Financing the New Business – With Special Emphasis on How to Conduct a Crowd Funding Offering Under the New Reg CF Changes

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1. Current Regulatory Landscape and Key Definitions.

1.1. Generally. Nearly every means by which a company raises capital involves securities laws. These laws regulate the manner in which securities are sold, the amount of money that may be raised, the persons to whom the securities may be offered, and the method by which investors may be solicited.

1.2. Federal Registrations and Exemptions. As a general rule, in order to comply with Federal securities laws, a person selling a security must either (a) "register" such sale with the SEC or (b) identify a specific exemption that allows such sale to be conducted without registration.

1.2.1. SEC registration is time consuming and expensive.

1.2.2. For most small businesses, SEC registration is not a feasible option.

1.3. State Blue Sky Laws. In addition, an issuer selling securities must adhere to **blue sky laws** in each state where the securities are being sold, all of which vary from each other. In Minnesota, the securities laws are set out in Chapter 80A.

1.4. Private Placements.

1.4.1. Section 4(2). The most common federal exemption entrepreneurs rely on is Section 4(2) of the Securities Act, which exempts "transactions . . . not involving any public offering" – i.e., a **private placement**. A company seeking to determine whether an offering will be exempt from registration under Section 4(2) will need to evaluate a number of factors which, although routinely addressed by courts, seldom lead to a definitive answer as to whether an offering is a "public offering" under Section 4(2). Different courts emphasize different factors critical to the Section 4(2) exemption, no single one of which necessarily controls. The factors are simply guidelines, and include:

(a) Offeree qualification (i.e., whether the investors are sophisticated);

(b) Manner of the offering (i.e., whether the company will engage in advertising or other promotional activities);

(c) Availability and accuracy of information given to offerees and purchasers (i.e., whether the people to whom the company proposes to sell securities have access to basic financial information about the company);

(d) The number of offerings and number of purchasers (i.e., whether the company solicited investment from a large group of people); and;

(e) Absence of intent to redistribute (i.e., whether the people to whom the company proposes to sell securities have an intention to hold the securities for investment purposes – generally for a minimum holding period of 24 months).

1.4.2. Regulation D. In Regulation D, the SEC provides a clear set of "safe harbor" rules that issuers can follow to ensure that they are conducting a valid private placement under Section 4(2). The most common safe harbors that small companies have customarily relied upon in conducting private placements are Rule 504 and Rule 506 (now called Rule 506(b) – *see below*).

1.5. Key Definitions.

1.5.1. General Solicitation Rule 502(c) of Regulation D provides that "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, the following: (1) any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and (2) any seminar or meeting whose attendees have been invited by any general solicitation or advertising." In general, this means that issuers will need to have a substantial pre-existing relationship with a potential investor before making an offer of securities under Rule 504 or Rule 506(b).

1.5.2. Accredited investor. Under Rule 501(a) of Regulation D, an accredited investor is a person who meets certain qualifications and, therefore, is deemed able to protect himself or herself in making investment decisions without additional protections under the securities laws, such as those obtained through the SEC registration process and the public disclosure of information about the company that is made through the process of becoming an SEC reporting company. There are several ways to qualify as an accredited investor with the most common being (1) an individual with at least $200,000 (or $300,000 jointly with a spouse) in annual income over the past 2 years or at least $1 million in net worth (excluding the value of a principal residence) or (2) an entity in which all of the equity owners are accredited investors or the entity has at least $5 million in net assets.

2. The "Old Rules" For Raising Capital.

2.1. Rule 504. Generally speaking, Rule 504 allows companies to raise up to $10 million[1] from an unlimited number of accredited and non-accredited investors

[1] This limit was increased from $5 million to $10 million effective as of January 2021. Prior to January 20, 2017, the Rule 504 limit was $1 million.

(subject to counterpart state Blue Sky registrations and exemptions). Companies are not permitted to engage is general solicitation except for in states where the securities have been registered or states that provide an exemption from registration that allows the company to generally solicit to accredited investors only.

