

The JOBS Act: Crowdfunding

On April 5, 2012, President Obama signed into law the [Jumpstart Our Business Startups Act](#) (the “Act”), a wide-ranging legislative response to the private sector which repeatedly voiced concerns regarding the existence of substantial burdens on the ability of issuers to engage in capital formation activities. As expected, the Act will have a significant impact upon federal securities laws and is intended, among other things, to provide increased access to debt and equity capital for issuers generally and “Emerging Growth Companies” specifically.

This Alert primarily addresses the Act’s sanction of crowdfunding (i.e., crowd financing, equity crowdfunding and/or hyper funding) (collectively, “**Crowdfunding**”), a capital raising mechanism which is an outgrowth of the Internet and recent technological advances. For additional information regarding the Act, please refer to The JOBS Act: General Solicitation and Advertising in Certain Private Placements and Exempt Offerings, The JOBS Act: Increase and Division of Section 12(g) Registration Requirements, The JOBS Act: Emerging Growth Companies and the IPO On-Ramp and The JOBS Act Quick Reference Chart.

What Is Crowdfunding?

Crowdfunding involves the pooling or combining of monies (usually through relatively small contributions or investments) from various sources to advance the particular purposes of an initiative. Crowdfunding has historically been used to further such causes as charitable events, political campaigns and, most pertinently to this Alert, start-up companies and small businesses such as [Buy a Beer Company LLC](#).

Why Would Crowdfunding Potentially Be Subject To Regulation?

If Crowdfunding is used to advance a business venture pursuant to which passive investors would share in the venture’s profits and/or returns, a security is most likely being offered for sale, and, absent registration of the Crowdfunded offering with foreign, federal and/or state securities regulators or an exemption from registration, a start-up company or small business would most likely be in violation of, among other potentially applicable laws, the Securities Act of 1933, as amended (the “**Securities Act**”). Compounding the regulation concern that Crowdfunding presents is the fact that the Internet and related technologies are global in scope, an inconvenient convenience which significantly increases the risk of a securities law violation.

ALABAMA
Birmingham
Montgomery

LOUISIANA
Baton Rouge
New Orleans

MISSISSIPPI
Bay St. Louis,
Greater Jackson
Gulfport, Oxford

PENNSYLVANIA
Greater Philadelphia
Fort Washington

TENNESSEE
Memphis
Nashville

Butler Snow has been a leading presence in the legal community for almost sixty years. With over 180 attorneys, we provide a full range of business and litigation services to clients on an international, national, regional and local basis. Our clients benefit from our strategic counsel, efficient execution and innovative solutions to complex matters. For more information, visit us at www.butlersnow.com.

Does The Act Impact The Regulation Of Crowdfunding?

Yes. The Act provides issuers with an exemption from the registration requirements of the Securities Act for Crowdfunded offerings, provided that the following conditions, among others, are satisfied:

- the aggregate amount sold to all investors in the Crowdfunded offering is not more than \$1,000,000;
- the aggregate amount sold to any investor does not exceed (i) the greater of \$2,000 or 5% of the annual income or net worth of the investor if either the annual income or the net worth of the investor is less than \$100,000 or (ii) 10% of the annual income or net worth of an investor not to exceed a maximum aggregate amount sold of \$100,000 if either the annual income or net worth of the investor is equal to or more than \$100,000; and
- the Crowdfunded offering is conducted through a compliant broker or “funding portal.”

Notably, the Act preempts state regulation of securities offered and sold in Crowdfunded offerings and of funding portals; however, the Act does not affect the authority of a state to undertake enforcement action or to implement notice filing requirements. In addition, subject to certain exceptions, securities sold in a Crowdfunded offering would not be transferrable by a purchaser for a one-year period beginning on the date of purchase.

Must Issuers Satisfy Any Conditions To Rely Upon The Crowdfunding Exemption?

Yes. As an initial matter, the Act provides that the Crowdfunding exemption would only be available for U.S. issuers that are not subject to the reporting requirements of the Securities Exchange Act of 1934, as amended, and that are not “investment companies.” To rely upon the Crowdfunding exemption, these issuers must:

- file with the SEC and provide to investors and the relevant broker or funding portal information regarding the issuer, including its financial statements and directors, officers and greater than 20% shareholders, and the offering, including the related risks and expected offering proceeds;
- not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker;
- not compensate persons promoting the offering through communication channels provided by a broker or funding portal unless the issuer ensures that the person, upon each instance of a promotional communication, clearly discloses the receipt of compensation; and
- file with the SEC, not less than annually, and provide to investors reports of the results of operations and financial statements of the issuer.

