerings) registered with the SEC. These third-party intermediaries will be required to implement extensive “know your investor” procedures to ensure potential investors are qualified and knowledgeable enough to participate in the offering, and that they have not exceeded the 12-month investing limit. Brokers and funding portals will also need to make certain disclosures to the SEC and investors, including the goal amount of the offering and a warning to investors about the risks and speculative nature of the offering and investment in start-up

companies. Companies using the crowdfunding exemption will have to file with the SEC and disclose certain information regarding the offering, but the offerings will be exempt from state blue sky registration requirements.

While the new law will provide small private companies with a new way to raise money, the potential accounting, brokerage, and legal fees, as well as the ongoing disclosure requirements, are likely to blunt the impact of this new capital raising tool.

If you have questions about the details of the JOBS Act or how the crowdfunding provision could affect you and your business, contact one of the authors of this article; we'll be happy to discuss it with you.

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1760-0312-NAT-VC