

CrowdFunding



A New Way for Montana Companies to
Raise Money

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WHAT IS CROWDFUNDING?

Paraphrasing Wikipedia:

- **“Equity crowdfunding ”** is offering/issuing securities in a small business or startup company to a broad groups of investors in return for money to fund the business. Because equity crowdfunding involves investment into a commercial enterprise, it is subject to securities regulation. Equity crowdfunding is also referred to as “investment crowdfunding” and “crowd investing.”
- Equity crowdfunding different than “reward crowdfunding”

FEDERAL CROWDFUNDING

- JOBS Act requires SEC to develop rules permitting capital raising by “crowdfunding”
 - Companies will be limited to raising \$1 million in any 12-month period
 - Companies will have to engage an intermediary that is registered with the SEC
- Individual investors will be limited in 12-month period to:
 - If annual income or net worth is less than \$100,000—the greater of \$2,000 or 5% of annual income or net worth, or
 - If annual income or net worth is more than \$100,000—10% of annual income or net worth up to a maximum of \$100,000.
- Companies cannot use JOBS Act crowdfunding to raise funds from investors until the SEC adopts rules for it

MONTANA CROWDFUNDING

- During 2015 legislative session, Montana passed exemption permitting the use of intrastate crowdfunding
- The exemption is subject to various limitations and restrictions, including:
 - The company must be formed under the laws of Montana and be registered with the Montana Secretary of State
 - The company may offer and sell securities only to purchasers who provide documentation reasonably indicating they are a Montana resident
 - The offer and sale must comply with the federal intrastate exemption requirements under section 3(a)(11) of the Securities Act of 1933
 - The company may sell up to \$1 million of securities in any 12 month period, minus the aggregate amount of other securities sold within 12 months prior to the first offer or sale made under the exemption
 - Each non-accredited investor may purchase up to \$10,000 of securities
 - Funds received must be deposited into a bank or depository institution authorized to do business in Montana and used in accordance with representations made to investors
 - The company must file a notice with, and pay a \$50 fee to, the Montana securities commissioner within 10 days of any solicitation or within 15 days after the first sale, whichever occurs first

INTRASTATE OFFERING EXEMPTION

Section 3(a)(11) of the Securities Act of 1933 must be satisfied to use Montana's crowdfunding exemption and to have a federal exemption

- To qualify for the intrastate offering exemption, a company must:
 - Be organized in the state where it is offering the securities;
 - Carry out a significant amount of its business in that state; and
 - Make offers and sales only to residents of that state.
- No limit on the size of the offering
- No limit on the number of purchasers
- Company must determine the residence of each offeree and purchaser
- If company holds some of its assets outside the state, or derives a substantial portion of its revenues outside the state where it proposes to offer its securities, it may also have difficulty qualifying for the exemption
 - Most companies follow Rule 147, a "safe harbor" rule, to ensure requirements for the intrastate offering exemption are met

RULE 147 – INTRASTATE SAFE HARBOR

- This is a “safe harbor”; it is possible that transactions not meeting all the requirements of Rule 147 may still qualify for the intrastate exemption
- Cannot be used if there are other exempt or registered offers made more than 6 months preceding and succeeding the Rule 147 offer
- *Nature of the issuer.* At the time of any offers and the sales, the issuer must be a resident and doing business within the state in which all of the offers and sales are made
 - Deemed to be doing business within a state or territory if:
 - At least 80% of its gross revenues from the state;
 - This impacts companies selling products outside of the state
 - At least 80% of its assets are located within the state;
 - At least 80% of the net proceeds from the offering are used within the state; and
 - The principal office located within the state
- *Offerees and purchasers.* Offers and sales of can only be made to persons resident within the state of which the issuer is a resident.
 - For purposes of determining the residence of offerees and purchasers:
 - A business organization shall be deemed to be a resident of a state if, at the time of the offer and sale , it has its principal office within such state or territory
 - An individual shall be deemed to be a resident of a state or territory if such individual has, at the time of the offer and sale, their principal residence in the state

**POTENTIAL BUSINESS
IMPLICATIONS OF
CROWDFUNDING**

POTENTIAL BUSINESS IMPLICATIONS

Costs

- Preparing the filing
- Preparing stock documents
- Preparing disclosure documents
- Preparing subscription agreements
- Verifying (if necessary?) accreditation status or residency
- Transferring funds (credit card fees; wire transfer fees)
- “Portal” commission/fee
- Others?

