

BizTech Law Blog

The SEC Crowdfunding Proposed Regulations: Use of Intermediary & Disqualified Issuers

November 20, 2013

Use of Intermediary. The proposed crowdfunding regulations require the issuer (the company raising capital) to make an offering through only a single intermediary. The SEC apparently believes that in order for an intermediary to perform the necessary monitoring functions, the intermediary needs to be the sole provider of intermediary services. Furthermore, the SEC sees value in having all public comments and discussions about an offering posted in one place.

Disqualified Issuers. The JOBS Act listed certain types of issuers who are not eligible to use the crowdfunding exemption, and gave the SEC latitude to exclude additional types of issuers. A list of the types of issuers who may not use the crowdfunding exemption under the proposed regulations follows:

- An issuer that is not organized in, and subject to the laws of, a U.S. state, territory or the District of Columbia.
- An issuer that is a reporting company under the Securities Exchange Act of 1934; i.e., a company that is publicly traded.
- An investment company, as defined in the Investment Company Act of 1940, or is excluded from the definition of investment company under Section 3(b) or 3(c) of that act. In general, this encompasses companies whose primary business is investing in or trading in securities, such as a mutual fund or similarly structured business.
- An issuer who has, or whose predecessor, affiliates, directors, officers, managers, or 20% equity owners have, engaged in prior "bad acts." These "bad acts" include prior criminal convictions, civil judgments and governmental agency orders in which the actor has been found to have violated the securities laws, along with other related violations of law. The list of "bad acts" that may disqualify an issuer is quite long.
- An issuer that has relied on the crowdfunding exemption in the past, and during the preceding two years has failed to file the reports it is required to file with the SEC. We will describe the reporting requirements in a later article.
- An issuer that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with one or more unidentified companies. The SEC's comments make it clear that a formal, fully developed business plan is not required. But the SEC wants to make sure the issuer has a specific business activity it plans to pursue with the proceeds of the offering.

Any controversy over this list is likely to focus on the last two bullet points. The SEC is quite serious about enforcing the report filing requirements, in part because it feels it needs the data to evaluate how the process is working. But any reporting requirement placed on early stage and small businesses is an administrative burden that takes time and energy away from the real work of growing a business. Look for more discussion about this issue.

The business plan requirement is likely to create consternation in some circles, who may feel that it is ambiguous as to what is actually required. In most cases, we believe it will be obvious whether a company has a business plan within the SEC's meaning, or whether it is a "blank check company" with no real future plan. If there is an articulated business concept relating to one or more specific products or services, the business plan requirement will be met. We agree with the SEC that it is wise to exclude issuers who do not have an articulated business plan. The law was intended to help actual operating businesses raise capital.

Click Below to read the previous posts regarding the Proposed Crowdfunding Regulations:

- **PART 2:** The SEC Crowdfunding Proposed Regulations: Platform for Offering Issuer's Maximum Offering Size
- **PART 1:** The SEC Crowdfunding Proposed Regulations: Process Overview

Please contact Iris Linder (517-371-8127 or ilinder@fosterswift.com) for more information.