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Crowdfunding

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I. OVERVIEW OF EXEMPTIONS USED FOR INVESTMENT "CROWDFUNDING"

The Securities Act of 1933 (the "**Securities Act**") provides that every offer and sale of securities in the U.S. is either registered with the Securities and Exchange Commission (the "**SEC**"), exempt from such registration, or is illegal. In addition, the various U.S. states and territories each have registration requirements, generally referred to as "blue sky" laws. As such, issuers seeking to raise capital in the U.S. must be concerned with the application of both the Securities Act and blue sky laws.

The following is a brief discussion of the alternatives by which issuers may offer and sell securities without registering those transactions with the SEC in transactions that have come to be known as investment "crowdfunding". These alternatives include the following exemptions:

- Rule 147 promulgated under Section 3(a)(11) of the Securities Act.
- Regulation A+ promulgated under Section 3(b)(2) of the Securities Act;
- Rule 504 promulgated under Section 3(b)(1) of the Securities Act;
- Rule 506(b) promulgated under Section 4(a)(2) of the Securities Act;
- Rule 506(c) promulgated under Section 4(a)(2) of the Securities Act; and
- Regulation Crowdfunding pursuant to Title III of the JOBS Act. [1]

This memorandum provides overview information on these various alternatives and does not constitute legal advice.

II. SECTION 3(a)(11) / RULE 147 – THE INTRASTATE EXEMPTION

Section 3(a)(11) of the Securities Act, and the Rule 147 safe harbor promulgated thereunder, provides an exemption from registration from with the SEC for the offer and sale of securities that are (i) made solely to residents of a single state and (ii) the issuer of the securities must be resident and doing business within such state.

Rule 147 of the Securities Act creates a safe-harbor for the intrastate exemption by creating various tests by which an issuer can establish that it is located and doing business within a state. No filing is required with the SEC if an issuer fits within the safe-harbor of Rule 147, and, as far as federal law is concerned, sales may be made to an unlimited number of individuals resident in the state in which the offering is to occur and may be conducted pursuant to general solicitation.

[1] Title III will not become effective until the SEC has adopted rules implementing the exemption. On October 23, 2013, the SEC proposed rules to implement the exemption, however, as of September 2015, such rules have not be adopted.

However, unlike many other exemptions from registration, the safe-harbor contained in Rule 147 does not include a reasonable basis standard for determining that an investor is a resident in the state in which the offering is to be conducted. Accordingly, any issuer must be hyper-diligent in determining that each potential investor that is offered a security or who ultimately purchases a security is a resident in the state in which the offering is to be conducted, otherwise the Rule 147 safe-harbor may not be relied upon, and the issuer is left with simply relying on the statutory exemption contained in Section 3(a)(11).

While the intrastate exemption provides an exemption from the registration requirements of the Securities Act, it does not create an exemption from state-level "blue-sky" registration requirements. Thus, any issuer that determines that it may rely on the Rule 147 safe-harbor must then consider whether it needs to register the offering with its local securities regulators.

As of September 2015, several states, including Texas, have established intrastate-exemptions that provide for an exemption from registration at the state-level from registration so long as (i) the offering will satisfy the requirements of Section 3(a)(11) and Rule 147, (ii) the issuer files its prospectus the files a notice filing which includes certain required information, (iii) the issuer pays a certain fee. The details of these exemptions vary from state to state, but often times the exemptions include some limit on the amount of the offering (usually $1 million over 12 months), and require some limited ongoing reporting requirements to the state-level securities regulator.

It is important to note, however, that since many of these exemptions are dependent upon the offering continuing to comply with both Section 3(a)(11) and Rule 147, failure to meet the requirements of either will result in an inability to rely on the state-level exemption.

Benefits of an Intrastate Offering

1. No federal filing requirements.

2. May generally solicit all potential investors resident in the state in which the offering is to be conducted.

3. No federal audited financial statement requirements.

4. Many states have established similar exemptions to facilitate the use of the intrastate exemption.

Drawbacks of an Intrastate Offering

1. Subject to state-level registration requirements.

2. No safe-harbor to reasonably believe purchasers are resident of the state in which the offering occurs.

3. Regulatory uncertainty as to what types of offering conduct (*e.g.*, offering of the internet) are permissible in an intrastate offering.

Title search: Crowdfunding

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Crowdfunding & Current Trends in Real Estate Financing

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