

## *Demystifying the Recently Enacted Crowdfunding and Private Offering Reforms: Opportunities for Issuers and Investors*

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The Senate and House have recently passed, and President Obama shortly is expected to sign into law, the Jumpstart Our Business Startups Act of 2012, or JOBS Act, a series of deregulatory reforms that are intended to facilitate capital formation in the United States.<sup>1</sup> The JOBS Act's crowdfunding and private offering reforms represent historically significant deregulatory changes to the Securities Act of 1933, a law that as previously administered by the Securities and Exchange Commission has placed significant impediments on the ability of startups and established enterprises to solicit investment capital from investors in the United States. The reforms create new alternatives pursuant to which eligible enterprises may solicit the general investing public through crowdfunding offerings as well as through private offerings conducted with general solicitation or advertising. In effect, the legislation turns on its head the prevailing orthodoxy embodied in the Securities Act and SEC regulatory policy, an orthodoxy many have asserted has unnecessarily constrained enterprises in their efforts to raise seed and growth capital through non-public offerings exempt from registration with the SEC.

Freed from the restraints imposed by the SEC's historical orthodoxy, capital seeking enterprises will be able to engage in heretofore prohibited general solicitation of individual and institutional investors with whom they do not otherwise have a prior substantive relationship. The JOBS Act crowdfunding and private offering reforms will enable market innovators to radically transform how venture and other capital is raised in the United States. On the flip side of the coin, the reforms will also expand opportunities for investment by both accredited and non-accredited investors alike, particularly in early stage enterprises, democratizing an area of investment for which ordinary investors have been excluded. Intermediaries will be able to use emerging social networking technologies to organize communities of angel investors to more efficiently deploy this important source of capital.

We discuss what these reforms mean for issuers and investors through the questions and answers presented below.

## I. Frequently Asked Questions concerning Crowdfunding Reforms

### ***How do the reforms facilitate crowdfunding capital formation?***

Crowdfunding involves fundraising through securities offerings directed to the general public, at large, through the internet and other mass communications media. Under existing securities law, an offer made to the general public is considered a “public offering” that must be registered with the SEC in accordance with the Securities Act, and unless applicable state securities laws are otherwise preempted, must be registered or qualified with the securities regulator of each state in which the offering is conducted. This regulatory regime practically precludes crowdfunding by startups and private emerging growth companies. Simply stated, the JOBS Act carves out a crowdfunding exemption from this regulatory regime by adding a new transaction exemption in Section 4 of the Securities Act. With this exemption contained in new Section 4(a)(6) of the Securities Act<sup>2</sup> (and preemption of related state securities laws), issuers and their intermediaries are free to engage in crowdfunding activities that what would otherwise be characterized as public offerings requiring registration under the Securities Act.

### ***Are all issuers eligible to rely on the crowdfunding exemption?***

No. The crowdfunding exemption is not available to foreign issuers, SEC reporting issuers and certain investment companies. By its terms, the exemption excludes from eligibility an issuer that:

- is not organized under the laws of a state or territory of the United States or the District of Columbia;
- is subject to reporting requirements pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934;
- is an investment company, as defined in Section 3 of the Investment Company Act of 1940; or
- is excluded from the definition of investment company by Section 3(b) or Section 3(c) of the Investment Company Act of 1940.

As a result, publicly traded companies (with the exception of those that have gone dark and ceased SEC reporting) may not engage in crowdfunding exempt offerings. Similarly, private funds excluded from regulation as an investment company under Section 3(c)(1) or 3(c)(7) of the Investment Company Act (whether formed as a pool investment vehicle or a conduit formed for investment in a particular issuer) may not rely on the crowdfunding exemption. The SEC has been delegated the rulemaking authority to exclude from eligibility other companies as it may determine appropriate.

