



2013 SEC Government-Business Forum on Small Business Capital Formation

Crowdfunding: Crystal ball-- Now that you raised the money, what's next for the company and the markets?

PUBLIC-IFYING THE PRIVATE MARKETS

EGS
Ellenoff Grossman & Schole LLP

Crowdfunding



Planting the Seeds of Change

Disclaimer of Liability

- The information which is being shared with you today seeks and may answer some questions of yours related to Title II and Title III and the developments which are being observed within the online funding platform industry, but is not intended as a comprehensive analysis of the topic or situations directly impacting you and any of your existing operations. In addition, this information should not be relied upon as legal advice— these are only general observations of ours. You are encouraged to speak with your own securities counsel. Your counsel may analyze the same facts and rules differently and come to dramatically different conclusions and recommendations for you.
- Visit SEC.gov
- This information is supplied from sources we believe to be reliable but we cannot guarantee its accuracy.
- For specific information on particular factual situations, an opinion of your legal counsel should be sought.

EG&S and Crowdfunding

Ellenoff Grossman & Schole has been meaningfully involved in the crowdfunding program since its inception. The Firm has sponsored conferences, webinars and has been invited to speak at different events on the topic. Douglas S. Ellenoff, a member of the Firm, has met with the SEC on many occasions to discuss many aspects of the proposed new law, how the industry currently operates and how both the SEC and FINRA will register and regulate funding portals and the crowdfunding activity to be conducted.

The Firm is actively engaged with clients (funding portals, broker-dealers, technology solution providers, software developers, investors and entrepreneurs). In cooperation with the industry trade association, the Firm is discussing what level of regulatory review and monitoring is appropriate by the SEC and FINRA in balancing the interests of the program with investor protection.

About The Panelist



Douglas S. Ellenoff, Esq. a member of Ellenoff Grossman & Schole, LLP, a 60 lawyer New York-based firm, Douglas S. Ellenoff, a member of the Firm since its founding in 1992, is a corporate and securities attorney with a specialty in business transactions and corporate financings. Mr. Ellenoff and the rest of the corporate department distinguish themselves from many other transactional lawyers on the basis of their ability to be part of the establishment of new securities programs, like PIPEs, SPACs, Registered Directs, Reverse Mergers and **CrowdFunding**, where the Firm's professionals have played leadership roles within each of those industries, assisting in the creation, formation and strategies relating to those financings, as well as working closely with the regulatory agencies; including the SEC and FINRA; and the listing exchanges - AMEX and NASDAQ.

Statutory Information Required Post Funding

Title III. Sec. 4A (b) (4) REQUIREMENTS FOR ISSUERS.

For purposes of section 4(6), an issuer who offers or sells securities shall not less than **annually**, file with the Commission and provide to investors reports of the results of operations and Financial statements of the issuer, as the Commission shall, by rule, determine appropriate, subject to such exceptions and termination dates as the Commission may establish, by rule; and

SEC Proposed Rule

- To implement the ongoing reporting requirement in Section 4A(b)(4), the proposed rules would require an issuer that sold securities in reliance on Section 4(a)(6) to file a report on EDGAR annually (Form C-AR), no later than **120 days after the end of the most recent fiscal year** covered by the report.
- Although the statute provides that an “issuer who offers or sells securities” in reliance on Section 4(a)(6) shall provide ongoing reports, we do not believe the intent was to require ongoing reports from a company that has not completed a crowdfunding transaction and thus did not issue any securities.

SEC Proposed Rule

- To implement the statutory requirement that issuers provide the report to investors, we propose to require issuers to **post the annual report on their websites**.
- We believe that investors in this type of Internet-based offering would be familiar with obtaining information on the Internet and that providing the information in this manner would be cost-effective for issuers.
- As discussed above, we believe Congress contemplated that crowdfunding would, by its very nature, occur over the Internet or other similar electronic media accessible to the public, so we are not proposing to require issuers to provide physical copies of the report to investors. We also are **not** proposing to require issuers to provide a copy of the annual report, or refer investors to the posting of the annual report, via e-mail because we believe that many issuers may not have e-mail addresses for the investors, especially after the shares issued pursuant to Section 4(a)(6) are traded by the original purchasers.
- To the extent e-mail addresses for investors are available to issuers, an issuer could refer investors to the posting of the annual report via e-mail.

