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CROWDFUNDING

SEC Adopts "Regulation Crowdfunding"

BY SARA HANKS

On October 30, 2015, the Securities and Exchange Commission ("SEC") voted to adopt "Regulation Crowdfunding" ("Regulation CF").[1] Regulation CF is the set of rules and forms that will implement securities crowdfunding.[2] The SEC was required to adopt these rules under the provisions of Title III of the JOBS Act of 2012.[3] The rules will go into effect on May 16, 2016, although entities that wish to act as broker-dealers and "crowdfunding portals" under Regulation CF will be able to start the application process from the end of January.

The changes from the SEC's proposed rules originally published in October 2013[4] are limited, and those changes generally reduce burdens on the issuer. Of particular note is the fact that first-time issuers under the new rules will not be required to have their financial statements audited, and ongoing reports are not required even to be reviewed by an accountant. Additionally, prospective crowdfunding portals will be pleased that the rules increase the ability of crowdfunding portals to use subjective criteria in deciding which companies' offerings to host on their sites, and also to invest in those offerings. On the negative side, individual investment limits have been lowered in some cases. The most problematic change from the proposed rules is that the exclusion of crowdfunding shareholders from the "shareholder of record" count that triggers full registration with the SEC has become conditional.

Three weeks prior to the SEC adopting its final rules, FINRA, which will oversee the new "funding portals" in addition to broker-dealers, submitted its final Funding Portal Rules to the SEC for final approval.[5]

Section 4(a)(6) of the Securities Act, the "Crowdfunding Exemption"

Offers of securities to the public (which includes offers made over the internet) must be registered with the SEC under the Securities Act of 1933, unless an exemption from registration is available.[6] The JOBS Act added a new exemption to the Securities Act, Section 4(a)(6),[7] to permit securities crowdfunding without registration. The exemption is subject to the following statutory conditions, as further elaborated by the SEC in some cases:

- The aggregate amount sold to "all investors," including any amount sold in reliance on the new exemption, may not exceed $1 million in any 12-month period. The language of the statute (the JOBS Act) suggests that offerings made under other exemptions (Regulation D, for example) might count towards the $1 million limit, but the SEC's view is that since Congress intended crowdfunding to be an additional source of funds for small companies, the limit applies solely to sales under Section 4(a)(6), and that amounts sold under other exemptions will not affect the limit.[8]

[1] Release No. 339974, Oct. 30, 2015 ("Adopting Release").
[2] 17 C.F.R § § 227.100-503.
[3] JOBS Act, Pub. L. No. 112-106, 126 Stat. 306.
[4] Release No. 33-9470, Oct. 23, 2013.

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[5] SR-FINRA-2015-040.
[6] Securities Act of 1933 § 5, 15 U.S.C. § 77e.
[7] Securities Act of 1933 § 4(a)(6), 15 U.S.C. § 77d(a)(6).
[8] Adopting Release, page 15.

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- An investor is limited in the amount he or she may invest in crowdfunding securities in any 12-month period:
  - o If either the annual income or the net worth of the investor is less than $100,000, the investor is limited to the greater of $2,000 or 5% of the lesser of his or her annual income or net worth.
  - o If the annual income and net worth of the investor are both greater than $100,000, the investor is limited to 10% of the lesser of his or her annual income or net worth, to a maximum of $100,000.

  For calculating an investor's net worth, Regulation CF uses the same method as used in Regulation D, which excludes the value of the investor's primary residence. Investors may include their spouse's income for the purposes of the income test.[9] The SEC, faced with an unclear statutory requirement where an investor's net worth and annual income fell into different percentage limits, imposed the ''lesser of'' standard in a change from the proposed rules, which took a ''greater of'' approach to calculating the investment limit.
- The transaction must be made through a broker, or through a ''funding portal'' (a new designation under the Securities Exchange Act of 1934) that meets the requirements set out below.
- The issuer must comply with the disclosure and other requirements set out below.

Requirements for Issuers

Incorporation and Eligibility. The issuer must be incorporated or organized under the laws of a state or territory of the United States, or the District of Columbia. It may not be an ''investment company'' as defined under the Investment Company Act of 1940,[10] and cannot be an SEC-reporting company. ''Blank check'' companies formed for unspecified purposes or to acquire other companies cannot make offerings under Regulation CF. Additionally, the exemption is not available to any issuer that is disqualified by reason of the bad actor disqualification, or if the issuer (or any entities controlled by or under common control with the issuer) has previously offered securities under Regulation CF and failed to file its ongoing reports with the SEC.