### ***Can issuers and their intermediaries engage in unrestricted general solicitation and advertising in connection with crowdfunding exempt offerings?***

No. While issuers and their intermediaries are free to provide the general public with unrestricted access to the online platform through which the securities are offered, they may not advertise the offering except with notices that direct investors to relevant broker or funding portal. This will preclude the use of detailed offering specific blast emails and faxes, mass mailed tout sheets and similar communications that promote the investment. However, as a commercial matter, intermediaries will compete on the basis of quality of service and would be able to promote their crowdfunding investment services to investors and potential crowdfunding offering candidates as long as they avoid highlighting particular investment opportunities. We expect the SEC to expand upon this restriction as it relates to offering specific information and specify the permissible content of such notices, and in

doing so the SEC may draw from its experience with Rule 134 under the Securities Act, a rule which permits specified communications (e.g., tombstone notices) in connection with registered public offerings.

***Are issuers required to conduct crowdfunding exempt offerings through intermediaries?***

Yes. Crowdfunding exempt offerings may not be conducted by the issuer directly through its own website. The exemption requires crowdfunding offerings to be conducted through SEC regulated brokers or funding portals, the latter of which, as discussed below, will be subject to registration and regulation under a separate regulatory regime established in the legislation.

***How much capital can an issuer raise through the crowdfunding exemption?***

Issuers can sell up to \$1,000,000 aggregate amount of securities, including the amount of securities sold through crowdfunding exempt offerings during the preceding 12 month period.

***Does the crowdfunding exemption impose limits on the number of investors that can invest?***

No. There is no limit on the number of investors that can invest, and in fact, as discussed below, investors that become securityholders through crowdfunding exempt offerings are excluded when calculating the number of record holders under Section 12(g) of the Securities Exchange Act.

***Does the crowdfunding exemption impose limits on how much any investor can invest?***

Yes, the crowdfunding exemption limits how much an investor may invest based on the investor's annual income or net worth and includes for purposes of calculating the limit all crowdfunding exempt investments made in the 12-month period preceding the investment in question. The limits are as follows:

- for investors with either an annual income or net worth less than \$100,000, the amount invested may not exceed the greater of \$2,000 or 5% of the investor's annual income or net worth; and
- for investors with either an annual income or net worth of at least \$100,000, the amount invested may not exceed 10% of the investor's annual income or net worth up to a \$100,000 maximum aggregate amount.

The crowdfunding exemption also imposes a requirement on intermediaries to make such efforts as the SEC may determine appropriate to ensure that no investor in the prescribed preceding 12-month period has purchased crowdfunding exempt securities from all issuers that exceed the individual investment limits described above. It is unclear whether an intermediary's compliance failure that results in a single investor's aggregate crowdfunding investments in the securities of all issuers in excess of the prescribed individual investment limit will lead to a loss of the crowdfunding exemption. We expect the SEC to clarify the consequences to a particular issuer's exemption in the event an investor's investments exceed the applicable individual aggregate investment limit.

***How do you determine an investor's annual income and net worth?***

They are required to be calculated in the same manner as prescribed in SEC regulations for determining accredited investor status.

***What conditions must issuers and intermediaries satisfy in order to conduct compliant crowdfunding exempt offerings?***

One of the initial criticisms of the original crowdfunding bills introduced during the legislative process centered on the lack of provisions in the bills that would advance the historical investor protection goals of the federal securities laws. Ultimately, the Senate advanced an amendment to the JOBS Act bill that was passed by Congress which addresses these investor protection concerns. The crowdfunding exemption does so by requiring compliance with prescribed disclosure, investor education and other substantive conditions by the issuer and its intermediating broker or funding portal. We expect the SEC to prescribe some form of filing that can be submitted electronically to facilitate compliance with the disclosure conditions.

***What regulatory conditions are applicable to issuers?***

- Issuers must file with the SEC and provide to investors and the relevant broker or funding portal the following information:
  - the name, legal status, physical address, and website address of the issuer;
  - the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;
  - a description of the business of the issuer and the anticipated business plan of the issuer;
  - a description of the financial condition of the issuer, including, for offerings that, together with all other crowdfunding exempt offerings within the preceding 12-month period, targeted offering amounts of:
    - \$100,000 or less, the income tax returns filed by the issuer for the most recently completed year (if any) and financial statements of the issuer, certified by the principal executive officer to be true and complete in all material respects;
    - more than \$100,000, but not more than \$500,000, financial statements reviewed by an independent public accountant, using professional standards and procedures for or standards and procedures set by the SEC; and
    - more than \$500,000 (or such other amount as the SEC may establish), audited financial statements
  - a description of the stated purpose and intended use of the proceeds of the offering;
  - the target offering amount, the deadline to reach the target offering amount, and regular updates regarding the progress of the issuer in meeting the target offering amount;
  - the price to the public or the method for determining the price, provided that, prior to sale, each investor must be provided in writing the final price and all

