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## Using the Internet to Raise Money: Securities Laws and Crowdfunding Part 2

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In last quarter's Technology Industry Newsletter, we discussed various forms of equity and non-equity crowdfunding including proposed regulations implementing Title III of the JOBS Act, which establishes an equity crowdfunding model involving non-accredited investors. Since our last publication, the Securities and Exchange Commission (SEC), on October 30, 2015, released final rules for this form of crowdfunding, and these new rules will become effective May 16, 2016.

Under Title III of the JOBS Act and the SEC regulations implementing Title III, companies can raise money by selling securities to non-accredited investors and advertise this securities offering in limited ways without having to register the securities issued with the SEC, subject to compliance with many restrictions on both the investors and the companies issuing the securities. The following is a summary of the general framework of the Title III crowdfunding exemption but not a complete statement of the rules.

### Limitations on Investment Amounts

To fit within the Title III crowdfunding exemption:

- The amount raised by the company may not exceed \$1 million in any 12-month period (not including funds raised in offerings other than under the Title III crowdfunding exemption);
- Each investor may invest only up to the following maximum amounts in ALL Title III crowdfunding offerings across all issuers in any 12-month period:
  - if either the investor's annual income or net worth is less than \$100,000, the greater of (a) \$2,000, or (b) 5% of the lesser of annual income or net worth; and
  - if both the investor's annual income and net worth are equal to or exceed \$100,000, the lesser of (a) \$100,000, (b) 10% of annual income or (c) 10% of net worth;

### Offering Must Be Conducted Through an Intermediary

To foster communication and information exchange between potential investors, each Title III crowdfunding offering must be conducted online through a single intermediary's online platform. A crowdfunding intermediary must register as either a broker under the Securities Exchange Act of 1934 or as a funding portal under Title III and the regulations implementing Title III.

Outside the intermediary's platform, the issuer may not advertise its Title III crowdfunding offering except by way of

notices that contain limited information with the intent that potential investors be directed to the intermediary's platform for more information. Within the platform, issuers can communicate with investors regarding the offering terms as long as the issuer identifies itself as the issuer.

### Disclosure Requirements

Prior to commencing a Title III crowdfunding offering, the issuer must complete a Form C, file it with the SEC and make it available to the intermediary and the investors. Form C contains the following information, as well as other disclosures:

- Biographies of the directors and officers of the issuer covering their business experience during the past three years;
- A list of the issuers beneficially owning 20% or more of the issuer's outstanding voting equity securities;
- The issuer's business plan;
- A discussion of risk factors related to the investment;
- A reasonably detailed discussion of intended use of proceeds from the offering;
- A discussion of the issuer's financial condition, including, to the extent material, liquidity, capital resources and historical results of operations;
- Financial information as follows:
  - If the offering amount is \$100,000 or less, (a) financial statements that have been reviewed or audited by an independent public accountant, if available, or (b) both (i) the amount of total income, taxable income and total tax, or the equivalent line items, as reported on the federal income tax returns filed by the issuer for the most recently completed year, and (ii) financial statements of the issuer certified by the principal executive officer of the issuer to be true and complete in all material respects;
  - If the offering amount is more than \$100,000 but not more than \$500,000, financial statements that have been audited by an independent public accountant, if available, or financial statements that have been reviewed by an independent public accountant;
  - If the offering amount is more than \$500,000, financial statements that have been audited by an independent public accountant; however, for issuers that are selling securities under the Title III crowdfunding exemption for the first time, reviewed financial statements are



sufficient if audited financial statements are not available; and

- Any material information necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

After the offering is complete, the issuer must file with the SEC and post on the issuer's web site an annual report that includes much of the same information requested in Form C except that the financial statements do not need to be reviewed or audited (unless such financial statements are available) and some of the offering-specific information does not need to be repeated. The annual reporting requirements terminate in a number of circumstances including after the filing of one annual report if the issuer has less than 300 stockholders of record.

In addition to the time required to prepare disclosures, the issuer's executive officers and director have exposure to liability for any information in the Form C that is materially false or misleading.

#### **Resales of Securities**

The securities purchased in a crowdfunding transaction cannot be resold for a period of one year, unless they are sold (i) to the issuer, (ii) to an "accredited investor", (iii) as part of a SEC registered offering, (iv) to a family member (or trust for the benefit of a family member) of the investor, or (v) in connection with certain events like death or divorce.

Although Title III opens a new avenue for early stage companies to raise money, the restrictions on these types of offerings are extensive.

If you would like more information about crowdfunding offerings, please contact us.



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