

Crowdfunding in Oregon: A Review of the Proposed Regulation of Intra-State Crowdfunding.

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Speaker Biographies

Aeron Teverbaugh, Senior Policy Analyst. Ms. Teverbaugh joined the Department of Consumer and Business Services as a Policy Analyst in 2007. Prior to coming to work for the State of Oregon she worked with the Northwest Intertribal Court System drafting tribal codes. She holds a Masters degree in Anthropology from Portland State University and a J.D. from Lewis and Clark Law School.

Jason Ambers, Registration Analyst. Mr. Ambers has been with the Division since 2008. In addition to his registration-related duties, he also serves as a Financial Enforcement Officer. After graduating from Stanford University in 1994 and prior to attending New York University School of Law from 1999 to 2002, Mr. Ambers was an investment banking analyst for J.P. Morgan & Co., Inc. in New York and Pacific Crest Securities Inc. in Portland. Mr. Ambers developed an interest in securities regulation and enforcement after spending a summer with the Securities and Exchange Commission while in law school. He has also worked as a corporate associate for the law offices of Stroock & Stroock & Lavan LLP in New York and a judicial clerk for the Honorable Adrienne C. Nelson in Multnomah County.

Crowdfunding in Oregon:

A Review of the Proposed Regulation of Intra-State Crowdfunding.

I. What is the proposed Oregon Intrastate Private Offering exemption?

An exemption to the securities registration requirements designed to allow small Oregon businesses to raise money through small contributions from a large number of Oregon residents.

Proposed rules allow an issuer to raise \$250,000 in a 12-month period (no more than \$2,500 from any one individual) without registration.

The proposed rules were filed on November 14. The public comment period is open until December 10. There will be a public hearing on the rules on December 3 in Salem. We anticipate the rules will become effective January 1, 2015.

II. Why Now?

Small businesses that are located in Oregon who want to raise less than \$250,000 in reliance on Section 3(a)(11) of the Securities Act of 1933 faced very few options. Many of the options are either too costly, or not feasible.

A. Bank Line of Credit

Benefits: Not a “security” and therefore not subject to ORS Chapter 59.

Problems: Banks tend not to lend money to companies with 1) irregular cash flow projections, 2) insufficient assets to offer as collateral, and 3) unsteady revenue.

B. Non-equity based Crowdfunding

C. Exemptions to the Securities Registration Requirements (ORS 59.035)

Sales to Sophisticated Purchasers

ORS 59.035(5) – Sales to “Accredited Investors” only. No general advertising or solicitation.

ORS 59.035(4) – Sales to “Qualified Institutional Buyers,” including banks, savings institutions, insurance companies, investment companies, institutional buyers, etc.

Small Offerings – Friends and Family

ORS 59.035(12) – Sales to 10 or fewer Oregon residents. No general advertising or solicitation. No commissions or remuneration. Sales made in reliance on other exemptions or filings do not count toward the investor limits under this exemption.

ORS 59.035(3) – Pro rata offering to existing security holders. No commissions. Must be pro rata as to all investors of a particular class (not just Oregon investors).

OAR 441-035-0050 – Isolated Issuer Transactions – Sales by an issuer to 3 or fewer persons during any 24-month period.

Potential Benefits:

Unlimited offering amount.

Not registered. No “merit review.”

No audited financial statement requirement.

No specific disclosure requirements.

No filings.

No fees.

Potential Problems:

Limitations on the nature of the investor (Accredited Investor, QIB, etc.)

Limitations on resale.

Some exemptions do not allow for general advertising and/or commissions.

Burden of proof is on the person relying on the exemption. (No-action letter process can be time consuming.)

Accredited investors and QIBs generally demand a seat on the issuer’s board of directors and some control over operating decisions.

D. Notice Filings Only – ORS 59.049

Rule 506(b)

No restrictions on offering amount.

Limitations on resale.

Sales to unlimited “Accredited Investors” and 35 non-accredited investors.

No general advertising or solicitation.

Specific disclosure requirements for sales to non-accredited investors.

“Certified” and/or “audited” financial statements to non-accredited investors. (Rule 505).

Bad actor disqualification.

Rule 506(c)

No restrictions on offering amount.

Limitations on resale.

Sales only to “Accredited Investors.” Seller must take “reasonable steps” to verify the investor’s status.

General advertising or solicitation is allowed.

Bad actor disqualification.

Potential Benefits of Rule 506:

No registration required. Notice filing 15-days after the first sale in Oregon.