2.1.1. Minnesota counterpart – Limited Offering Exemption. Minnesota has a "limited offering" exemption that is often relied on by companies who are conducting Rule 504 offerings. Under Minn. Stat. § 80A.46, sales by a company to no more than 35 non-accredited investors (and an unlimited number of accredited investors) in Minnesota during any 12 consecutive months are exempt from registration in Minnesota if the following conditions are met:

(a) The company does not use general solicitation or general advertising;

(b) The company reasonably believes all non-accredited investors participating in the offering are purchasing for investment;

(c) The company does not pay any commission or other remuneration, directly or indirectly, for soliciting any prospective buyer in Minnesota, except for payments to a broker-dealer or agent registered in Minnesota; and

(d) If the company is selling securities to more than 10 non-accredited investors, then the company must file a "Statement of Issuer" with the Minnesota Securities Division.

2.2. Rule 506. Rule 506 is the most common "safe harbor" relied on by companies conducting private placements. Generally speaking, Rule 506 allows an issuer to raise an unlimited amount of capital from an unlimited number of accredited investors and up to 35 non-accredited investors. However, if even one non-accredited investor becomes a purchaser in the offering, then the company must provide all investors with a very detailed disclosure document that satisfies other SEC requirements. For this reason, the practical reality is that Rule 506 offerings are usually restricted to accredited investors only.

2.2.1. Minnesota counterpart. Securities issued in reliance on Rule 506 are considered Federal "covered securities" and the offer and sale of such securities are exempt from registration in Minnesota (Minn. Stat. § 80a.50) as long as the issuer makes a notice filing with the Minnesota Securities Division containing the following:

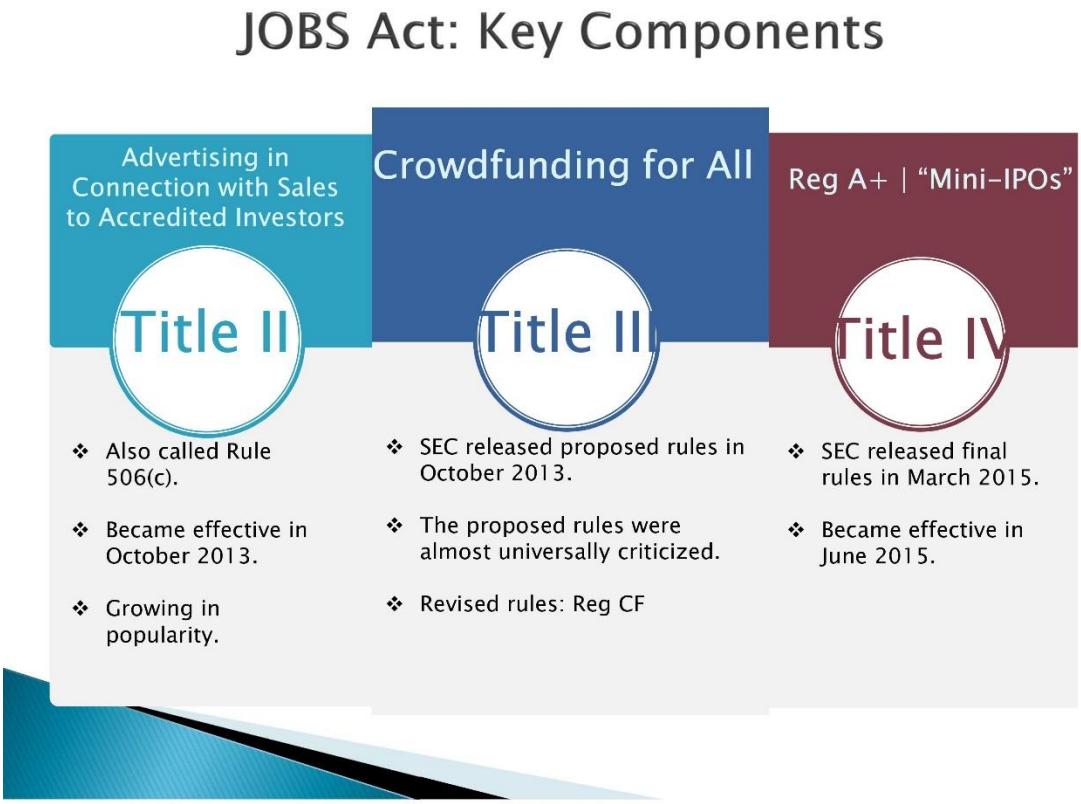
(a) A copy of the Form D that the issuer filed with the SEC;

(b) A statement of the aggregate amount of securities already sold or offered to persons in Minnesota;

(c) A consent to service of process signed not later than 15 days after the first sale of securities to persons in Minnesota; and

(d) A filing fee, which is currently $100 plus 0.1% of the maximum aggregate offering price at which the securities are to be offered in Minnesota, with total fees not to exceed $300.