- required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities;
- a description of the ownership and capital structure of the issuer, including
    - terms of the securities of the issuer being offered and each other class of security of the issuer, including how such terms may be modified, and a summary of the differences between such securities, including how the rights of the securities being offered may be materially limited, diluted, or qualified by the rights of any other class of security of the issuer;
    - a description of how the exercise of the rights held by the principal shareholders of the issuer could negatively impact the purchasers of the securities being offered;
    - the name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer;
    - how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions;
    - the risks to purchasers of the securities relating to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related parties; and
    - such other information as the SEC may prescribe, for the protection of investors and in the public interest.
  - Issuers must not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal unless in compliance with SEC rules requiring such person disclose the receipt, past or prospective, of such compensation.
  - Issuers must, not less than annually, file with the SEC and provide to investors reports of their results of operations and financial statements as the SEC may determine appropriate, subject to exceptions and termination dates as the SEC may establish.
  - Issuers must comply with such other requirements as the SEC may prescribe for the protection of investors and in the public interest.

***What regulatory conditions are applicable to intermediaries?***

- Intermediaries must register with the SEC as a broker or as a funding portal (a new category of regulated entity defined in Section 3(a)(80) of the Securities Exchange Act which was added to such Act as part of the JOBS Act crowdfunding reforms).
- Intermediaries must register with any applicable self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act).
- Intermediaries must provide such disclosures, including those related to risks and other investor education materials, as the SEC may determine appropriate.

- Intermediaries must ensure that each investor:
  - reviews investor-education information, in accordance with standards established by the SEC;
  - positively affirms that the investor understands that the entire investment is subject to the risk of loss, and that the investor has to bear such a loss; and
  - answers questions demonstrating:
    - an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;
    - an understanding of the risk of illiquidity; and
    - an understanding of such other matters as the SEC may determine appropriate.
- Intermediaries must take such measures to reduce the risk of fraud with respect to such transactions, as established by the SEC, including obtaining a background and securities enforcement regulatory history check on each officer, director and greater than 20 percent equity holder.
- Intermediaries must not later than 21 days prior to the first day on which securities are sold to any investor (or such other period as the SEC may establish), make available to the SEC and to potential investors any information provided by the issuer as described above.
- Intermediaries must ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, and allow all investors to cancel their commitments to invest, as the SEC may determine appropriate.
- Intermediaries must make such efforts as the SEC may determine appropriate to ensure that no investor in a 12-month period has purchased crowdfunding exempt offered securities that, in the aggregate, from all issuers, exceed the investment limits set forth above.
- Intermediaries must take such steps to protect the privacy of information collected from investors as the SEC may determine appropriate.
- Intermediaries must not compensate promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor.
- Intermediaries must prohibit their directors, officers, or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using their services.
- Intermediaries must meet such other requirements as the SEC may prescribe, for the protection of investors and in the public interest.

Does an intermediary's failure to satisfy the foregoing requirements negate the issuer's exemption from registration? Will it separately expose the intermediary to SEC enforcement action? We expect

the SEC to clarify the consequences to an issuer's exemption in the event an intermediary fails to comply with the foregoing requirements.

***What is a funding portal within the meaning the new statutory definition?***

Section 3(a)(80) added by the JOBS Act defines a "funding portal" as any person engaged in the business of effecting transactions in securities for the account of others, solely pursuant to the crowdfunding exemption contained in new Section 4(a)(6) of the Securities Act, that does not:

- offer investment advice or recommendations;
- solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal;
- compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;
- hold, manage, possess, or otherwise handle investor funds or securities; or
- engage in such other activities as the SEC may determine appropriate.