No restriction on offering amount.

Limited disclosure requirements.

Potential Problems of Rule 506:

Limitations on the nature of the investor, especially if the issuer wants to engage in general advertising or solicitation.

Specific disclosure requirements for sales to non-accredited investors.

Cost for verification requirements, background checks.

Federal Regulation of Crowdfunding – PENDING

Offering amount limited to \$1 million during any 12-month period.

Investor Caps:

10% of annual income or net worth for incomes greater than \$100,000, or

\$2,000 or 5% of annual income or net worth for incomes less than \$100,000.

(Net worth should not include the value of the investor's primary residence.)

Sales and advertising only through a funding portal or licensed broker-dealer.

“Audited” and/or “reviewed” financial statement requirement depending on the size of the offering for offerings \$100,000 to \$1 million.

Annual reporting requirements.

One-year restriction on transferability.

Potential Benefits:

Disclosures not subject to SEC or State review.

Potential Problems:

Not yet promulgated. Not clear when will be promulgated.

Cost: SEC estimates cost would be \$18,000 in fees to accountants, lawyers, and funding portals for offerings up to \$100,000. \$40,000 to \$70,000 for offerings between \$100,000 and \$500,000.¹

Complexity: Rule proposal is 585 pages long.

E. Registration – ORS 59.065

SCOR Offering (OAR 441-065-0225)

\$1 million offering amount during the registration period and preceding 12 month period.

Form U-7 – “Simplified” question and answer form that can be used as the offering document.

General advertising allowed if advertising materials are first cleared by the Division (OAR 441-065-0110). Tombstone style advertisements only.

Purchaser Qualifications: Accredited Investors, Permitted Oregon Purchasers, Sophisticated Purchasers, and Direct Purchasers from the Issuer.

Two-years audited financial statements for offerings that exceed \$500,000 (\$100,000 if debt offering). (See OAR 441-011-0040).

Registration Fee – \$200 to \$1,500.

Salesperson License.

Coordinated review – SCOR West <http://www.dfi.wa.gov/sd/scorwest.htm>

Potential Benefits:

Freely tradable. No resale restrictions.

Potential Problems:

Form U-7 disclosures. Generally requires assistance of counsel.

¹ Release Nos. 33-9470; 34-70741, page 358.

Merit Review – Under ORS 59.105, the Division can reject an offering if an issuer is in “unsound financial condition” or if the business plan is “unfair, unjust, or inequitable.”

Audited financial statement requirement.

Observation:

In 2012,

One SCOR application was withdrawn.

One SCOR application went active. Total offering amount was \$200,000. Issuer did not renew the offering in 2014.

One Solicitation of Interest filing was made.

In 2013,

Two SCOR applications abandoned.

One SCOR application went active. Total offering amount was \$299,000. Issuer did not renew the Order of Registration in 2014.

Two SCOR registrations are currently active. Total amount registered is \$1.3 million.

One Solicitation of Interest filing was made.

Rule 701 Compensatory Benefit Plan Offerings – (OAR 441-065-0270)

Shares that are issued for compensatory purposes and exempt under SEC Rule 701, cannot be used to raise capital.

Limitation on type of holders – Employees, directors, general partners, trustees, officers, consultants, and advisers.

Filing Fee – \$200 to \$1,500.

Licensed Salesperson and salesperson licensing fee.

Limited “merit” review.

Discrete Offering – does not affect other registrations or exemptions.

Potential Benefits:

Allows issuers to compensate employees, etc. through the offer and sale of securities, even if other exemptions would not ordinarily be available to the issuer.

Potential Problems:

Can be used for compensatory purposes only.

III. Investor Protection Considerations

A. General Concerns

The investor is provided with all material disclosures that would allow them to make an informed investment decision (See ORS 59.135(2)).

The terms of the offering are “fair, just, and equitable.” Business plan makes sense, issuer not in unsound financial condition. (See ORS 59.105).

Investment is suitable for the investor. (See OAR 441-205-0140).

Observation:

The SEC notes that many small start-up companies and small businesses are likely to fail after receiving funding. It cited a 2010 study that found that only 68% of a random sample of 4,022 new high-technology businesses started in 2004 survived by the end of 2008.

The SEC cited other studies finding that startups and small businesses financed by venture capitalists also tend to have high failure rates. One such study found that one-third of companies that received venture capital funding failed after receiving their first round. Another study found that three-quarters of companies that received \$1 million in venture funding between 2004 and 2010 failed.²

B. Traditional Basis for Exemptions

Private offerings involving persons with whom the issuer has a close personal relationship. (An issuer is unlikely to defraud a friend or family member.)