The SEC has clarified the language contained in the statutory text of Section 4(a)(6), which provides that the definition of issuer includes all entities controlled by or under common control with the issuer and any predecessors of the issuer.[11] The definition of common control may also have an impact on franchisees. If the franchise agreement controls the issuer and all other franchisees (i.e., has the power to direct or cause the direction of the management and policies of the entity), then all franchisees would be aggregated together when determining amounts offered and sold under Regulation CF and the financial statements to be required.

Disclosure. The SEC requires that issuers provide certain information to investors through the intermediaries' platforms and to the SEC directly through filing Form C on EDGAR, the SEC's data handling system. Form C will consist of XML-fillable fields in the front portion of the Form and then ''Exhibits'' which will include the rest of the information required to be filed. Some information is mandatory, but the issuer may include other information in the Form. The mandatory information for each issuer presents no surprises; it largely tracks the information mandated by the JOBS Act and includes basic information about the issuer, the securities being issued (and any other securities issued by the issuer that might affect the rights of the offered securities) and the offering process.

In response to suggestions made in the comment process, the SEC includes in Form C an optional Question and Answer (''Q&A'') format that an issuer can follow in order to provide the mandatory disclosure not covered by the XML portion of the Form. While this might assist some issuers who have not sought professional advice to make sure that they do not miss any important items, the Q&A itself is quite technical, and uses securities concepts such as ''beneficial owner'' and ''material terms of outstanding classes of securities'' which may be confusing to non-lawyers.

Other than the information about the issuer that is required to be entered into the XML portion of the Form C (which is covers things like name, address, size of offering, etc.), the SEC does not specify the format or medium in which the mandatory disclosure must be presented, leaving flexibility for crowdfunding issuers to present some information in written offering documents, some in videos, and other information by graphic means.

All information about an offering posted on an intermediary's site must be filed with the SEC. The wording of the SEC's original proposals suggested that while the mandatory disclosure would have to be filed on Form C, it might be possible to post on the intermediary's website additional information that did not have to be filed. The SEC has made it clear that this is not the case. All information on the intermediary's site will need to be filed, but the SEC has made that process easier by permitting the filing of data in PDF format (not permitted in other types of SEC filing). Video and audio cannot be filed through EDGAR; a transcript must be filed instead. Not only must all these optional materials be filed, but the issuer (and in some circumstances the intermediary, as discussed in ''Liability'' below) is liable for any misstatements made in them. The SEC does not review, comment on or in any way approve the disclosure.

Financial Statements. The issuer must provide financial statements prepared in accordance with US Generally Accepted Accounting Practices (U.S. GAAP) covering the two most recently completed fiscal years (or shorter period since inception). The type of review that these financial statements have to undergo depends on the amount sought, the amount of securities that the issuer has already sold in reliance on Regulation CF in the preceding 12 months, and whether the issuer has previously sold securities in an offering under Regulation CF:

[9] 17 C.F.R. § 501(a)(5).
[10] 15 U.S.C. § § 80a-1-80a-64.
[11] Adopting Release, page 18.

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- If current offer plus previous raises amounts to $100,000 or less, the financial statements must be certified by the principal executive officer and accompanied by information from the company's tax returns (but not the tax returns themselves).
- If current offer plus previous raises amounts to $100-500,000, the financial statements must be reviewed by a CPA.
- If current offer plus previous raises amounts to $500,000 or more, the financial statements must be audited by a CPA. However, if the issuer has not previously sold securities under Regulation CF, the financial statements will only be required to be reviewed by a CPA.

The financial statements may not be more than 18 months old. If more than 120 days has passed since the end of the most recently-ended fiscal year, the issuer will have to produce financial statements for that most recent year, but until that point could use financial statements from the preceding year. No interim financials are required.

The SEC does not exempt very early-stage companies from these requirements.

Ongoing Disclosure Requirements. Issuers that have sold securities in reliance on Section 4(a)(6) must file information with the SEC and post it on their websites on an annual basis. The annual filing must be made within 120 days of the issuer's fiscal year-end. The information included in the annual report is similar to that required in the initial filing, except that, in response to numerous objections to the burden of ongoing reporting as originally proposed, no accountants' audit or review of the financial statements will be necessary.

