

A Guide to Crowdfunding for Companies Seeking to Raise Capital

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On April 5, 2012, President Obama signed into law the Jumpstart Our Business Startups Act, or JOBS Act, which is intended by Congress to facilitate the creation of jobs by making it easier for small businesses to raise capital in public and private offerings and comply with ongoing securities law requirements.

One of the provisions of the JOBS Act creates a new type of simplified capital raising process known as "crowdfunding," which permits eligible companies to raise up to an aggregate of \$1 million from an unlimited number of investors during a twelve month period without having to register the securities with Federal and state securities regulators and without the investors having to meet particular suitability standards.

The new crowdfunding offering exemption is designed to permit the offering to be conducted on the internet through a registered broker-dealer or funding portal in order to reach a large group of potential investors who would invest a limited amount per investor in the offering.

The JOBS Act directs the Securities and Exchange Commission ("SEC"), to adopt regulations to implement the crowdfunding provisions within 270 days of enactment of the Act (i.e., December 31, 2012). Until the SEC's regulations have been adopted, companies are not permitted to make crowdfunding offerings.

The following guide is intended to assist companies that may be interested in making a crowdfunding offering to begin the preparations for such an offering, pending the issuance of the required SEC regulations.

What Companies Are Eligible to Make Crowdfunding Offerings?

In general, all issuers of securities will be eligible to make crowdfunding offers other than foreign issuers, issuers that are required to file reports with the SEC (i.e., public companies) and issuers that are considered to be investment companies under the Investment Company Act of 1940.

Are There Any Limitations on the Amount that Individual Investors May Invest?

The amount raised in a crowdfunding offering during any twelve month period from any single investor may not exceed:

- the greater of \$2,000 or 5% of the annual income or net worth of the investor, as applicable, if either the annual income or the net worth of the investor is less than \$100,000; or
- 10% of the annual income or net worth of an investor, as applicable, not to exceed a maximum aggregate amount sold of \$100,000, if either the annual income or net worth of the investor is equal to or more than \$100,000.

These limits are cumulative for all crowdfunding securities that are purchased by an investor during a twelve month period.

What Requirements Must a Company Meet to do a Crowdfunding Offering?

Companies making a crowdfunding offering will be required to satisfy several requirements, including, among other requirements and any additional rules the SEC may establish:

- (1) limiting the amount raised in reliance on the crowdfunding exemption to a total of \$1 million in any twelve month period;
- (2) limiting the amount raised per investor to the amounts discussed above;
- (3) conducting the offering through a broker or "funding portal" (as described below);
- (4) providing investors with a reasonable opportunity to rescind the purchase prior to the sale;
- (5) not advertising the terms of the offering, except for notices which direct investors to the relevant broker or funding portal;
- (6) filing financial statements periodically with the SEC; and
- (7) filing with the SEC and the relevant broker or funding portal certain business and financial information, which is described on Schedule A hereto.

What Requirements Must be Met by a Broker or Funding Portal That is Participating in a Crowdfunding Offering?

Brokers and funding portals acting as intermediaries in crowdfunding offerings will be required to satisfy several requirements, including, among other requirements and any additional rules the SEC may establish:

- (1) registering with the SEC and any other applicable self-regulatory organization;
- (2) providing disclosures, including disclosures related to risks and other investor education materials;
- (3) ensuring that each investor reviews investor-education information and affirms that the investor understands the risks of the investment;
- (4) obtaining a background and securities enforcement regulatory history check on each officer, director and person holding more than 20 percent of the outstanding equity of the issuer;
- (5) ensuring that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than the issuer's target offering amount, and allowing all investors to cancel their commitments to invest;
- (6) making efforts to ensure that no investor exceeds the investment limits described above;
- (7) protecting the privacy of information collected from investors; and
- (8) prohibiting its directors, officers or partners from having any financial interest in an issuer using its services.

A person may act as a "funding portal" if, in addition to satisfying any other requirements imposed by the SEC, that person does not offer investment advice or recommendations, solicit purchases, sales or offers to buy securities offered or displayed on its website or portal, compensate employees, agents or other persons for the solicitation or sale of securities displayed or referenced on its website or portal or hold, manage, possess or otherwise handle investor funds or securities.

Will an Issuer and its Officers, Directors and Partners Have Any Liability to Investors Under the JOBS Act Crowdfunding Provisions?

Issuers and their directors, partners and executive officers will be liable for an action for rescission or damages for any misstatements or omissions in the information required to be furnished to investors in connection with a crowdfunding offering unless the person did not know, and in the exercise of reasonable care could not have known, of the misstatement or omission.

What are the Restrictions on the Transfer of Crowdfunding Securities?

Purchasers of securities being sold in crowdfunding offerings may not transfer the securities within one year of purchase unless the securities are transferred to the issuer, to an "accredited investor," as part of a registered offering or to a family member.

Are Crowdfunding Offerings Exempt from State Blue Sky Laws?