3. The "New" Rules: Jumpstart Our Business Startups (JOBS) Act. On April 5, 2012, Congress passed the JOBS Act in an effort to foster job growth by modernizing Federal securities laws. The JOBS Act consisted of three key parts that are relevant for securities crowdfunding:



3.1. Title II and Rule 506(c) – Advertising to Accredited Investors. In late 2013, the SEC (pursuant to the authority granted to it under Title II of the JOBS Act), finalized new Rule 506(c) which allows companies to generally solicit (or advertise) their securities offerings so long as all of the investors who actually purchase securities in the offer are accredited. This means that companies may now talk about their offerings in public seminars, send out email blasts, push offering information out on social media sites, as well as run ads on TV, radio, and the internet. Companies who comply with Rule 506(c) are now free to talk about their offering to whomever they want (including non-accredited investors). Companies who generally solicit under Rule 506(c) may only sell the securities to accredited investors.

3.1.1. Verification Steps. Using Rule 506(c), however, comes with certain additional compliance requirements. Companies must take additional steps to verify that all purchasers actually are accredited. In Rule 506(c), the SEC listed several non-exclusive methods that are deemed to satisfy

the verification requirements (provided that the issuer does not have knowledge that the purchaser is non-accredited). The "safe harbors" include:

(a) Income verification by checking federal tax forms, including W-2's and tax returns, and a statement by the investor that he or she expects enough income in the current year to remain accredited;

(b) Net worth verification by checking a recent credit report (with the past 3 months) and bank or investment account statements, together with a written representation from the purchaser that he or she has disclosed all liabilities necessary to make a determination of net worth; and

(c) Certification of accredited investor status by a registered broker-dealer, SEC-registered investment advisor, licensed attorney, or CPA who has verified the purchaser's accredited investor status.

3.1.2. MN Notice Filing. MN still requires a notice filing for 506(c) offerings (see Section 2.3.1 above). Other states may also require similar notice filings.

3.1.3. Comparison of Rules 504, 506(b), and 506(c).

	Rule 504	Rule 506(b)	Rule 506(c)
How much money can I raise?	Up to $10M	Unlimited	Unlimited
Can I advertise the sale of my securities?	**No, unless coupled with a state exemption or registration that allows advertising.**	**No, unless coupled with a state exemption or registration that allows advertising.**	**Yes.**
To whom can I sell securities?	Anyone However, counterpart state exemptions or registrations may impose additional restrictions on number of non-accredited investors.	Unlimited number of accredited investors Up to 35 non-accredited investors if you believe they are "sophisticated"	Unlimited number of accredited investors
Do I have to comply with the SEC's formal information delivery requirements?	No, but counterpart state exemption or registration may impose additional requirements.	No, if only accredited investors are included Yes, if any non-accredited investors are included	No.
Do I have to verify that any accredited investors are truly accredited?	No, accredited investors can "self-certify."	No, accredited investors can "self-certify."	Yes, you must take "reasonable steps" to verify that the investors are, in fact, accredited.

3.2. Title III "retail" crowdfunding and Regulation CF. Title III of the JOBS Act was meant to democratize the business funding process by allowing non-accredited individuals the opportunity to participate online and invest into private companies. Like Titles II and IV, implementation of this law is dependent on the SEC promulgating rules, but unlike Titles II and IV these rules have not yet been adopted. On October 23, 2013, the SEC issued proposed rules, which were criticized by most commentators as onerous and impractical. The nearly 600-page rules set out a very difficult and expensive process for any business that wished to raise funds through crowdfunding.

The SEC adopted securities-based crowdfunding rules on October 30, 2015. Issuers were able to use the new exemption beginning May 16, 2016, when the final rules became effective. Amendments to these rules in March 2021 increased the maximum amount(s) that could be raised under Regulation CF.

1. Requirements of Regulation Crowdfunding. In order to rely on the Regulation Crowdfunding exemption, certain requirements must be met:

a. Maximum Offering Amount of $5,000,000.[2] A company issuing securities in reliance on Regulation Crowdfunding (an "issuer") is permitted to raise a maximum aggregate amount of $1,070,000 in a 12-month period. In determining the amount that may be sold in a particular offering, an issuer should count:

- the amount it has already sold (including amounts sold by entities controlled by, or under common control with, the issuer, as well as any amounts sold by any predecessor of the issuer) in reliance on Regulation Crowdfunding during the 12-month period preceding the expected date of sale, plus

- the amount the issuer intends to raise in reliance on Regulation Crowdfunding in this offering.