POTENTIAL BUSINESS IMPLICATIONS

Investor risk:

- Fraud
- Insufficient funds raised to accomplish business plan
- Is there a future market for the shares?
- Is there an exit?
- What are the economics? Can there be a good return?
- Others?

POTENTIAL BUSINESS IMPLICATIONS

Management Issues

- Number of shareholders
- Identity of shareholders
- MT shareholder consent requirements
- Will subsequent investors be comfortable?

POTENTIAL BUSINESS IMPLICATIONS

Which Businesses Might Benefit?

- Single project businesses (apps, movies, brewery)
- But, perhaps NOT an LLC
- What type of exit is required?
- Industry or relevant expertise in your crowd
- How do you get rid of investors?
 - Stock that becomes debt?
 - Redemption clauses?

ALTERNATIVES TO CROWDFUNDING

REGULATION D – RULES 504 & 506

- Required to file a notice on Form D with SEC
- Subject to the antifraud provisions of securities laws
 - Necessary information must be provided to investors
 - Any information provided to investors must be free from false or misleading statements.
- Felons and other "bad actors" are disqualified from involvement in 506 offerings

RULE 504: SEED CAPITAL EXEMPTION

- Provides exemption for the offer and sale of up to \$1,000,000 of securities in a 12-month period
- In general, may not use general solicitation or advertising to market the securities (i.e. not public offering)
- No specific disclosure requirements, but disclosure must be provided
- Purchasers generally receive “restricted securities”
 - May not sell them without SEC registration or using another exemption

MONTANA 10 OR FEWER OFFERS EXEMPTION

- Can be used in connection w/ Reg D Rule 504 or Section 4(2)
- Limited to 10 offers in or from Montana in a 12 month period
- Can be increased to 25 offers with filing of an application and payment of a fee
 - Usually takes several weeks to obtain approval

RULE 506: NON-PUBLIC OFFERING

- No limit on the amount company can raise
- No limit on the number of accredited investors
- No specific disclosure requirements, but disclosure must be provided
- To qualify, a company must:
 - Not use general solicitation or advertising to market the securities unless:
 - All purchasers in the offering are accredited investors and
 - The issuer takes reasonable steps to verify their accredited investor status
 - Not sell securities to more than 35 non-accredited investors
 - Give non-accredited investors specified disclosure documents
 - This disclosure requirement makes this aspect of the Rule not feasible for most emerging companies wanting to raise smaller amounts of capital
 - Provide financial statements

MONTANA LIMITED OFFERING EXEMPTION

- Exempts securities sold in compliance with federal Rule 506
- Must file notice and Form D and pay a significant fee at least 10 days prior to an offer or sale being made

HOW CROWDFUNDING COMPARES

	Montana Crowdfunding	Rule 504 with Montana 10 or Fewer Offers Exemption	Rule 506 with Montana Limited Offering Exemption
Company Residency Requirements	Yes	No	No
Company Requirements for 3(a)(11)	1) Organized in the state of the offering 2) Do business in the state a) At least 80% of gross revenues from the state b) At least 80% of assets located in the state c) At least 80% of net proceeds from offering used within the state	NA	NA
Number of Investors/Offers	Not Limited	10 or fewer <i>offers</i> with possibility of increasing to 25 with application and payment of fee	Unlimited Accredited Investors (or up to 35 other sophisticated investors; however, significant disclosure is required if non-accredited investors)
Maximum Offering	\$1,000,000 in 12-month period less other securities sold within 12 months prior	\$1,000,000 in 12-month period	Unlimited

HOW CROWDFUNDING COMPARES

	Montana Crowdfunding	Rule 504 with Montana 10 or Fewer Exemption	Rule 506 with Montana Limited Offering Exemption
Offerees	All, including non-accredited	All, including non-accredited	Accredited Investors (or else heightened disclosure requirements)
Investment Limits	\$10,000 for non-accredited investors Not limited for accredited investors	None	None
Investor Verification	Residency verification	None	Accreditation verification
Advertising/General Solicitation	Unrestricted, but must be only to residents	No general solicitation/advertising	General solicitation allowed if all purchasers are Accredited and company takes steps to verify Accredited Investor status

QUESTIONS?