Annual filing requirements continue until:

- The issuer becomes a fully-reporting registrant with the SEC;
- The issuer has filed at least one annual report, but has no more than 300 shareholders of record;
- The issuer has filed at least three annual reports, and has no more than $10 million in assets;
- The issuer or another party purchases or repurchases all the securities sold in reliance on Section 4(a)(6); or
- The issuer ceases to do business.

The ability for an issuer to cease filing if it has 300 or fewer holders of record, or assets not exceeding $10 million, is a modification from the proposed rule.

Advertising and Publicity. Pursuant to Section 4A(b)(2) of the Securities Act, an issuer may ''not advertise the terms of the of the offering, except for notices which direct investors to the funding portal or broker.''

Under the new rules, an issuer and any person acting on behalf of the issuer may publish a limited notice (similar to ''tombstones'' in registered offerings) that advertises the terms of an offering so long as the notice includes the address of the intermediary's platform on which information about the issuer and offering may be found. While acknowledging that the statute restricts the ability of potential issuers to advertise, the SEC has explained that restrictions on advertising the terms of the offering are meant to direct the investors to the intermediary's platform. Once at the intermediary platform, the investors will have access to the information that will allow them to make an informed decision about the offering.

A notice advertising the terms of an offering may contain no more than the following (it can contain less):

- A statement that the issuer is conducting an offering, the name of the intermediary conducting the offering and a link to the intermediary's platform;
- The terms of the offering (the amount of the securities being offered, the nature of the securities, the price of the securities, and the closing date of the offering); and
- Factual information about the legal identity, nature of business and location of the issuer.

The rules do not place restrictions on how the issuer distributes these notices, the format of the notice, or its medium. Issuers can use social media, audio, video or street theater, so long as only the permitted content is included.

Under the rules, an issuer is allowed to communicate with investors and potential investors about the terms of the offering through communication channels provided by the intermediary through its platform, so long as the issuer identifies itself as the issuer in all communications.

Issuers may engage third parties to promote the offering in two contexts – through the communication channels provided by the intermediary, and through tombstone notices. Intermediaries are required to create communication channels on their platforms to facilitate discussion between prospective investors and the issuer (see below). Regulation CF anticipates instances where the issuer will have paid a promoter to respond to investors through those communication channels. In that situation, such compensation must be disclosed by the promoter with any communication on the platform. The second context involves payments to third parties for publishing notices that direct to the intermediary's offering page. Regulation CF states that an issuer may not pay a third party to do what it cannot do itself. Paid promoters should also consider whether the disclosure requirements of Section 17(b) of the Securities Act[12] apply to them.

Requirements for Intermediaries

The following requirements apply to both broker-dealers and funding platforms; funding platforms will be subject to some limitations on their activities discussed in ''Special limitations on funding portals'' below.

Registration. A person acting as an intermediary in a transaction involving the sales of securities for someone else pursuant to Section 4(a)(6) must register with the SEC and FINRA.

Obligations With Respect to Fraud Prevention and Compliance. The statute requires intermediaries to take risks to reduce the risk of fraud, and Regulation CF requires intermediaries to take positive action in several areas:

[12] 15 U.S.C. § 77q(b).

- Intermediaries must have a ''reasonable basis for believing'' that the issuer has met the disclosure and process requirements described below. An intermediary may rely on issuer representations to form that reasonable basis for belief. However, the SEC emphasized that an intermediary has a responsibility to assess whether reliance on representations is reasonable, given its course of interactions with potential issuers. This means that the representation must be detailed enough to evidence a reasonable awareness by the issuer of its obligations and its ability to comply with those obligations. As a result, this requirement cannot be met with a simple representation (''checking the box'') that the issuer has complied with Regulation CF, but requires an inquiry into the issuer and the steps it has taken to comply with Regulation CF.
- Intermediaries must have a ''reasonable basis for belief'' that the issuer has established a way to keep accurate records of the holders of securities. As with the reasonable basis for belief as to issuer compliance, the SEC provides that an intermediary may accept representations from an issuer that it has established a means to keep track of securityholders. However, any such representation from the issuer must specifically detail how recordkeeping functions are performed. If the issuer has engaged a registered transfer agent, the intermediary will be deemed to have met this requirement.
- The intermediary must deny access to its platform if it has a reasonable basis to believe that any specified person (officers, directors and 20% shareholders) is subject to a ''Bad Actor'' disqualification.
- The intermediary must deny access to its platform if it has a reasonable basis to believe that the issuer or the offering presents the potential for fraud or otherwise raises concerns about investor protection. The intermediary must be able to adequately and effectively assess the risk of fraud from the issuer or its offering, and may not ignore facts about the issuer that indicate fraud or investor protection concerns.

