



Tired of Waiting on the SEC, Texas Adopts Intrastate Equity Crowdfunding Exemption



By Thomas Conner

214.855.3092 | tconner@ccsb.com

Back on April 5, 2012, President Obama signed the Jumpstart Our Business Startups Act—or the JOBS Act—into law. Title III of the JOBS Act contained an important provision that permitted a much-anticipated federal crowdfunding exemption.¹ Crowdfunding is the process of raising small capital contributions from a large number of individuals via the internet and an online platform. Crowdfunding became popular through reward or donation-based models, such as Kickstarter, where individuals contribute to a startup in return for either a small reward (e.g., a t-shirt or a copy of actual goods that the startup is producing) or just for charity. Equity crowdfunding, in contrast, offers investors a stake in the company itself in exchange for his or her capital contribution, and thus qualifies as a security offering. Therefore, barring an exemption, such offerings would have to be registered with the SEC, a costly and time-consuming process.

The federal crowdfunding exemption the JOBS Act authorized was to be implemented through regulations drafted by the Securities and Exchange Commission (“SEC”). Almost immediately, however, the SEC expressed concern about the potential for fraudulent schemes to operate within an equity crowdfunding model. Accordingly, the SEC delayed in publishing its proposed crowdfunding rules, finally releasing a version a year and a half after the passage of the JOBS Act, on October 23, 2013. More than thirteen months and hundreds of comment letters later, the SEC has still not enacted its final federal crowdfunding regulations.

With increased pressure from its local businesses and crowdfunding backers, late last year, Texas joined a growing number of states—thirteen by the latest count, and with many others in the process of adopting crowdfunding exemptions—in enacting an intrastate equity crowdfunding exemption as an alternative to the federal crowdfunding exemption. On October 22, 2014, the Texas Securities Board (“TSB”) unanimously approved new rules that permit equity crowdfunding within Texas, and those new rules went into effect less than a month later on November 17, 2014. The new crowdfunding rules exempt from registration, concurrently with the intrastate offering exemption in SEC Rule 147 and Section 3(a)(11) of the Securities Act of 1933, securities that are sold through a certified Texas crowdfunding portal.² To qualify under the intrastate offering exemption, the securities can only be offered and sold within Texas and to Texas residents. To regulate the offering, the Texas crowdfunding portal must ensure that the investor is a Texas resident by requiring proof of a valid Texas driver’s license number, voter registration number, or property tax records showing the individual owns and occupies property in Texas as his or her principal residence.

Moreover, the securities issuer must be a Texas entity that has filed a certificate of formation with the Texas Secretary of State, has its principal office in Texas, is authorized to do business in Texas, has at least 80% of its gross revenues derived from operation of a business located within Texas, and has at least 80% of its assets in Texas. The issuer must also direct at least 80% of the proceeds from the offering towards the operation of its business within Texas. The exemption does not apply to any company that does not have a business plan or has not defined its business operations, is an SEC reporting company, or is an investment company. Moreover, traditional bad actor disqualifications, common in other securities laws, also apply.

Any equity crowdfunding sales must be completed through a TSB-certified crowdfunding portal, and there are specific requirements and limitations on information that must and can be posted on the portal and limitations on other communications that are permitted with prospective investors. For example, all communications, with the exception of a general notice stating that the issuer is conducting a crowdfunding offering and providing a link to the crowdfunding portal, must occur through the website of the crowdfunding portal itself. And all communications must be via open message boards that are accessible by all other prospective investors. The portal website must contain a summary of the offering and a disclosure statement that provides the material information about the issuer and the securities being offered, risk factors, certain mandatory disclosures about the nature of the securities and the offering, and the issuer’s financial statements. Unlike the SEC’s proposed regulations, which require audited financial statements for offerings over \$500,000, the financial statements do not need to be audited, unless the issuer has prepared audited financial statements within the three years prior

to the offering. Instead, the financial statements must only be certified by the principal executive officer as true and complete in all material respects.

A crowdfunding portal must register with the TSB by filing a new Form 133.15. The portal must also conduct “a reasonable investigation of the background and regulatory history” of each issuer of securities it hosts to determine that its officers and control persons are eligible for the crowdfunding exemption and are not engaging any act or practice that will operate as a fraud on any person.³ The crowdfunding portal is subject to extensive recordkeeping requirements and, amongst other prohibited activities, is prohibited from offering investment advice, managing investor funds, and holding a financial interest in any issuer whose securities it is offering.

Issuers seeking to avail themselves of the equity crowdfunding exemption must also register with the TSB by filing a new Form 133.17 and providing the disclosure statement and summary of the offering that will appear on the crowdfunding portal. There is, however, no annual filing requirement as under the proposed federal regulations.

Issuers can only raise \$1 million through the intrastate equity crowdfunding exemption in a twelve-month period. Importantly, the new crowdfunding exemption opens the crowdfunding process to nonaccredited investors for the first time⁴ (*i.e.*, individuals with less than \$1 million in net worth and less than \$200,000 in annual net income), but each nonaccredited investor is limited to investing \$5,000 in each specific offering. Investor funds that are raised must be placed in an escrow account until the minimum target offering amount is reached, but if the minimum target offering amount is not reached, then the funds are returned to the investors. All in all, Texas’s equity crowdfunding rules are fairly straightforward and appear liberal enough for Texas entities to actually take advantage of.

While the status of the federal crowdfunding exemption remains uncertain, Texas’s intrastate crowdfunding exemption could result in an influx of new startups and businesses in Texas. The Texas equity crowdfunding rules were purposefully drafted with much more relaxed requirements than the proposed federal regulations, which critics have speculated would be unusable by small companies because of the extensive compliance costs required to adhere to the regulations. Texas’s equity crowdfunding rules, in contrast, permit Texas companies, especially startups, an important new avenue for raising much needed capital and provide new investment opportunities for all Texas residents. Texas is the largest state to date to adopt equity crowdfunding and continues its recent push to adopt a business favorable regulatory-scheme for Texas businesses.

1. Jumpstart our Business Startups Act, PUB. L. NO. 112-106, § 302, 126 Stat. 306, 315 (2012).
2. 7 Tex. Admin. Code § 139.25 (2014) (Tex. Secs. Bd.).
3. 7 Tex. Admin. Code § 115.19 (2014) (Tex. Secs. Bd.).
4. Certain sales to accredited investors qualify for a separate federal exemption. See 17 C.F.R. § 230.506(c) (2014).