

Corporate Finance Alert

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Four Times Square
New York, NY 10036
212.735.3000

SEC Finalizes Crowdfunding Rules, Proposes to Expand Intrastate Offering and Rule 504 Exemptions

The U.S. Securities and Exchange Commission (SEC) recently took several important steps to facilitate smaller securities offerings. First, it adopted final rules for the new Securities Act exemption for securities-based crowdfunding transactions, marking the completion of the last of the SEC's capital formation rulemakings mandated by the Jumpstart Our Business Startups Act (JOBS Act). Second, the SEC proposed changes to encourage greater use of Securities Act Rule 147, which exempts intrastate offerings from Securities Act registration, including through the elimination of the current prohibition on offers to out-of-state residents. Finally, the SEC proposed to increase the aggregate amount of securities that may be offered and sold under Rule 504 of Regulation D from \$1 million to \$5 million within a 12-month period.

New Regulation Crowdfunding

Regulation Crowdfunding offers eligible issuers a new means of raising capital through the Internet by soliciting relatively small investments from a large number of investors. Companies that are ineligible to use the new crowdfunding exemption include Exchange Act reporting companies, foreign issuers, certain investment companies and companies that have no specific business plan or have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies.

Under Regulation Crowdfunding, issuers can raise a maximum aggregate amount of \$1 million through crowdfunding offerings in a 12-month period. Individual investors, over a 12-month period, can invest in the aggregate across all crowdfunding offerings up to:

- if either their annual income or net worth is less than \$100,000, then the greater of \$2,000 or 5 percent of the lesser of their annual income or net worth; or
- if both their annual income and net worth are equal to or more than \$100,000, 10 percent of the lesser of their annual income or net worth.

During the 12-month period, the aggregate amount of securities sold to an investor through all crowdfunding offerings may not exceed \$100,000. For investors who are natural persons, annual income and net worth are calculated in the same manner as they are for determining accredited investor status under Rule 501 of Regulation D. There are no restrictions on the types of investors who may purchase securities under the new exemption and, contrary to some commenters' requests, the investment limitations apply to accredited investors and institutional investors alike.

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The new rules require issuers to file certain disclosures with the SEC and provide the disclosures to investors and the intermediary facilitating the offering. While the disclosure requirements are not as prescriptive or detailed as those applicable to registered offerings, they are designed to provide, in very general terms, key information about the issuer and the offering that would be important to potential investors, such as:

- the offering price, the target offering amount, the deadline to reach the target offering amount and whether the issuer will accept investments in excess of the target offering amount;
- a business description, disclosures regarding the issuer's officers, directors and major shareholders, use of proceeds discussion, discussion of the issuer's financial condition and related parties disclosures; and
- the issuer's financial statements, including audited financial statements for certain offerings.

All transactions relying on the new crowdfunding rules must take place through an SEC-registered intermediary, either a broker-dealer or a funding portal registered with the Financial Industry Regulatory Authority.

Issuers utilizing the crowdfunding exemption must file annual reports with the SEC and provide such reports to investors. The annual reports must provide the same information contained in the offering statement (other than offering-specific information), such as information about the issuer's directors and officers, financial condition and related parties transactions. Importantly, the annual reports generally do not need to contain audited financial statements. Other than the annual reports, issuers do not need to provide any other ongoing reporting, such as quarterly reports or current reports. An issuer can terminate its reporting obligations if (1) it filed at least one annual report and has fewer than 300 record holders, (2) it filed at least three annual reports and has less than \$10 million in total assets, (3) the securities issued under the crowdfunding exemption are repurchased, or (4) the issuer liquidates or dissolves in accordance with state law.

Securities purchased in a crowdfunding transaction generally cannot be resold for one year. Holders of these securities will not count toward the threshold that requires an issuer to register its securities under Exchange Act Section 12(g) if the issuer is current in its annual reporting obligations, retains the services of a registered transfer agent and has less than \$25 million in total assets as of the end of its most recently completed fiscal year.

The final crowdfunding rules are expected to be effective in early May 2016. The adopting release can be found [here](#).