An issuer does not aggregate amounts sold in other exempt (non-crowdfunding) offerings during the preceding 12-month period for purposes of determining the amount that may be sold in a particular Regulation Crowdfunding offering.

b. Investors Subject to Limits. Individual investors are limited in the amounts they are allowed to invest in all Regulation Crowdfunding offerings over the course of a 12-month period. If either of an investor's annual income or net worth is less than $107,000, then the investor's investment limit is the greater of:

- $2,200 or

- 5 percent of the greater of the investor's annual income or net worth.

[2] NOTE: the original maximum amount permitted to be raised under Regulation CF was $1,070,000. The maximum amount was increased to $5,000,000 effective March 15, 2021.

- If both annual income and net worth are equal to or more than $107,000, then the investor's limit is 10 percent of the greater of their annual income or net worth.

- During the 12-month period, the aggregate amount of securities sold to an investor through all Regulation Crowdfunding offerings may not exceed $107,000, regardless of the investor's annual income or net worth.

c. Transactions Conducted Through an Intermediary. Each Regulation Crowdfunding offering must be exclusively conducted through one online platform. The intermediary operating the platform must be a broker-dealer or a funding portal that is registered with the SEC and FINRA. Issuers may rely on the efforts of the intermediary to determine that the aggregate amount of securities purchased by an investor does not cause the investor to exceed the investment limits, so long as the issuer does not have knowledge that the investor would exceed the investment limits as a result of purchasing securities in the issuer's offering.

d. Eligibility. Certain companies are not eligible to use the Regulation Crowdfunding exemption. These include:

- non-U.S. companies;
- companies that already are Exchange Act reporting companies;
- certain investment companies;
- companies that are disqualified under Regulation Crowdfunding's disqualification rules;
- companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding during the two years immediately preceding the filing of the offering statement; and
- companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies.

2. Disclosure by Issuers

a. Form C. Any issuer conducting a Regulation Crowdfunding offering must electronically file its offering statement on Form C through the Commission's Electronic Data Gathering, Analysis and Retrieval (EDGAR) system and with the intermediary facilitating the crowdfunding offering. A Form C cover page will be generated when the issuer provides information in XML-based fillable text boxes on the EDGAR system. Other required disclosure that is not requested in the XML text boxes must be filed as attachments to Form C. There is not a specific presentation format required for the attachments to Form C; however, the form does include an optional "Question and Answer" format that issuers may use to provide the disclosures that are required but not included in the XML portion.

b. Offering Statement Disclosure. The instructions to Form C indicate the information that an issuer must disclose, including:

- information about officers, directors, and owners of 20 percent or more of the issuer;
- a description of the issuer's business and the use of proceeds from the offering;
- the price to the public of the securities or the method for determining the price,
- the target offering amount and the deadline to reach the target offering amount,
- whether the issuer will accept investments in excess of the target offering amount;
- certain related-party transactions; and
- a discussion of the issuer's financial condition and financial statements.

The financial statements requirements are based on the amount offered and sold in reliance on Regulation Crowdfunding within the preceding 12-month period:

For issuers offering less than $250,000: Financial statements of the issuer and certain information from the issuer's federal income tax returns, both certified by the principal executive officer. If, however, financial statements of the issuer are available that have either been reviewed or audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and will not need to include the information reported on the federal income tax returns or the certification of the principal executive officer.

Issuers offering $250,000 but not more than $1,070,000: Financial statements reviewed by a public accountant that is independent of the issuer. If, however, financial statements of the issuer are available that have been audited by a public accountant that is independent of the issuer, the issuer must provide those financial statements instead and will not need to include the reviewed financial statements.