Under current law, brokers or dealers operating in the over-the-counter market must register as brokers or dealers under the Securities Exchange Act and become members of a registered securities association, a form self regulatory organization. The Financial Industry Regulatory Authority, Inc., or FINRA, is the sole registered securities association in existence today. In the absence of the crowdfunding reforms, funding portals would otherwise be deemed brokers required to register as such under the Securities Exchange Act. The crowdfunding reforms address this regulatory requirement by establishing a special exemption from broker-dealer registration that would subject crowdfunding industry participants to ongoing regulation and oversight tailored to the nature of their activities.

New Section 3(h) of the Securities Exchange Act requires the SEC to exempt a registered funding portal from the requirement to register as a broker or dealer, provided that the funding portal:

- remains subject to the examination, enforcement, and other rulemaking authority of the SEC;
- is a member of a national securities association registered under Section 15A of the Securities Exchange Act (such as FINRA or any new association organized by the crowdfunding industry); and
- is subject to such other requirements under this title as the SEC may determine appropriate under such rule.

The JOBS Act also makes corresponding amendments to provisions of the Securities Exchange Act that govern national securities associations and required membership in such associations that, when considered with the foregoing, will effectively require funding portals to become members of FINRA, unless operators of funding portals otherwise organize and register their own national securities association. At least one group, the Crowdfund Intermediary Regulatory Association, has announced plans to pursue registration as a national securities association.<sup>3</sup> Absent such organizing efforts by the emerging crowdfunding industry, amendments to FINRA's rules will be necessary in order to allow funding portals to become FINRA members. A FINRA official has advised us that the organization is studying the JOBS Act and has made no decision with respect to initiating the necessary rulemaking to



allow funding portal membership in FINRA, and it remains to be seen whether the SEC will mandate the adoption of FINRA rules to accommodate funding portal membership. If the FINRA rules are so amended, FINRA's examination and enforcement authority over registered funding portals will extend only to FINRA rules written specifically for funding portals.

The SEC is required to adopt implementing regulations within 270 days after the date of enactment. It remains to be seen whether the SEC will mandate changes to FINRA's rules, or whether any such mandated or FINRA-initiated rulemaking will be completed within the timetable set for the required SEC rulemaking.

### ***What liability regime governs crowdfunding exempt offerings?***

Issuers and their intermediaries participating in crowdfunding exempt offerings will be subject to a liability regime that imposes a private right of action which is nearly identical to that provided in Section 12(a)(2) of the Securities Act. New Section 4A(c)(2) of the Securities Act provides that an "issuer" will be subject to liability if it:

- by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by any means of any written or oral communication, in the offering or sale of a security in a transaction exempted by the provisions of Section 4(a)(6), 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 the light of the circumstances under which they were made, not misleading, provided that the purchaser did not know of such untruth or omission; and
- does not sustain the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.

Investors in crowdfunding offerings may institute actions for rescission or damages. Significantly, as is the case with liability under Section 12(a)(2) of the Securities Act for public offerings, defendants can defeat liability if they can demonstrate an adequate due diligence defense, *i.e.*, that they have conducted a reasonable investigation as has been developed by the federal courts in their interpretation of Section 12(a)(2) of the Securities Act.<sup>4</sup>

Section 4A(c)(3) of Securities Act contains an expansive definition of the term "issuer" for purposes of the liability provisions. The term "issuer" includes any person who is a director or partner of the issuer, and the principal executive officer or officers, principal financial officer, and controller or principal accounting officer of the issuer (and any person occupying a similar status or performing a similar function) that offers or sells a security in crowdfunding exempt offering, and any person who offers or sells the security in such offering.

Since crowdfunding offerings are expressly exempt from registration, issuers and their intermediaries will not be subject to liability under Section 11 of the Securities Act for any disclosure defects contained in a registration statement. As is the case with any securities transaction, crowdfunding exempt offerings also will be subject to the general anti-fraud provisions of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.



