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State Crowdfunding Rules: Often An Intriguing Option Where Available

With the passage of the Jumpstart Our Business Startups Act of 2012 (JOBS Act), Congress and President Obama sought to facilitate capital formation by relaxing certain securities registration requirements. Specific changes included (i) amending Regulation D to allow advertising and general solicitations by issuers raising capital from accredited investors, (ii) amending Regulation A to allow offerings up to \$50 million through a streamlined registration process (colloquially referred to as a “mini-IPO” or “Regulation A+”), and (iii) creating a new Regulation CF to allow companies to raise up to a fixed ceiling (current \$1.07 million) from both accredited and unaccredited investors in a manner different from previous registration exemptions. Despite these liberalizations, the JOBS Act still may not help every company in every situation. The changes to Regulation D only benefit companies whose investors are all wealthy. The costs of complying with Regulation A remain high even if such costs are lower than the cost of registering an initial public offering. Regulation CF caps investments from unaccredited investors in all Regulation CF securities in a twelve-month period at (a) \$2,200 or (b) 5% of net worth or annual income, and requires that issuers provide certain information to both investors and the Securities and Exchange Commission as well as post-offering reporting in some situations.

A State Option May Be Available. If an issuer finds the JOBS Act provisions or other federal exemptions inapplicable, cumbersome, or unhelpful, the issuer may be able to take advantage of a state’s exemption from registration. To qualify for an exemption, the issuer must be based and seek investors in a state that has passed its own crowdfunding rules which work in conjunction with certain federal rules (discussed below) to allow for raising additional capital without federal registration or state qualification. Crowdfunding rules vary from state to state, but generally address the following elements:

Fundraising Cap. Some states have a single cap on how much an issuer can raise; for example, \$1 million in Florida. Other states have variable caps; for instance, Illinois allows issuers to raise up to \$1 million, but the cap increases to \$4 million if the issuer provides audited financial statements that have been certified by its officers.

Individual Investor Cap. Another key variable is how much money the issuer may raise from each investor; there is substantial variation among states with caps, generally ranging somewhere between \$2,000 and \$10,000 (or a specified percentage of net worth) unless the investor is an accredited investor.

Internet Funding Portals. Some states require that crowdfunding offerings be conducted through third-party internet portals.

General Solicitations. Many states allow general solicitation over the Internet and in other media after the filing of appropriate notices with the state regulatory agency. Other states are either silent regarding general solicitation (a troubling omission) or have more complex requirements regarding the extent to which general solicitation is permitted – Illinois is one example of the latter.

Other Requirements. Each state that has enacted an intrastate crowdfunding exemption has its unique set of requirements. As a partial list, the types of additional provisions include some or all of the following: (i) filing a notice with the state securities regulatory agency; (ii) providing specified information to the investors on intended use of proceeds and risk factors; (iii) using an in-state escrow agent until a stated minimum offering amount is reached; and (iv) filing financial statements with the state regulatory agency. As a result, any potential issuer must obtain a complete understanding of all requirements of any exemption that it intends to utilize.

SEC Rule 147 and Rule 147A. In order to remain exempt from federal registration requirements, an offering taking advantage of state crowdfunding rules must also qualify for a registration exemption under the federal securities laws in addition to complying with state law. Rules 147 and 147A promulgated under the Securities

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Act of 1933 establish safe harbors from registration. Under either rule, issuers wishing to conduct an exempt offering must both have their principal place of business in-state and satisfy *at least one* of the following requirements: (a) derive at least 80% of its gross revenues from the operation of a business located in-state or from the rendering of services in-state; (b) have at least 80% of its assets located in-state; (c) use at least 80% of the net proceeds from the offering towards the operation of a business in-state or the rendering of services in-state; or (d) have a majority of its employees based in-state. The major differences between the two rules are that Rule 147A (i) permits an issuer to be incorporated in a state other than the state in which it is selling securities, and (ii) expressly allows an issuer to use general solicitations and general advertisements so long as it makes sure that all purchasers securities in the offering are residents of the same state in which the issuer has its principal place of business.

Georgia – A Broad State Funding Exemption. With the Invest Georgia Exemption (“IGE”), Georgia provides a broad crowdfunding exemption which allows issuers to raise up to \$5 million (with integration of all investment funds received in the previous twelve months). Companies may raise up to \$10,000 from each unaccredited investor and unlimited amounts from each accredited investor, subject to the overall cap. The issuer must be registered with the Georgia Secretary of State (so no partnerships or sole proprietorships, but entities formed in other states are permitted), and all funds must be deposited into a bank authorized to do business in Georgia.

Not All States Have Enacted Crowdfunding Rules. As of the publication of this Update, not all states have crowdfunding exemptions. States without crowdfunding rules include California, New York, and Pennsylvania. However, offerings may still be conducted in compliance with Rules 147 and 147A in those states as long as the offerings comply with the securities laws of such states.

Transfer Restrictions. Securities sold in offerings under state crowdfunding rules are “restricted securities” under federal law and subject to transfer restrictions, including placement of specific language on certificates and in disclosure materials. Restricted securities need to be addressed on a case-by-case basis.

FisherBroyles Corporate and Securities partners are pleased to work with you to discuss your plans for raising capital and the possible use of various exemptions at the state and federal levels.

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