What Is A Funding Portal?

The Act defines a “funding portal” as an intermediary for a Crowdfunded offerings that does not:

- offer investment advice or recommendations;
- solicit purchases, sales, or offers to buy securities offered or displayed on its website or portal;
- compensate employees, agents and/or other persons for such solicitation or based on the sale securities displayed or referenced on its website or portal; and
- hold, manage, possess, or otherwise handle investor funds or securities.

How Does A Broker or Funding Portal Become “Compliant?”

For a broker or “funding portal” to be compliant for purposes of the Act, it must satisfy a myriad of conditions, including:

- registering with the SEC and any applicable self-regulatory authority;
- providing disclosures to investors, including investor education materials, related to risks;
- ensuring that all Crowdfunded offering proceeds are only provided to issuers when the amount equals or exceeds the target offering amount;
- allowing investors to cancel commitments to purchase in a Crowdfunded offering;
- ensuring that no investor in a 12-month period has invested in excess of the limits prescribed by the Act;
- protecting the privacy of information collected from investors in a Crowdfunded offering;
- prohibiting the compensation of promoters, finders or lead generators for providing personal identification information of investors; and
- prohibiting insiders from having any financial interest in an issuer using the funding portal’s services.

Although a funding portal would be required to register with the SEC as a funding portal, it would not have to register as a “broker” or “dealer” in accordance with the Securities Exchange Act of 1934, as amended, provided that the funding portal is a member of a registered national securities association and remains subject to SEC regulation and oversight.

Did The Crowdfunding Exemption Become Effective Immediately?

No. The SEC must adopt rules and regulations to implement the Crowdfunding Exemption within 270 days of April 5, 2012. As of the date of this Alert, the SEC has not promulgated such rules and regulations and, on April 23, 2012, released a [warning](#) issuers that any offers or sales of securities purporting to rely upon the Crowdfunding exemption prior to the issuance of SEC rules and regulations would be unlawful. Also, the SEC recently instituted an [enforcement action](#) involving a transaction quite similar to Crowdfunding.

Are There Any Potential Consequences?

Yes. The future ability of issuers to conduct Crowdfunded offerings may likely result in a number of consequences, including the following:

- although Crowdfunded offerings offer issuers the ability to raise capital at lower costs and from a greater variety of sources due to the Internet and technologies such as Twitter, Crowdfunded offerings must be conducted through brokers or funding portals which, because they have their own compliance requirements to address, may be forced to increase the price of conducting a Crowdfunded offerings in order to achieve a profit;

- Crowdfunded offerings may result in largely unsophisticated bases of equity holders which may require much greater efforts on the parts of issuers to communicate effectively with such holders, to conduct routine corporate business and to execute future corporate transactions that require the focus and consent of potentially disparate and disjointed bases of equity holders;
- according to the Act, national securities associations may only examine for and enforce against a registered funding portal the association's rules which are written specifically for registered funding portals; thus, FINRA or another to-be-formed national securities association would need to adopt and implement rules regarding registration and conduct which specifically apply to funding portals.

The content of this Alert is intended for general informational purposes only, is not intended to be comprehensive with respect to the subject matter and is not intended to create an attorney-client relationship with any user. This Alert is not designed nor intended to render legal or other professional advice, as any such advice requires the consideration of the facts regarding a specific situation. For further information, please contact a member of the Capital Markets and Securities Group below. The invitation is not a solicitation to render professional services and should not be construed as a statement as to any availability to perform legal services in any jurisdiction in which such attorneys are not permitted to practice.

IRS Circular 230 Disclosure: As required by U.S. Treasury Regulations, you are hereby advised that any federal tax advice contained in this communication or any attachment does not constitute a formal tax opinion. Accordingly, any federal tax advice contained in this communication or any attachment is not intended, or written to be used, and cannot be used, by any recipient for the purpose of avoiding penalties that may be asserted by the Internal Revenue Service.

Free Background Information is available upon request. This Alert is an advertisement.

If you have questions regarding this Capital Markets and Securities Alert, please call your primary contact at Butler Snow.