***How are investors in crowdfunding exempt offerings treated for purposes of calculating the number of record holders triggering registration under Section 12(g) of the Securities Exchange Act?***

Section 12(g) of the Securities Exchange Act in its form prior to the enactment of the JOBS Act mandates that private issuers with 500 or more holders of record of their securities and more than \$10 million in assets register as public reporting issuer and comply with ongoing SEC periodic reporting requirements. As has been widely reported with respect to Facebook, Inc.'s challenges in remaining a private company, the 500 holder threshold has been a burden on many private enterprises. Other provisions of the JOBS Act raise the holder of record threshold triggering reporting requirements to either 2,000 or 500 (for holders that are not accredited investors as defined in SEC regulations) and exclude from the threshold's calculation any employees holding only securities issued under equity compensation plans.

The crowdfunding reforms also amend Section 12(g) to require the SEC to exempt from Section 12(g), conditionally or unconditionally, securities acquired in crowdfunding exempt offerings.

***Can state blue sky regulators regulate crowdfunding offerings?***

State blue sky registration, documentation and offering requirements that would otherwise apply to crowdfunding exempt offerings are preempted. The JOBS Act amends Section 18(b)(4) of the Securities Act to add to the list of covered securities for which preemption applies securities that are the subject of crowdfunding offerings exempt under Section 4(a)(6) of the Securities Act. However, this amendment does not affect any state's enforcement authority over an issuer, broker, dealer, or funding portal for fraud or deceit or unlawful conduct in crowdfunding exempt offerings or the filing or fee requirements of the securities regulator of the state in which the issuer maintains its principal place of business or in which purchasers of 50% or greater of the aggregate amount of the securities issued are residents.

In addition, the JOBS Act preempts state blue sky regulation of registered funding portals, except that the state where the funding portal maintains its principal place of business will retain enforcement and examination authority, but only to the extent any law, rule, regulation or administrative action is not in addition to or different from the requirements established by the SEC for registered funding portals.

***What resale restrictions apply to securities acquired in crowdfunding exempt offerings?***

Securities sold in crowdfunding exempt offerings are not transferable by the purchaser for a one-year period beginning on the date of purchase, except such securities may be transferred:

- to the issuer,
- to an accredited investor,
- as part of an offering registered with the SEC; or
- to a member of the purchaser's family or the equivalent, or in connection with the purchaser's death or divorce or other similar circumstance, in the discretion of the SEC.

The SEC is authorized to impose other restrictions.

It is unclear whether for purposes of Rule 144 under the Securities Act securities issued in crowdfunding exempt offerings will be deemed a public offering by the SEC. If not deemed a public offering, such securities will be considered "restricted securities" within the meaning of Rule 144.

Under Rule 144, after the one-year holding period lapses, non-affiliates of the issuer will be permitted to sell freely transfer or sell their securities.

***How "bad actors" are treated under the crowdfunding reforms?***

Like other provisions of the federal securities laws, "bad actors" (e.g., persons barred from engaging in the business of securities, insurance or banking) are disqualified from relying on the crowdfunding exemption.

***When will the crowdfunding reforms be effective?***

Numerous provisions of the JOBS Act crowdfunding reforms require implementing SEC regulations, including, among other things, rules with respect to the content, filing and dissemination of issuer and intermediary required disclosures, the exclusion of crowdfunding investors as holders of record for Section 12(g) Securities Exchange Act registration purposes and funding portal registration. The JOBS Act requires the SEC to adopt the implementing regulations within 270 days after the date of enactment.

**II. Frequently Asked Questions concerning Private Offering Reforms**

***How do the private offering reforms expand opportunities for capital formation under the Regulation D private offering exemption?***

Since its adoption in the 1980s, numerous enterprises, both public and private, have relied on Regulation D under the Securities Act to raise debt and equity capital in U.S. private capital markets. Regulation D provides a non-exclusive safe harbor from registration of the offering with the SEC. Many enterprises have conducted their private offerings in reliance on Rule 506 of Regulation D, which permits offerings to an unlimited number of accredited investors in an unlimited dollar amount, provided that, the issuers comply with the conditions set forth in the regulation. One key condition prohibits the issuer or any person acting on its behalf from offering or selling securities by any form of general solicitation or general advertising, including, but not limited to (i) any advertisement, article, or other published or broadcast communication or (ii) any seminar or meeting whose attendees have been invited by general solicitation or advertising. This prohibition on general solicitation also implicates private offerings conducted in reliance on Rule 144A under the Securities Act since issuers initially place their securities (intended for resale by initial purchasers to qualified institutional buyers, or QIBs) in reliance on the statutory private placement exemption contained in Section 4(2) of the Securities Act or Regulation D. Market participants have advocated to the SEC for well over a decade that the prohibition on general solicitation be removed provided that the ultimate sales are made to accredited investors or QIBs.

