When it Rains, It Pours! The End of the Crowdfunding Regulatory Drought?

March 30, 2015
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Wednesday, March 25, 2015 was a BIG day for crowdfunding in North Carolina. After months (and years!) of waiting, lawmakers and regulators took steps that may drastically change the way North Carolina companies raise capital.

NC PACES Act: On Wednesday, the long-awaited North Carolina Providing Access to Capital for Entrepreneurs and Small businesses (NC PACES) Act (SB481) was introduced to the General Assembly by Senators Barringer (R), Hise (R) and Gunn (R). This new bill, which closely mirrors the NC JOBS Act proposal that easily passed the House in 2013 but stalled in the Senate, would allow North Carolina businesses to access capital locally and flexibly.

Whether sourcing capital from the "crowd" through the use of the internet or through a more traditional "friends-and-family" approach, under the NC PACES Act, a North Carolina company that satisfies certain disclosure and procedural requirements could raise $1 million in a 12-month period ($2 million, if it delivers audited or reviewed financial statements) from any North Carolina resident, irrespective of his or her investment experience or wealth, subject to a $5,000 individual cap.

Regulation A+: Also on Wednesday—nearly a year-and-a-half since proposing regulations—the SEC approved final regulations to implement Title IV of the JOBS Act. Often referred to as Regulation A+, Title IV required the SEC to adopt rules to create a new exemption from registration under the Securities Act of 1933 for offerings of up to $50 million dollars in a 12-month period.

Generally, Regulation A+ as adopted by the SEC creates a two-tiered exemption:

- Tier I covers offerings of up to $20 million in a 12-month period, including no more than $6 million of securities sold on behalf of selling security holders; and

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- Tier II covers offerings of up to $50 million in a 12-month period (an increase from the current $5 million cap), including no more than $15 million of securities sold on behalf of selling security holders.

Tier I and Tier II share many common requirements. For instance, certain types of companies (e.g., bad actors, investment companies, 1934 Act reporting companies, blank check companies) are ineligible to use Regulation A+. Companies will be able to use “test the waters” communications under either tier. In addition, companies will be required to file detailed disclosure documents with the SEC (which will be subject to the SEC Staff’s review and comment) under either Tier I or Tier II. Although there will be procedures available to make initial filings on a non-public basis, ultimately all filings will be made electronically through EDGAR— the SEC’s electronic database (as compared to the paper-filing requirement under the old Regulation A regime).

While there are still many details to parse through (the draft adopting release is over 450 pages long), the most significant differences between the Tier I and Tier II are as follows:

- State Preemption: Tier I offerings are subject to the registration and qualification requirements of state law, while Tier II offerings are not. Practically speaking, this means that companies undertaking Tier I offerings would need to file and submit disclosures for review in each state where an offering takes place. Although there is a relatively new coordinated review system in place that could make this process less arduous than in the past, companies undertaking a Tier I offering would nevertheless become subject to additional procedural and substantive requirements imposed by the states.

- Audited Financial Statements: Tier II offerings must be accompanied by audited financial statements, a requirement the SEC did not impose on Tier I offerings.

- Investor Caps: Individual investors who are not accredited investors (as defined under Securities Act Rule 506 for private placements) typically will not be permitted to invest more than 10% of the greater of their annual income or net worth in Tier II offerings. Investors subject to this limitation would be permitted to self-certify to this fact.

- Ongoing Reporting Requirements: Tier II issuers will be required to file scaled annual, semiannual and current reports through EDGAR.

These are exciting developments in the ever changing world of raising capital. Although we still await word from the SEC on final rules implementing “crowdfunding” under Title III of the JOBS Act, many crowdfunding supporters believe that Regulation A+ could offer an alternative way to access the “crowd.” Issuers will be allowed to use “general solicitation” under Regulation A+ and anyone (including non-accredited investors) may invest, subject to certain individual caps.

Absolutely, we need both!

NC PACES and Regulation A+ provide companies with more flexibility. There are significant differences between the two regulations, not only in the amount of funds that can be raised but in the cost and amount of time involved in completing a transaction. Pursuing a Regulation A+ offering would not make sense economically for companies looking to raise smaller amounts (in terms of hundreds of thousands of dollars as opposed to tens of millions of dollars). We would expect to see significant efficiencies in dealing with one local regulator, rather than with the SEC and the regulators of other states scattered throughout the country.

NC PACES is, by design, targeted for the smaller local company, looking to raise a lower threshold of capital quickly and efficiently each year.

There is room and the need for both Regulation A+ and NC PACES. These regulations share a common spirit. They both recognize that smaller businesses are, in **Wednesday's words** of SEC Chairman White, "essential to the livelihood of millions of Americans, fueling economic growth and creating jobs." And they share a common purpose: to smooth the way for smaller companies to access capital so they can grow their businesses, while providing strong investor protections.

Look soon for more on each of these developments.

If you have questions or comments, feel free to contact me by email at: benjisblog@smithlaw.com.