Issuers offering more than $1,070,000: Financial statements audited by a public accountant that is independent of the issuer.

c. Amendments to Offering Statement. For any offering that has not yet been completed or terminated, an issuer can file on Form C/A an amendment to its offering statement to disclose changes, additions or updates to information. An amendment is required for changes, additions or updates that are material, and in those required instances the issuer must reconfirm outstanding investment commitments within 5 business days, or the investor's commitment will be considered cancelled.

d. Progress Updates. An issuer must provide an update on its progress toward meeting the target offering amount within 5 business days after reaching 50% and 100% of its target offering amount. These updates will be filed on Form C-U. If the issuer will accept proceeds over the target offering amount, it also must file a final Form C-U reflecting the total amount of securities sold in the offering. If, however, the intermediary provides frequent updates on its platform regarding the progress of the issuer in meeting the target offering amount, then the issuer will need to file only a final Form C-U to disclose the total amount of securities sold in the offering.

e. Annual Reports. An issuer that sold securities in a Regulation Crowdfunding offering is required to provide an annual report on Form C-AR no later than 120 days after the end of its fiscal year. The report must be filed on EDGAR and posted on the issuer's website. The annual report requires information similar to what is required in the offering statement, although neither an audit nor a review of the financial statements is required. Issuers must comply with the annual reporting requirement until one of the following occurs:

(1) the issuer is required to file reports under Exchange Act Sections 13(a) or 15(d);

(2) the issuer has filed at least one annual report and has fewer than 300 holders of record;

(3) the issuer has filed at least three annual reports and has total assets that do not exceed $10 million;

(4) the issuer or another party purchases or repurchases all of the securities issued pursuant to Regulation Crowdfunding, including any payment in full of debt securities or any complete redemption of redeemable securities; or

(5) the issuer liquidates or dissolves in accordance with state law.

Any issuer terminating its annual reporting obligations is required to file notice on Form C-TR reporting that it will no longer provide annual reports pursuant to the requirements of Regulation Crowdfunding.

3. Limits on Advertising and Promoters. An issuer may not advertise the terms of a Regulation Crowdfunding offering except in a notice that directs investors to the intermediary's platform and includes no more than the following information:

(a) a statement that the issuer is conducting an offering pursuant to Section 4(a)(6) of the Securities Act, the name of the intermediary through which the offering is being conducted, and a link directing the potential investor to the intermediary's platform;

(b) the terms of the offering, which means the amount of securities offered, the nature of the securities, the price of the securities, and the closing date of the offering period; and

(c) factual information about the legal identity and business location of the issuer, limited to the name of the issuer of the security, the address, phone number, and website of the issuer, the e-mail address of a representative of the issuer, and a brief description of the business of the issuer.

Although advertising the terms of the offering off of the intermediary's platform is limited to a brief notice, an issuer may communicate with investors and potential investors about the terms of the offering through communication channels provided on the intermediary's platform. An issuer must identify itself as the issuer and persons acting on behalf of the issuer must identify their affiliation with the issuer in all communications on the intermediary's platform.

An issuer is allowed to compensate others to promote its crowdfunding offerings through communication channels provided by an intermediary, but only if the issuer takes reasonable steps to ensure that the promoter clearly discloses the compensation with each communication.

Oral communications with prospective crowdfunding investors are permitted once the Form C is filed, so long as the communications comply with the requirements of Rule 204. The amendments also permit an issuer to provide information about the terms of an offering under Regulation Crowdfunding in the offering materials for a concurrent offering without violating Rule 204.

The definition of the "terms of the offering" includes:

- the amount of securities offered;
- the nature of the securities;
- the price of the securities;
- the closing date of the offering period;
- the planned use of proceeds; and
- the issuer's progress toward meeting its funding target.

4. Restrictions on Resale. Securities purchased in a crowdfunding transaction generally cannot be resold for a period of one year, unless the securities are transferred:

(1) to the issuer of the securities;

(2) to an "accredited investor";

(3) as part of an offering registered with the Commission; or

(4) to a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.

5. Exemption from Section 12(g). Section 12(g) of the Exchange Act requires an issuer with total assets of more than $10 million and a class of securities held of record by either 2,000 persons, or 500 persons who are not accredited investors, to register that class of securities with the Commission. However, securities issued pursuant to Regulation Crowdfunding are conditionally exempted from the record holder count under Section 12(g) if the following conditions are met:

- the issuer is current in its ongoing annual reports required pursuant to Regulation Crowdfunding;
- has total assets as of the end of its last fiscal year of $25 million or less; and
- has engaged the services of a transfer agent registered with the SEC.

As a result, Section 12(g) registration is required if an issuer has, on the last day of its fiscal year, total assets greater than $25 million and the class of equity securities is held by more than 2,000 persons, or 500 persons who are not accredited investors. In that circumstance, an issuer is granted a two-year transition period before it is required to register its class of securities pursuant to Section 12(g), so long as it timely files all of the annual reports required by Regulation Crowdfunding during such period.