The JOBS Act requires the SEC to amend Rule 506 and Rule 144A within 90 days of enactment to allow general solicitation or advertising, even to the extent it reaches non-accredited investors, so long as the issuer takes reasonable steps to ensure that any actual sales of securities are made to accredited investors or QIBs, as applicable. Armed with the ability to engage in general solicitation or advertising, issuers and their intermediaries will be able to reach more investors.

***How do the private offering reforms benefit broker-dealers offering securities on behalf of issuers?***

Since general solicitation or advertising is permitted in Rule 506 and Rule 144A offerings, broker-dealers can expand the universe of investors to whom they can offer securities beyond those with whom they already have a prior substantive relationship. This will enable broker-dealers to respond to and act on reverse inquiries from accredited investors or QIBs who learn of the offering through general solicitation or advertising.

Public reporting issuers will no longer be constrained by Rule 135c under the Securities Act, which permits the disclosure of certain limited information (excluding the names of the broker-dealers acting on an issuer's behalf) with respect to private offerings of public companies, and will be able to name the broker-dealers acting on their behalf in offering announcements, term sheets and other publicly disseminated soliciting literature.

Since general solicitation and advertising is permitted, pre- and post-launch publication of research reports and updates by the research arm of a broker-dealer participating in a private offering will no longer expose offering participants to the risk of non-compliance with the prohibition on general solicitation or advertising in connection with Rule 506 or Rule 144A offerings.

***How does the private offering reform affect the private investment in public equity (PIPE) market?***

Like any other Rule 506 or Rule 144A offering, publicly traded issuers and their intermediaries will be able to engage in general solicitation or advertising in connection with their PIPE offerings. However, the use of general solicitation or advertising may have implications for SEC policy with respect to the pre-closing filing of Securities Act resale registration statements covering securities acquired in PIPE offerings. This policy was developed under circumstances where general solicitation and advertising was prohibited. Given that an offering conducted with such general solicitation and advertising has the character of a public offering, a question remains as to whether the SEC will reaffirm its guidance which enables the filing of pre-closing resale registration statements as long as the investor is irrevocably committed to the investment in the private offering prior to the filing of the registration statement for the public resale offering.

***Do the private offering reforms expand opportunities for late stage pre-IPO or post-IPO filing offerings?***

Unclear. Existing SEC guidance has permitted private offerings to be completed prior to the filing of an IPO registration statement without integration concerns. Similarly, existing SEC guidance has permitted issuers in registration after the filing of an IPO registration statement to conduct exempt private offerings in limited circumstances. A question remains as to whether the SEC will reaffirm its guidance to the extent general solicitation or advertising is employed in any such pre-IPO or post-IPO filing offerings.

***Can crowdfunding type offerings be conducted under Regulation D?***

Yes. Given that general solicitation and advertising is permitted, issuers can conduct crowdfunding type offerings in reliance of Rule 506 of Regulation D through online portals as long as the securities are sold only to accredited investors. Since statutory "funding portals" registered under new Section 3(h) of the Securities Exchange Act must limit their business to facilitating crowdfunding exempt offerings conducted pursuant to Section 4(a)(6) of the Securities Act, a publicly accessible online portal that facilitates a Rule 506 offering must either be operated by a registered broker-dealer or

must otherwise be operated in compliance with new Section 4(b) of the Securities Act, which is intended to codify existing SEC no action letter guidance relating to online matching services. Section 4(b) exempts the operator of any such online matching service portal from the requirement to register as a broker or dealer. This limited broker-dealer registration exemption requires compliance with conditions that (i) prohibit the payment of transaction based compensation to the matching service operator and its associated persons, (ii) preclude the matching service operator from possessing customers' funds or securities and (iii) render ineligible any matching service operator or associated person that is subject to a statutory disqualification. The matching service operator can provide ancillary services to facilitate Rule 506 offerings as long as it does not provide for separate compensation any investment advice or recommendations to issuers and investors.

