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Intrastate Crowdfunding

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by
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I. Introduction.

A. Background.

Crowdfunding is generally described as the process of financing a particular venture through small contributions from the public using the internet. The crowdfunding process has been used to fund popular non-profit causes, finance artistic endeavors, and provide startup funding for entrepreneurs to develop promising products or services. Kickstarter.com and Indiegogo.com are two well-known websites that have specialized in facilitating such funding. Because of the possible application of federal and state securities laws, compensation, if any, paid to members of the public who contributed to crowdfunded ventures has typically been limited to a token of value related to the project (*e.g.*, a music album or one of the entrepreneur's new products). Equity crowdfunding allows for the sale to the public of shares or interests in the ownership, financial returns, or profits of the issuer pursuant to an exemption from the securities registration requirements of the law.

In 2013, the staff of the Texas State Securities Board ("TSSB" or "Agency") began closely reviewing recent initiatives to develop an equity crowdfunding exemption. The TSSB staff analyzed the equity crowdfunding initiatives of the states that had taken action in this area as well as the proposed rulemaking by the U.S. Securities and Exchange Commission ("SEC") to implement the crowdfunding provisions of the federal Jumpstart Our Business Startups Act ("JOBS Act"), passed by Congress in 2012. The staff also obtained information from firms and individuals with interest and expertise in crowdfunding, including industry attorneys, consultants, control persons of an existing crowdfunding portal, board members of the national advocacy organization known as CFIRA, other state regulators, and senior legal counsel at the SEC's Division of Trading and Markets.

In April 2014, the TSSB issued proposed rules to create an exemption from the securities registration requirements of the Texas Securities Act for Texas-based firms seeking to raise capital from the public through equity crowdfunding. During the comment period, the Agency's staff worked with members of the bar, industry, and others to identify and address areas requiring clarification or modification to ensure that the funding mechanisms provided through these rules operate as efficiently and effectively as possible to benefit small business issuers and the investing public in Texas.

In October 2014, Texas became the 13th state to adopt intrastate crowdfunding provisions. The Texas rules became effective on November 17, 2014.

The Texas rules create a structure that will minimize burdens on small business issuers while maintaining basic investor protections necessary for the long-term success of the exemption as a vehicle to raise capital for legitimate businesses. Key features are:

1. The issuer is an entity organized under the laws of the state of Texas; authorized to do business in the state; maintains its principal office in Texas; and meets specified standards for intrastate offerings;

2. The issuer may not be an investment company, SEC reporting company, company with no business plan, or with a business plan to merge with an undetermined entity;

3. The offering is made exclusively through an internet website maintained by a registered Texas crowdfunding portal or a general dealer and all communications between the issuer, prospective purchasers, or investors during the offering occur on the Internet website;

4. Offerings may not raise more than $1 million in a 12-month period;

5. An investment in an issuer is limited to no more than $5,000 unless the purchaser is an accredited investor;

6. Investor funds are deposited directly in a bank or other regulated depository institution in Texas and held until the minimum target amount of the offering is raised;

7. Specified disclosures are provided on the website and to prospective investors and steps are taken by the website operators so only Texas residents are viewing the information; Texas residency must be confirmed before a sale of securities can occur;

8. For a period of 21 days in advance of any sale being made in the offering, specific information must be posted on the website and a notice must be filed with the TSSB by the issuer; and

9. The exemption is unavailable if the issuer, the issuer's predecessors, any affiliated issuers, or any control person of the issuer is subject to bad actor disqualifications specified in the rule. The exemption is also not available if the proceeds will be combined with other offerings as part of a single plan of financing or if there is commonality of control persons among issuers using the exemption in the last 12 months.

The framework for the proposed rules also includes requirements for crowdfunding portals:

1. The portal must register with the TSSB as a restricted securities dealer;