Proposed Amendments to Rule 147

Rule 147 exempts from Securities Act registration requirements the offers and sales of securities by an issuer to residents of the

same state in which it is a resident and "doing business." This intrastate offering exemption, however, has not been widely used due to its requirement that offers be limited to persons residing in the same state or territory as the issuer, which severely constrained the ability to publicly communicate with potential investors, and due to its restrictive residency and "doing business" requirements for issuers (e.g., to be deemed an in-state issuer, the issuer must satisfy several quantitative tests specified in the rule, such as deriving at least 80 percent of its consolidated revenues from that state).

The proposed amendments to Rule 147 would eliminate the current restriction on offers, thereby allowing an issuer to engage in any general solicitation or general advertising for its offering (including through the Internet), as long as:

- sales are made only to residents of the issuer's state or territory; and
- the offering is either registered in that state or conducted under an exemption from state law registration that limits the amount of securities an issuer may sell to no more than \$5 million in a 12-month period and imposes an investment limitation on investors.

The proposed amendments also would allow more issuers to become eligible to use the exemption by, among other things, eliminating the current requirement that the issuer be incorporated or organized in the same state that it is conducting the offering. The amendments would require only that the issuer have its principal place of business in that state and would provide greater flexibility for satisfying the rule's quantitative tests for determining the in-state nature of the issuer's business.

The public comment period for the Rule 147 proposal is expected to end in early January 2016. Comments can be submitted through the SEC's website. The proposing release can be found [here](#).

Proposed Amendments to Rule 504

The SEC proposed amending Rule 504 of Regulation D, which currently provides a Securities Act registration exemption for offers and sales of up to \$1 million of securities in a 12-month period, by:

- increasing the aggregate amount of securities that may be offered and sold under Rule 504 in any 12-month period from \$1 million to \$5 million; and
- disqualifying certain "bad actors" from participation in Rule 504 offerings through a new disqualification provision that is substantially similar to those found in Securities Act Rules 505 and 506.

The public comment period for the Rule 504 proposal is expected to end in early January 2016. Comments can be submitted through the SEC's website. The proposing release can be found [here](#).

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Contacts

New York

Gregory A. Fernicola
212.735.2918
gregory.fernicola@skadden.com

David J. Goldschmidt
212.735.3574
david.goldschmidt@skadden.com

Stacy J. Kanter
212.735.3497
stacy.kanter@skadden.com

Laura A. Kaufmann Belkhayat
212.735.2439
laura.kaufmann@skadden.com

Phyllis G. Korff
212.735.2694
phyllis.korff@skadden.com

Andrea L. Nicolas
212.735.3416
andrea.nicolas@skadden.com

Michael Schwartz
212.735.3694
michael.schwartz@skadden.com

Yossi Vebman
212.735.3719
yossi.vebman@skadden.com

Dwight S. Yoo
212.735.2573
dwight.yoo@skadden.com

Michael J. Zeidel
212.735.3259
michael.zeidel@skadden.com

Chicago

Richard C. Witzel, Jr.
312.407.0784
richard.witzel@skadden.com

Los Angeles

Michelle Gasaway
213.687.5122
michelle.gasaway@skadden.com

Jonathan B. Ko
213.687.5527
jonathan.ko@skadden.com

Palo Alto

Thomas J. Ivey
650.470.4522
thomas.ivey@skadden.com

Gregg A. Noel
650.470.4540
gregg.noel@skadden.com

Washington, D.C.

Brian V. Breheny
202.371.7180
brian.breheny@skadden.com

Frankfurt

Stephan Hutter
49.69.74220.170
stephan.hutter@skadden.com

Hong Kong

Z. Julie Gao
852.3740.4850
julie.gao@skadden.com

Jonathan B. Stone
852.3740.4703
jonathan.stone@skadden.com

Alec P. Tracy
852.3740.4710
alec.tracy@skadden.com

London

James A. McDonald
44.20.7519.7183
james.mcdonald@skadden.com

Danny Tricot
44.20.7519.7071
danny.tricot@skadden.com

Pranav L. Trivedi
44.20.7519.7026
pranav.trivedi@skadden.com

Singapore

Rajeev Duggal
65.6434.2980
rajeev.duggal@skadden.com

Sydney

Adrian J. S. Deitz
61.2.9253.6015
adrian.deitz@skadden.com

Toronto

Riccardo A. Leofanti
416.777.4703
riccardo.leofanti@skadden.com

Counsel **Ted Yu** assisted in the preparation of this alert.