Private offerings involving sophisticated parties. (Sophisticated purchasers have the financial acumen and purchasing power to fend for themselves.)

² Release Nos. 33-9470; 34-70741, p. 334.

Offerings have been subjected to substantial review by a different jurisdiction such that our review would be redundant. (Oregon review would be unnecessary and redundant.)

C. Crowdfunding challenge

Allow sales through the web where the issuer does not necessarily have a close personal relationship with the investor and the investor is not necessarily sophisticated.

A rule that is simple and useable.

Not registered, no auditors, no lawyers.

Protect Investors.

IV. The Proposed Oregon Intrastate Private Offering Exemption

A. Nature of the Offering

\$250,000 12-month period, but offering period can be extended for an additional 12 months.

\$2,500 investor limit.

Must comply with Section 3(a)(11) of the Securities Act of 1933.

B. Nature of the Securities

Note, Debenture, or Equity securities only.

C. Integration Safe Harbor

Generally, all sales of securities by an issuer – including sales that would ordinarily be exempt under a different exemption – will be subject to this exemption, unless it can be shown to be part a different offering.

Safe harbor for sales made six months before and after a Crowdfunding offering.

D. Nature of the Issuer

Formed in Oregon. Registered with the Oregon Secretary of State.

Fewer than 50 employees.

No bad actors. No blank check companies, etc.

Must have met with a “business technical service provider” prior to offering or selling a security.

E. Nature of the Investor

Must be an individual and a resident of Oregon.

Prior to advertising or offering a security, the issuer must obtain “affirmative certification” that the prospective investor is an Oregon resident.

Prior to “selling” a security, the issuer must have a “reasonable documentary basis” to believe that the prospective investor is an Oregon resident. Investors must also affirm that they have been provided with a copy of the offering documents and understand the risks associated with investing in the issuer.

F. Nature of the Seller

No commissions or other remuneration.

G. Pre-offer filing requirements

14-days prior to offer.

Filing fee \$200.

Information requirements specified in the rule.

Can use a form prepared by the Division.

H. Disclosure requirements

Can be electronic, but prospective investor must be given the opportunity to obtain the disclosure materials in writing and free of charge.

Content requirements.

Disclaimer requirements.

I. Advertising

Must be filed with the Division 14-days before use.

Tombstone style advertisement only. Not subject to the content disclosure requirements if the advertisement complies with the advertising rules.

J. Third Party Platform Provider

A business technical service provider can provide a platform for issuers. Content limited to advertisements and disclosure materials.

Must host at least 5 issuers.

Cannot hold or transmit funds. Can direct investors to an unaffiliated third- party that is licensed or authorized to transmit money. Can direct the money transmitter to transmit funds to an issuer.

Cannot engage in any broker dealer, salesperson, or investment advisory activity.

Can only collect a nominal fee.

K. Escrow

No specific requirements. Issuer must disclose how the investor funds will be used if they do not raise a minimum offering amount.

L. Post-Sale Requirements

Bi-annual reporting requirements to investors. Can be satisfied by making information available on its website.

Sales report to the Division must be filed 30-days after the conclusion of a Crowdfunding offering.

Issuer must retain records at least 4 years after a Crowdfunding offering has concluded.

M. Limitations on Investor Resale

First nine months: Sale back to issuer, registered.

After nine months: Back to issuer, registered, under an exemption.

N. Burden of Proof

V. Other Applicable Provisions Securities Law

OAR 441-001-0040 – Request for Opinions or Interpretations.

OAR 441-011-0020 – Waiver by the Director.

ORS 59.135 – Antifraud.

ORS 59.035 – Exemption is not available if it is “part of an attempt to evade fraudulently any provision of the Oregon Securities Law.”

VI. Next Steps

A. Public Comments

Comments can be sent to Shelley Greiner, Rules Coordinator, at:

Email: Shelley.A.Greiner@state.or.us

Fax: 503-947-7862

Mail: Division of Finance and Corporate Securities; 350 Winter Street, Suite 410; Salem, Oregon 97301-3881.

B. Public Hearing

Hearing is scheduled for December 3, 2014 at 9:00 AM at 350 Winter Street NE, Room 260; Salem, Oregon 97301-3881.

NO comments will be accepted after 5:00 P.M. Wednesday, December 10, 2014.