Account Opening and Notices. An intermediary may not accept any investment commitment from investors in a transaction under Regulation CF, until that investor has opened an account with the intermediary and consented to electronic delivery of materials.

At the time that an investor opens an account with an intermediary, the intermediary must inform the investor that anyone who promotes an offering in exchange for compensation, or who is a founder or an employee of an issuer promoting the issuer through the communication channels on the platform must disclose the fact that he or she is engaging in promotional activities on behalf of the issuer.

Intermediaries must also disclose the manner in which they will be compensated (e.g., flat fee, commission, equity interest, etc.).

Provision of Educational Materials. As part of the statutory requirements for offerings under Section 4(a)(6), intermediaries are required to provide disclosures and investor educational materials. Regulation CF requires these educational materials to be provided to investors at the time they open accounts with intermediaries. Regulation CF further requires that the materials be written in plain language and otherwise designed to communicate effectively specified information. These materials are required to cover the types of securities to be offered on the intermediary's platform, the process for investing, investors' rights and the risks involved in crowdfunding.

Acknowledgement of Risk. Prior to accepting any investor commitments for any particular offering (even for a repeat transaction by the investor), intermediaries must receive a representation from the investor that the investor has reviewed the educational materials and understands that the entire amount of the investment is at risk and may be lost. Additionally, intermediaries must require investors to complete a questionnaire that demonstrates the investor's understanding as to his or her rights and the risk involved.

Intermediary Must Make Issuer Information Available. During the course of an offering, the intermediary must make the issuer's required disclosure information publicly available on the intermediary's website. This information must be available for at least 21 days prior to any sale of securities and displayed in a manner that allows for any visitor, including regulators, to access, download, and save.

Investor Qualifications. Intermediaries are responsible for ensuring an investor stays within the annual investment limit. To comply with this requirement, intermediaries must have a reasonable basis for believing that the investor satisfies his or her annual investment limit. An intermediary may rely on investor representations concerning the investor's annual income, net worth, and the amount of the investor's other investments made under Section 4(a)(6).

Communication Channels for Issuers and Investors. Regulation CF is designed on the premise that crowdfunding requires the crowd to be able to communicate with each other and with the issuer to evaluate the investment opportunity. As such, the final rules require that the intermediary establish communication channels on the intermediary's platform to provide a centralized and transparent means for members of public to asset the investment offering.

Providing Notices to Prospective Purchasers. Upon receipt of an investment commitment, the intermediary must provide the investor with a notification confirming the details of the commitment and how the investor may cancel the investment.

Transmission or Maintenance of Funds From Investors. The rules pertaining to transmission of funds under Regulation CF vary based on the status of the intermediary as a registered broker-dealer or funding portal. Broker-dealers must comply with existing regulations set out in Rule 15c2-4.[13] Funds must be promptly deposited into a separate bank account until the close of the offering when they are promptly transmitted to the issuer.

Funding portals, which are prohibited from handling funds or securities, must direct funds to a qualified third-party that has agreed to hold the funds in escrow, with qualified third parties such as a registered broker-dealer, bank or credit union; and direct the qualified third party to transmit funds to the issuer or return

[13] 17 C.F.R. § 240.15c2-4.

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funds to the investor depending on the result of the offering.

Confirmation of Transactions. Intermediaries are responsible for sending notice to investors confirming the completion of the transaction. Those notices must disclose pertinent details of the transaction.

