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News Briefs

Be Careful, Entrepreneurs: Crowdfunding Securities Offerings Aren't Yet Legal

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Amid all the excitement over the JOBS Act's creation of an exemption for crowdfunding, few have noticed that crowdfunding securities offerings are not yet lawful under the Securities Laws. While the JOBS Act did create a new exemption from registration for crowdfunding under Section 4(6) of the Securities Act, the SEC has been given a 270-day mandate to create and implement

rules governing crowdfunding by sale of securities. This mandate runs until Dec. 31, 2012, so crowdfunded securities offerings will not be lawful until late 2012 or even 2013, depending on when the SEC adopts the necessary rules.

Nonetheless, there appears to be a widespread belief that crowdfunded securities offerings are already legal under the JOBS Act. On April 23, **the SEC issued a sternly worded reminder** that until the implementing rules are adopted, “any offers or sales of securities purporting to rely on the crowdfunding exemption would be unlawful under the federal securities laws.”

The SEC has 270 days from the April 5 passage of the JOBS Act — until Dec. 31 — to adopt rules implementing the Section 4(6) exemption to permit crowdfunded securities offerings. For a detailed primer on the JOBS Act’s creation of the crowdfunding exemption, and its likely effects on entrepreneurs and the securities markets, see my **earlier post**. It notes that the SEC openly opposed crowdfunding prior to the JOBS Act, including pointed criticism by SEC Chairwoman **Mary Schapiro that crowdfunding would weaken investor protection and be “a step backwards.”** In light of this regulatory opposition, entrepreneurs should expect burdensome compliance and disclosure requirements from the SEC in the name of “investor protection.”

Until the SEC rule-making is complete, the crowdfunding exemption under Section 4(6) is not available for offers and sales of securities. Nonetheless, equity crowdfunding offers are already easy to find. A simple search of the Twitter hashtag “#Crowdfunding” produces several equity fundraising offers. One example is this offer of 40% equity in Scotland’s Kingsbarns Distillery, posted to Twitter around April 23:

Douglas Clement @KingsbarnWhisky

Can you help me turn my whisky dream of creating a craft distillery at the home of golf into reality?

<http://www.crowdcube.com/investment/kingsbarns-distillery-10564>
#crowdfunding

As a fan of both golf and single malt scotch, I believe Mr. Clement’s ambition of building a craft distillery in **Fife, Scotland, the spiritual home of golf**, is truly

God's work. But as a corporate lawyer, I believe the SEC would view this tweet as an offer to sell securities which presumably have not been registered under the Securities Act. Unless Mr. Clement can find an available exemption from registration under Regulation D, the SEC would take a dim view of this offering and any sales consummated from it in the U.S. Even if an exemption were available, this tweet would constitute a general solicitation, which is prohibited under the U.S. securities laws for unregistered offerings and would disqualify Kingsbarns from using the exemption.

As discussed in this article, JOBS Act reforms will permit general solicitation for private placements as long as all sales are to accredited investors. However, the general solicitation reforms are themselves subject to a 90-day SEC rule-making period that runs through early July. In the meantime, general solicitation is still prohibited.

Mr. Clement's attempt to raise crowdfunding for Kingsbarns Distillery shows how easy it is for ambitious and enthusiastic entrepreneurs to inadvertently run afoul of U.S. securities laws. I doubt that Kingsbarns intended to engage in a general solicitation, or was even aware of the restrictions on securities offers and sales under U.S. laws. But this is exactly why the SEC issued its warning.

The stakes are high: Promoters and entrepreneurs who sell securities in violation of securities laws may be liable for **civil and criminal penalties**, and buyers may rescind their purchases of unlawfully offered securities. Would-be crowdfunders should wait for the SEC to adopt its rulemaking, and then follow it very closely.

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