The crowdfunding exemption preempts state registration, documentation and offering requirements. State filing fees are also preempted, except from the State of the principal place of business of a crowdfunding issuer and the State in which purchasers of a majority of the securities being issued in a crowdfunding offering are resident. States, however, will retain the ability to bring enforcement actions for fraud, deceit or unlawful conduct against issuers, brokers and funding portals.

What Can a Company Do Now to Begin Preparing for a Crowdfunding Offering?

In order to begin preparing for a crowdfunding offering, a company can begin to prepare the disclosure information that is required to be furnished to investors under the JOBS Act as set forth on [Schedule A](#) hereto.

In addition, a company can review its organizational documents to be sure they are up to date and can begin to assemble a file of due diligence materials consisting of the company's legal, financial, business and regulatory documents and materials to be furnished to the broker-dealer or funding portal. We have attached hereto as [Schedule B](#) a typical due diligence request list to serve as a guideline for assembling such as due diligence file.

How Much Will it Cost to do a Crowdfunding Offering and What Are the Largest Cost Components?

The principal costs involved in making a crowdfunding offering will be the fees and expenses of the broker or funding portal and the issuer's legal and accounting fees. Because crowdfunding is a new form of offering, there are no established standards by which to estimate the broker/funding portal fees, but if they are going to be similar to the fees charged by brokers for smaller private placement offerings, then they will be between 7% to 10% of the offering amount. Legal and accounting expenses will likely be approximately 5% of the offering amount in the aggregate.

If you have any questions concerning the foregoing, please do not hesitate to contact:

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This information is provided as a public service to highlight matters of current interest and does not imply an attorney-client relationship. It is not intended to constitute a full review of any subject matter, nor is it a substitute for obtaining specific legal advice from independent counsel.

Information to be Provided by an Issuer in Connection with a Crowdfunding Offering

1. The name, legal status, physical address, and website address of the issuer.
2. 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.
3. A description of the business of the issuer and the anticipated business plan of the issuer.
4. A description of the financial condition of the issuer, including, for offerings that, together with all other offerings of the issuer under section 4(6) within the preceding 12-month period, have, in the aggregate, target offering amounts of -
 - (i) \$100,000 or less: (A) the income tax returns filed by the issuer for the most recently completed year (if any); and (B) financial statements of the issuer, which shall be certified by the principal executive officer of the issuer to be true and complete in all material respects;
 - (ii) more than \$100,000, but not more than \$500,000: financial statements reviewed by a public accountant who is independent of the issuer, using professional standards and procedures for such review or standards and procedures established by the SEC, by rule, for such purpose; and
 - (iii) more than \$500,000 (or such other amount as the SEC may establish, by rule): audited financial statements.
5. A description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount.
6. 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.
7. The price to the public of the securities or the method for determining the price, provided that, prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities.
8. A description of the ownership and capital structure of the issuer, including:
 - (i) 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;
 - (ii) 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;
 - (iii) the name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer;
 - (iv) 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; and
 - (v) 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.
9. Such other information as the SEC may, by rule, prescribe for the protection of investors and in the public interest.

Sample Due Diligence Document Request List**A. Corporate Documents**

- A.1 The organizational documents and by-laws of the Company and all amendments thereto to date.
- A.2 Minutes of all meetings of the Board of Directors and stockholders of the Company for the last three years.
- A.3 List of states where the Company is qualified as a foreign corporation or has offices.
- A.4 Any agreements relating to sales of securities by the Company, including any private placement memoranda, offering circulars or prospectuses relating to sales of securities of the Company.
- A.5 A list of all of the stockholders of the Company.
- A.6 A list of the directors and officers of the Company.

B. Government Filings and Reports

- B.1 List of all material federal, state or local regulatory filings and reports of the Company, other than tax returns.
- B.2 Copies of material notices, licenses, permits and authorizations from federal, state or local regulatory authorities involving the Company.
- B.3 Copies of all material correspondence with federal, state, local or other U.S. regulatory agencies during the last three years.

C. Financial Documents and Accounting

- C.1 The Company's financial statements for the most recent fiscal year and interim period.
- C.2 All indentures, credit agreements, lines of credit, covenants, restrictions or any other debt instruments relating to the Company's lines of credit or outstanding debt (including bank credit facilities) including all consents, waivers and amendments thereto, and the latest current compliance certificates thereunder, including all instruments defining the rights of the holders of any long-term debt of the Company.
- C.3 All guarantees or loans made or entered into by, including promissory notes payable to, the Company.
- C.4 Schedule of amounts of outstanding indebtedness of the Company, as of a recent date.
- C.5 Any other documents and agreements evidencing other material financing arrangements, such as sale-leaseback arrangements, capitalized leases and installment purchases.
- C.6 Schedule setting forth any material intercompany transactions between the Company and its officers, directors and 5% or greater stockholders.
- C.7 Schedule setting forth the compensation and other benefits paid to the Company's chief executive officer of the Company for its most recent fiscal year. This schedule should include all amounts paid as salary and bonuses and amounts contributed to retirement plans.
- C.8 Identify and describe any (a) contingent liabilities not reflected in the Company's financial statements, (b) monetary reserves established for specific risk situations and (c) disagreements with the Company's outside auditors concerning the Company's financial reporting.