Intermediary Responsibility for Cancellations And Reconfirmations. At various times during an offering, the intermediary may be responsible for reconfirming an investment commitment with investors or cancelling the investment commitment. In the event than an issuer makes a material change to the terms of an offering or to the information provided by the issuer, intermediaries are required to contact investors that have made a commitment and request the investor re-commit to the investment in light of the new information. This confirmation must be received within five days or else the investment commitment must be cancelled by the intermediary. If the intermediary was required to cancel the investment commitment, it must then send a notice of the cancellation to the investor and direct a refuse of the investor's funds. In the case of a material change occurring within five days of the target end of the offering established by the issuer, the officer must be extended to allow five full business days for the investor to recommit to the investment.

If an issuer does not raise the target funds by the deadline it established, the intermediary has five days to provide investors with notice of the cancellation of the investment commitment, direct the refund of investor funds, and prevent investors from committing any additional funds to the offering.

Protect the Privacy of Information Collected From Investors . The statutory language of Section 4A(a)(9) of the Securities Act requires that intermediaries protect the privacy of information collected from investors. Rather than creating new privacy rules, the SEC adopted rules to clarify that broker-dealers and funding portals are required to comply with Regulation S-P, Regulation S-ID, and Regulation S-AM.[14] Taken together, these regulations obligate intermediaries to have policies and procedures in place to protect nonpublic information about investors, prevent identify theft, and limit the information shared with affiliates.

Limitation on Payments to Finders. An intermediary in an offering under Section 4(a)(6) is prohibited from compensating finders or any person for providing personally identifiable information on any investor or potential investors.

Financial Interest in Issuers. By statute, the directors, officers, or partners of an intermediary are prohibited from having a financial interest in an issuer using its services. The SEC clarified the way in which this prohibition applies to the intermediary itself. An intermediary may receive a financial interest in the intermediary as a form of compensation for the services performed by the intermediary; the financial interest must be of the same class and at the same terms as the securities being sold under Section 4(a)(6).

Special Limitations on Funding Portals

Under the Securities Exchange Act and Regulation CF, funding portals are limited purpose broker-dealers that may assist issuers in the offering and sale of securities subject to certain limitations on their activities. The statutory prohibitions on funding portals include:

- Paying for finding potential investors;
- Giving investment advice or recommendations;
- Soliciting offers or sales to buy the securities offered on their portal;
- Compensating anyone for such solicitation or based on the sale of securities on their portal;
- Holding or managing funds; and
- Permitting their officers, directors or partners to have a financial interest in an issuer using their services.

The SEC provided additional clarification of the statutory limitations by creating a conditional safe harbor for funding portals. Under the conditional safe harbor, funding portals may:

- Determine whether and under what terms to allow an issuer to offer securities on the funding portal's platform;
- Apply objective criteria to highlight offerings on the platform;
- Provide search functions for investors to search and sort offerings based on objective criteria;
- Provide communication channels that allow the issue to communicate with investors and potential investors;
- Advise issuers on the structure and content of the offering;
- Compensate third parties for referring persons to the portal and other services, so long as the referral does not include personally identifiably information of any potential investor and the compensation is not transaction based unless the party is a registered broker-dealer;
- Pay or offer to pay compensation to a registered broker-dealer for services;
- Receive compensation from a registered broker-dealer;
- Advertise the existence of the funding portal and identify one or more issuers using objective criteria to determine which issuers to identify;
- Deny access to the funding portal's platform if the funding portal has a reasonable basis for believing that the issuer presents the potential for fraud;
- Direct investors where to transmit funds for the purchase of securities; and
- Direct third-parties to release funds to issuers or return funds to investors.

In its proposed rules, the SEC expressly prohibited funding portals from ''curating'' offerings, as such subjective curation would be investment advice — an activity prohibited to funding portals by statute. In the final rules, the SEC relaxed this requirement by providing

[14] 17 C.F.R. § 248.

funding portals the ability to determine whether and under what terms to allow issuers onto their platforms so long as curation does not result in the provision of investment advice. Curation by the funding portal may not, for example, support a claim that the issuers on the platform ''are safer or better investments''.

Funding portals may enter into certain agreements with registered broker-dealers where they can pay each other for services. The proposed rules permit a funding portal to pay or offer to pay a registered broker-dealer for services in connection with an offering made in reliance on Section 4(a)(6). In addition, the SEC allows funding portals to provide services and be paid by a registered broker-dealer in connection with the funding portal's offer or sale of securities in reliance on Section 4(a)(6). However, the final rules do not allow a funding portal to receive compensation for referrals of investors in offerings made other than in reliance on Section 4(a)(6). This is relevant in the case of an issuer pursuing concurrent offerings under Section 4(a)(6) and Rule 506(c). The funding portal may not receive commissions for referring accredited investors to a broker-dealer managing the Rule 506(c) offering.

