

Small biz advocates gain support for SEC exemption for 'crowdfunding'

BY ANTRENISE COLE & KENT HOOVER | ACBJ

Bipartisan support is building for allowing small businesses to use Internet platforms to raise capital from large numbers of individual investors through "crowdfunding."

This concept already is being used to raise contributions for films, books and other ideas that don't offer a return on investment, other than a T-shirt or some other perk. More than 500,000 projects have been funded through crowdfunding websites such as Indiegogo and Kickstarter, according to Sherwood Neiss, an entrepreneur in Miami Beach, Fla., who co-founded FLAVORx, a company that makes medicines taste better.

Current Securities and Exchange Commission rules, however, make it difficult for businesses to raise money through crowdfunding. Neiss and other small business advocates want the SEC to provide a crowdfunding exemption to its registration requirements.

They've won support from President Barack Obama, who endorsed crowdfunding in his jobs plan as a way to help entrepreneurs. Rep. Patrick McHenry, R-N.C., introduced legislation this month that would direct the SEC to provide a crowdfunding exemption for small businesses that are trying to raise up to \$5 million. Individual investments would be limited to \$10,000 or 10 percent of an investor's income.

McHenry said his bill would allow everyday investors to connect with entrepreneurs.

"In today's fast-paced world of information and innovation, all Americans, rather than just banks and venture capitalists, should be able to invest in the next Google or Apple," he said.

James Childs, partner at Bradley Arant Boult Cummings LLP, said the proposed \$10,000 limit and 10 percent of income caps are reasonable metrics to ensure an adequate level of investor protection.

Childs said under the current regulatory landscape, anyone who chooses to use crowdfunding to sell securities may be doing so in violation of applicable securities laws, which could give investors a rescission right – the right to force the company to buy back their securities – and create problems for the company with respect to any future financing or an ultimate sale of the busi-

ness.

"The currently proposed crowdfunding exemption would resolve this existing disconnect between the law and the objectives of crowdfunding and thereby permit non-accredited investors to participate in the potential returns offered by start-ups and make it easier for entrepreneurs to secure start-up capital," he said.

Karen Kerrigan, president and CEO of the Small Business & Entrepreneurship Council, said she was "pleasantly surprised" that Obama included crowdfunding in his jobs plan, and hopes the president will continue pushing it.

"I think small business owners need new sources of capital," Kerrigan said, noting that credit is still tight.

"Legalizing crowdfunding would be a great breakthrough for the entrepreneurial sector," Kerrigan said.

At a Sept. 15 hearing on McHenry's bill, Meredith Cross, director of the SEC's division of corporate finance acknowledged crowdfunding's potential. But, she added, "an exemption from registration and the investor protections provided thereby also would present an enticing opportunity for the unscrupulous to engage in fraudulent activities that could undermine investor confidence."

Katharine Musso, a partner at Jones Walker Waechter Poitevent Carrère & Denègre LLP, said in the absence of some type of regulatory oversight, it is inevitable that "fraudsters" will take advantage of this trend.

"This is not to say that there aren't legitimate players in the market just that criminals will always fill an unregulated market with fraud," she said.

Florida entrepreneur Neiss said the "crowd" aspect of crowdfunding offers strong protections against fraud.

"Opening the funding process to the general public adds transparent and trust signaling," he said. "It's much harder for fraud to occur when the whole world is watching on an open and transparent platform, especially with credibility and performance ratings that are visible to the community."

acole@bizjournals.com | (205) 443-5636
khoover@bizjournals.com