Crowdfunding Issuers

- Portal Listing Agreements may require or Issuers could voluntarily provide
 - quarterly/semi-annual updates
 - current reporting of all material developments
 - online investor communications through Google Hangouts or Sky
 - provide access to password protected information about the status of the Use of Proceeds

SEC Proposed Rule

- The issuer would be required to disclose information **similar to the information required in the offering statement**, including disclosure about its financial condition that meets the financial statement requirements that were applicable to its offering statement.
- Investors should benefit from receiving annual updates to the information they received when making the decision to invest in the issuer's securities, which should allow them to continue to be informed about issuer developments.
- Under the statute and the proposed rules, the securities will be **freely tradable after one year** and, therefore, this information also would benefit potential future holders of the issuer's securities and help them to make more informed investment decisions.
- Any issuer terminating its annual reporting obligations would be required to file on EDGAR, within five business days from the date of the terminating event, a notice to investors and the Commission that it will no longer file and provide annual reports pursuant to the requirements of Regulation Crowdfunding. The issuer would check the box for "Form C-TR: Termination of Reporting" on the cover of Form C.

Statutory Transfer of Securities

(e) RESTRICTIONS ON SALES.

Securities issued pursuant to a transaction described in section 4(6)—

(1) may not be transferred by the purchaser of such securities during the **1-year** period beginning on the date of purchase, unless such securities are transferred—

(A) to the issuer of the securities;

(B) to an accredited investor;

(C) as part of an offering registered with the Commission

After the holding period, although the securities may be transferred, they remain subject to state securities “blue sky” law compliance.

Secondary Market Transfers

- Facilitating crowd-funded transactions alone would not require an intermediary to register as an exchange or as an alternative trading system (*i.e.*, registration as a broker-dealer subject to Regulation ATS). To the extent that an intermediary facilitates secondary market activity in securities issued in reliance on Section 4(a)(6), the intermediary would be required to register as an exchange or as an alternative trading system if it met the criteria in Exchange Act Rule 3b-16.
- We note, however, that a funding portal, by definition, is limited to acting as an intermediary in transactions involving the offer or sale of securities for the account of others solely pursuant to Section 4(a)(6),³²⁰ which are primary issuances of securities. Thus, a funding portal could not effect secondary market transactions in securities.

Secondary Market Transfers

- An Alternative Trading System (ATS) is an SEC-regulated trading venue which serves as an alternative to trading at a public exchange.
- Selling Shareholders or Issuers could have a Broker file a Form 211
- Apply for trading on the OTC Marketplace (OTC QX)
- After the one year holding period a marketplace could develop
- Blue sky

Holders of Record

- Proposed Rule 12g-6 provides that securities issued pursuant to an offering made under Section 4(a)(6) would be permanently exempted from the record holder count under Section 12(g).
- An issuer seeking to exclude a person from the record holder count would have the responsibility for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6). We believe that allowing issuers to sell securities pursuant to Section 4(a)(6) without becoming Exchange Act reporting issuers is consistent with the intent of Title III.
- This proposal could, however, result in an unintended and potentially costly outcome. It is possible that an issuer that sells securities in reliance on Section 4(a)(6) could become an Exchange Act reporting company, but then deregister and go dark with potentially thousands of investors. For example, in an attempt to provide additional liquidity to its shareholders, an issuer could voluntarily register a class of securities under Exchange Act Section 12(g) so that the securities could be quoted in the over-the-counter market. The issuer would become subject to Exchange Act reporting requirements and would no longer be subject to the ongoing reporting requirements of Regulation Crowdfunding. If the issuer does not sell securities in a registered offering or trigger the asset and holder of record thresholds for mandatory Exchange Act registration in Section 12(g), the issuer could deregister its securities and stop all ongoing reporting obligations even if all the securities sold in reliance on Section 4(a)(6) remain outstanding.

Thank You