Funding portals are subject to limitations on publicity that do not apply to broker-dealers (which have pre-existing and strict rules about advertising and the use of social media). A funding portal is permitted to advertise its own existence and to identify issuers or offerings in its advertisements based on objective criteria that would identify a large selection of issuers; it cannot be paid specific compensation for identifying or highlighting an issuer or offering in its advertisements.

Relief for Insignificant Deviations

The statutory and regulatory requirements for crowdfunding issuers and intermediaries are complex and extensive, and inexperienced issuers may innocently fail to comply with them. The SEC has adopted a three-prong test that would provide issuers a safe harbor for insignificant deviations from a term, condition, or requirement of Regulation CF.

In order to qualify for the safe harbor under proposed Rule 502, the issuer relying on the exemption in Section 4(a)(6) must show:

- The failure to comply with a term, condition, or requirement was insignificant with respect to the offering as a whole;
- The issuer made a reasonable and good faith effort to comply with all terms, conditions, and requirements of Regulation CF; and
- The issuer did not know of the failure to comply, where the failure to comply with a term, condition or requirement was the result of the failure of the intermediary to comply with the requirements of Section 4A(a) and the related rules, or such failure by the intermediary occurred solely in offerings other than the issuer's offering.

So long as the issuer acted in good faith while attempting to comply with the rule, the issuer should not lose the Section 4(a)(6) exemption just because there was a failure to comply with the rule that was insignificant in light of the offering as a whole.

Liability

The statutory language expressly set out the liability imposed on issuers for making false or misleading statements and omissions. Section 4A(c) of the Securities Act, added by the JOBS Act, provides that an issuer, including its officers and directors, will be liable to the purchaser of its securities in a transaction under Section 4(a)(6) if the issuer makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in light of the circumstances under which there were made, not misleading. The company and its officers and directors bear the burden of proof with this respect to this liability: they must show that they did not know, and in the exercise of reasonable care, could not have known of the misleading statement or omission.

The statutory language applies this liability to ''any person who offers or sells the security in such offering.'' The SEC (applying interpretation set out in a Supreme Court case) originally noted that on the basis of this definition, intermediaries, including funding portals, would be subject to this liability. While many commenters objected to this interpretation, the SEC declined to retract the statement or to create an exemption from liability for funding portals (or any intermediaries). The SEC states that the status of an intermediary as ''issuer'' will depend on a facts and circumstances analysis. The SEC points out that there are appropriate steps that intermediaries might take in order to rely on the ''reasonable care'' defense provided by Congress. These steps may include establishing policies and procedures reasonably designed to achieve compliance with Regulation CF, conducting a review of the issuer's offering documents before posting them to the platform, to evaluate whether they contain materially false or misleading information. CrowdCheck can help with these processes.

Issuers and intermediaries should be aware that the JOBS Act and Regulation CF do not limit liability associated with other anti-fraud rules and statutes of the securities laws that already exist. For instance, issuers will continue to face liability for manipulative or deceptive practices or misleading statements under Rule 10b-5. Additionally, intermediaries, issuers, and anyone who ''willfully participates'' in an offering could be liable for false or misleading statements made to induce a securities transaction under Section 9(a)(4) of the Exchange Act.[15]

There has been little discussion of the impact of the Supreme Court 2011 *Janus* decision on potential intermediary liability.[16] This decision examined what it means to ''make'' a misleading statement under Rule 10b-5, which has many common elements with Section 4A(c).

Simultaneous Accredited and Crowdfunding Offerings

The SEC makes clear its position that that an offering made in reliance on Section 4(a)(6) should not be integrated with another exempt offering. ''Integration''

[15] 15 U.S.C. § 78i(a)(4).

[16] *Janus Capital Group, Inc. v. First Derivative Traders*, 564 U.S. ___ (2011).

