

## SMALL INVESTMENTS + MANY INVESTORS = CROWDFUNDING

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What do Walt Whitman, Peter Ilyich Tchaikovsky and James Franco have in common? All their creative endeavors were brought to life by way of small donations from numerous donors. While the idea of “crowdsourcing” from the general public is not new, recent legislation has infused the concept with high hopes for its potential as a game-changer for how start-ups get funded.

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### Public Issues by “Emerging Growth Companies”

In April 2012, Congress passed the Jumpstart Our Business Startups Act (JOBS Act), which included provisions for facilitating raising capital by small companies. The act defined a new business category, the “Emerging Growth Company” (EGC), as a company with less than \$1 billion in revenue at the time it goes public.

Benefits of being designated an EGC include: only two years of audited financial reports required in a registration statement, no requirement of Sarbanes-Oxley (SOX) auditor attestation of internal controls and, perhaps most beneficial, allowing the EGC to raise up to \$1 million in aggregate annual investment by way of crowdfunding.

### Will the SEC Model Kick-Start IPOs?

Numerous crowdfunding portals are already in existence for funding everything from independent films to arctic snow art to the latest language-learning app. The well-known portal “Kickstarter,” founded in 2009, boasts an impressive 5.4 million backers, who have pledged \$937 million to launch 54,000 projects. The proposed open-platform equity-raising model is intended to combat the problem of lack of credit faced by many promising start-ups.

### Some States Not Waiting for the SEC

To date, legislators in Michigan, Kansas and Georgia have passed their own local versions of equity crowdfunding, and lawmakers in Alabama and North Carolina are considering such bills for their upcoming sessions. The state statutes restrict investment to within their borders and/or solicitation to their own residents.

### Testing the Waters

As part of the goal to provide an “IPO on-ramp” for smaller companies trying to raise capital, EGCs will be permitted to communicate, orally or in writing, with qualified institutional investors and accredited institutional investors to gauge interest in the potential offerings prior to the filing of a registration statement. Furthermore, the EGCs will be allowed to submit their data confidentially to the SEC—a significant benefit to companies that prefer to keep their pending IPO intentions confidential.

### Interest by Foreign Issuers

The EGC rules will also apply to foreign private issuers who meet the criteria for EGC designation, thereby giving both issuers and investors greatly enhanced opportunity pools to draw from.