D. Material Agreements

- D.1 Any material contracts to which the Company is a party, including, without limitation, long-term contracts for the provision of goods and services, non-compete agreements, licensing agreements, partnership agreements, management agreements, consulting agreements, any consents or waivers with respect thereto.
- D.2 Contracts and other agreements with or pertaining to the Company and to which the directors, officers or 5% or greater stockholders of the Company are parties.
- D.3 Any material merger, acquisition (of assets or stock), divestiture (of assets or stock), subscription, joint venture, partnership, material equity or debt investment and related agreements entered into by the Company.
- D.4 Any other material agreement, including, without limitation, any agreement restricting additional indebtedness or the sale, lease or transfer (by dividend or otherwise) of any of the Company's assets.
- D.5 Any agreements, including options and warrants relating to the purchase, issuance, transfer or voting of securities of the Company not provided above in item D.2.
- D.6 Any material contracts with, or to which the Company is subject between third parties and, any federal or state governmental authority.

E. Tax Matters

- E.1 Copies of federal and state tax returns for the last three years.
- E.2 Description of status of federal, state and foreign tax audits -- years closed, years under audit, etc., including a description of the potential liability exposure of any current audits.
- E.3 Description of the potential liability exposure to the Company of current audits.

- E.4 Description of any issues involved in any audits of a recurring or ongoing nature or that could affect future tax liability.
- E.5 Copies of any tax rulings or closing agreements materially affecting the Company.
- F. Employee Plans and Labor-Related Materials
- F.1 Copies of all union and collective bargaining agreements.
- F.2 Copies of all existing or proposed management employment agreements for employees of the Company.
- F.3 Copies of all compensation plans, programs and arrangements (e.g., bonus, incentive, compensation, stock option, stock purchase, loans, severance pay), employment contracts with executives and collective bargaining agreements.
- F.4 List of any partial or complete withdrawal from a multiemployer pension plan involving the Company or a related entity.
- F.5 Documentation regarding labor disputes, requests for arbitration, grievance proceedings, etc. involving employees of the Company.
- F.6 Copies of any citations from, or consent agreements with, state, local or federal government agencies relating to employees or employment practices, including, but not limited to, SEC, Department of Labor, EEOC, OSHA and INS.
- F.7 All indemnification contracts or similar arrangements for officers and managers of the Company.
- F.8 Copies of any material secrecy, non-compete or assignment of intellectual property rights agreements between the Company and current or former employees or third parties and amendments thereto.
- G. Real Estate
- G.1 A list of all material properties owned or operated by the Company, identifying whether such properties are owned or leased.
- G.2 All material leases of the Company and all material mortgages and other instruments conveying liens on the Company's properties.
- G.3 Copies of all agreements or other documents relating to the purchase, lease, sublease or license (or the option to purchase, lease, sublease or license) by the Company of material real estate.
- G.4 Identify and describe all outstanding or anticipated notices of any actual or alleged violation of any zoning requirements or classification, environmental, pollution control or hazardous waste, occupational safety or other federal, state or local statutes, ordinances or regulations relating to the contracts, property or business of the Company and relating to the health and safety of their respective employees.
- H. Patents and Trademarks
- H.1 List of material patents, copyrights, trademarks, service marks, proprietary technology, licenses and trade names owned or used by the Company, and a schedule of any confidentiality agreements.
- I. Litigation/Environmental
- I.1 Complete list of all pending and possible litigation and contractual disputes, including a list of counsel representing the Company.
- I.2 All litigation letters addressed to the auditors of the Company or to the Company from counsel with respect to the annual audit for each fiscal year of the Company.
- I.3 Any material consent decrees, judgments, other decrees or orders, settlement agreements and other agreements to which the Company is a party or is bound, requiring or prohibiting any activity.
- I.4 Summary of (and access to files relating to) all litigation, administrative, governmental or bankruptcy proceedings, investigations or inquiries currently pending, threatened or ongoing in connection therewith or otherwise, relating to the Company.
- I.5 Significant regulatory reports filed by the Company with any governmental agency or authority during the last three years.
- I.6 Significant correspondence between any regulatory agency and the Company relating to the facilities or operations of the Company during the last three years.
- I.7 Any reports of environmental consultants, Phase I studies, environmental audits or assessments or inspections, or other reports relating to environmental matters with respect to property currently or formerly owned, leased or operated by the Company.
- I.8 Any documents relating to the presence, release or threat of release of hazardous substances, wastes or materials from or at any property owned or operated by the Company.
- I.9 Any other material information concerning compliance with any applicable environmental or other laws or regulations.
- J. Insurance
- J.1 A list of all material insurance policies, with description of risks, amount of coverage and premium and copies of the insurance policies.
- K. Miscellaneous
- K.1 Any other documents or information which, in the judgment of officers of the Company, are significant with respect to the business of the Company.