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means treating two different offerings made at the same time as if they were one offering, subject to all the conditions of both offerings. Because the SEC will not automatically integrate Section 4(a)(6) offerings with other offerings, an issuer may make a Section 4(a)(6) offering that occurs simultaneously with, or is closely preceded or followed by an offering made under Regulation D.[17] While the offers will not be integrated, an issuer must take care that if the Regulation D exemption prohibits general solicitation (e.g. Rule 506(b)), purchasers in that offering may not be solicited by the Section 4(a)(6) offering. Similarly, if the other exemption allows for general solicitation (e.g., Rule 506(c)), then those general solicitations may not include advertisements prohibited under Section 4(a)(6).

It seems likely that ''side-by-side'' offerings, made to ''accredited'' investors under Rule 506(b) or 506(c) alongside offerings to unaccredited friends and family in reliance on Section 4(a)(6), will become popular. Rule 506 does not mandate specific disclosure, but the mandatory information requirements would be relatively easy to comply with for most issuers making a Rule 506 offering, and the modest additional costs would be more than offset by the goodwill engendered by including customers and early supporters. In particular, the disclosure requirements under Regulation CF are easier to comply with than the requirements that would apply if non-accredited investors were to be included in an offering under Rule 506(b). Side-by-side offerings of this type may be most easily undertaken by fully-registered broker dealers, who would be able to charge commissions for both the accredited and non-accredited investors.

State Law

Under the JOBS Act, the states are pre-empted from requiring registration of Section 4(a)(6) offerings, but there is no restriction of their ability to take enforcement action with respect to fraud or deceit by issuers, brokers or funding portals. States may impose fees if they are the principal place of business of the issuer or if more than half the purchasers of a crowdfunding offering are in that state. A funding portal's home state may regulate the portal, but cannot impose different or additional rules.

Resale Restrictions

Securities issued pursuant to Section 4(a)(6) are not freely transferrable by the purchaser for one year after the date of purchase. The statutory text outlines four situations in which a transfer may be made prior to the end of the one-year period; the SEC did not significantly alter these provisions in its Rule 501. Prior to the end of one year, transfers may be made:

- To the issuer of the securities;
- To an accredited investor;
- As part of an offering registered with the SEC; or
- To a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser, or in connection with the death or divorce of the purchaser.

The SEC clarified that the restrictions on transfer apply to all holders during the one-year period, whether they purchased their securities from the issuer or in a secondary transaction. It should be noted that the JOBS Act pre-emption of state regulation applies only to the initial offer and sale of securities by the issuer. After the end of the statutory restriction on transfer, investors would likely be able to transfer their securities to someone else without registration at the federal level, in reliance on Section 4(a)(1) of the Securities Act.[18] However, subsequent trades must also be made in accordance with state law (which is only preempted when the issuer is a full SEC-reporting company), and the law varies widely from state to state with respect to how securities of non- public companies can be resold. Crowdfunding securities will thus be extremely illiquid.

Crowdfunding Securities and Registration Under the Exchange Act

The Exchange Act typically requires companies to become reporting companies under the Exchange Act when their shares are held of record by 2,000 persons or 500 persons who are not accredited investors and assets exceed $10 million.[19] Recognizing that offers under Section 4(a)(6) are likely to bring in many shareholders, the JOBS Act exempts Section 4(a)(6) securities from the shareholder threshold. The SEC interpreted the statute in Rule 12g-6 to provide that all securities issued pursuant to a Section 4(a)(6) offering would be exempted from the holders-of-record count under the Exchange Act. In other words, the exemption follows the security, not the purchaser. Issuers will have to make sure their securities sold under Section 4(a)(6) bear clear identification as such. In a change from the proposed rules, the exemption from record holder count is conditional upon:

- The issuer being current in its ongoing reporting obligations;
- The issuer not having assets more than $25 million; and
- The issuer engaging a transfer agent registered with the SEC to keep its books.

This conditionality may prove problematic to issuers whose operations (and thus assets) grow rapidly, although the SEC grants them a two-year period in which to transition to full reporting status. Since the ''insignificant deviations'' provisions do not apply to Section 12(g), small companies (by their nature prone to missing regulatory deadlines) will have to be very careful to meet annual report filing deadlines. This may be the single most problematic aspect of the new regulation.

[17] 17 C.F.R § 230.501 et seq.

[18] 15 U.S.C. § 77d(a)(1).

[19] 15 U.S.C. § 78l(g).