***Does the ability to engage in general solicitation or advertising change the liability regime governing offerings conducted under Rule 506 of Regulation D?***

No. Rule 506 offerings are not subject to liability under Sections 11 and 12(a)(2) of the Securities Act. Rule 506 offerings will remain subject to the general anti-fraud provisions of Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder.

***Can state blue sky regulators regulate crowdfunding offerings conducted under Regulation D?***

No. Nothing in the JOBS Act changes the preemption of state blue sky law with respect to Regulation D offerings that has been in place since enactment of the National Securities Markets Improvement Act of 1996. States retain existing enforcement authority over any issuer, broker or dealer, for fraud or deceit or unlawful conduct in connection with Regulation D offerings and existing administrative authority with respect to applicable filing or fee requirements.

***How will securities issued in Regulation D and Rule 144A offerings be treated with respect to resale restrictions?***

The securities will be treated as "restricted securities" since the statute specifically provides that the offerings conducted pursuant to the revised regulations will not be deemed public offerings under the federal securities laws as a result of general advertising or general solicitation. Therefore, the trading exemption in Section 4(1) of the Securities Act will not be available and investors instead can rely on the exemptions provided in Rules 144 and 144A under Securities Act for any resale transactions.

***How are the SEC's historical integration criteria implicated by the crowdfunding and Regulation D reforms? For example, can an issuer conduct side-by-side crowdfunding and Regulation D offerings?***

Unclear given the SEC's interpretation of its historical integration criteria under which one or more exempt offerings could be integrated into one non-exempt public offering.<sup>5</sup> When separate offerings are integrated into one single offering, that integrated offering must either be exempt from the registration requirements of the Securities Act or registered under the Securities Act.

New Section 4A(f) of the Securities Act states that nothing in Section 4A or Section 4(a)(6) of the Securities Act will be construed as preventing an issuer from raising capital through methods not described under Section 4(a)(6). Arguably, this provision may be read to prohibit the integration of a Section 4(a)(6) crowdfunding exempt offering with a separate exempt offering simultaneously conducted under Rule 506. The SEC will need to clarify how it will interpret its traditional integration criteria in the face of this statutory provision.

### III. Conclusion

The JOBS Act's crowdfunding and private offering reforms will engender significant opportunities for issuers and capital market participants. The reforms will enable issuers and their intermediaries to embrace further online and innovative social media technologies to reach investors throughout the United States. We will address the SEC's implementation of these important deregulatory initiatives in future Stay Current client alerts.

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<sup>1</sup> For a general overview of the JOBS Act reforms, please refer to our Stay Current client alert entitled [House and Senate Pass Bill Simplifying IPO Process and Private Capital Raising](#).

<sup>2</sup> By virtue of other amendments to Section 4 of the Securities Act made by the JOBS Act, the crowdfunding offering exemption will be contained in new Section 4(a)(6) of the Securities Act.

<sup>3</sup> See, *Crowdfunding Industry to Unite Behind Regulatory Organization to Protect Investors*, <http://www.marketwatch.com/story/crowdfunding-industry-to-unite-behind-regulatory-organization-to-protect-investors-2012-03-23>.

<sup>4</sup> By contrast, Section 11 of the Securities Act does not allow issuers a due diligence defense for material misstatements or omissions in a registration statement.

<sup>5</sup> SEC Release No. 33-4552 establishes a five-factor test to determine whether two or more separate offerings should be integrated. Those five factors are:

- whether the offerings are part of a single plan of financing;
- whether the offerings involve issuance of the same class of securities;
- whether the offerings are made at or about the same time;
- whether the same type of consideration is to be received by the issuer; and
- whether the offerings are for the same general purpose.