An issuer seeking to exclude a person from the record holder count of Section 12(g) is responsible for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6).

6. Bad Actor Disqualification. Rule 503 of Regulation Crowdfunding includes "bad actor" disqualification provisions that disqualify offerings if the issuer or other "covered persons" have experienced a disqualifying event, such as being convicted of, or subject to court or administrative sanctions for, securities fraud or other violations of specified laws.

a. Covered Persons

Understanding the categories of persons that are covered by Rule 503 is important because issuers are required to conduct a factual inquiry to determine whether any covered person has had a disqualifying event, and the existence of such an event will generally disqualify the offering from reliance on Regulation Crowdfunding.

"Covered persons" include:

- the issuer, including its predecessors and affiliated issuers;
- directors, officers, general partners or managing members of the issuer;
- beneficial owners of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power;
- promoters connected with the issuer in any capacity at time of sale; and

- persons compensated for soliciting investors, including the general partners, directors, officers or managing members of any such solicitor.

b. Disqualifying Events

Under the final rule, disqualifying events include:

- Certain criminal convictions;
- Certain court injunctions and restraining orders;
- Certain final orders of certain state and federal regulators;
- Certain SEC disciplinary orders;
- Certain SEC cease-and-desist orders;
- Suspension or expulsion from membership in a self-regulatory organization (SRO), such as FINRA, or being barred from association with an SRO member;
- SEC stop orders and orders suspending the Regulation A exemption; and
- U.S. Postal Service false representation orders.

Many disqualifying events include a look-back period (for example, a court injunction that was issued within the last five years or a regulatory order that was issued within the last ten years). The look-back period is measured from the date of the disqualifying event – for example, the issuance of the injunction or regulatory order and not the date of the underlying conduct that led to the disqualifying event – to the date of the filing of an offering statement.

Disqualification will not arise as a result of disqualifying events relating to any conviction, order, judgment, decree, suspension, expulsion or bar that occurred before May 16, 2016, the effective date of Regulation Crowdfunding. Matters that existed before the effective date of Regulation Crowdfunding, are still within the relevant look-back period, and would otherwise be disqualifying are, however, required to be disclosed in the issuer's offering statement.

7. Testing the Waters. Rule 206 of Regulation Crowdfunding allows issuers to "test the waters," or solicit interest in a potential offering from the general public, orally or in writing prior to filing a Form C, provided that the solicitation materials used include the legends required by rule. The issuer is required to include any Rule 206 solicitation materials with the Form C that is filed with the Commission. Once the Form C is filed, any offering communications are required to comply with the terms of Regulation Crowdfunding, including the Rule 204 advertising restrictions.

3.3. Title IV and Regulation A+. Reg A+, which went into effect in June 2015, has been described as a mini-IPO or "IPO-Lite," in that it allows nearly any company with principal offices in the U.S. or Canada to use internet crowdfunding to raise up to $50 million per year from any number of both accredited and non-accredited investors under a regulatory scheme that is far less burdensome than that of a traditional IPO. There is no prohibition on general solicitation, and offering companies are not required to independently verify the sophistication (income or net worth) of their investors. Corporations, limited liability companies, and limited partnerships can take advantage of Reg A+'s two-tiered offering scheme and can sell nearly all types of securities, including equity, debt, and debt securities convertible into equity securities. Furthermore, the securities issued in Reg A+ will be unrestricted and freely transferable. One of the most exciting changes for companies seeking to raise capital under Reg A+ is that Tier 2 offerings are not subject to state Blue Sky registration and merit review (further explained below).

3.3.1. Tier 1. Tier 1 offerings are largely similar to old Regulation A offerings, but the old limit of $5 million raised in a 12-month period per issuer has now been increased to $20 million. Unlike Tier 2, there is no limit on the amount a non-accredited investor may invest in any Tier 1 offering.

(a) State Registration. Tier 1 still requires that offerors register under the Blue Sky laws of every state in which money is raised. However, the NASAA (North American Securities Administrators Association) recently launched a multi-state coordinated review program for Regulation A offerings that, if successful, would allow an issuer to register with multiple states by filing just one package with a relatively quick turnaround time. This could make Tier 1 much more attractive for many issuers, given its lower cost.

(b) Reporting. Tier 1 is less burdensome than Tier 2 in terms of SEC requirements for initial filing and ongoing reporting. Tier 1 does not require audited financial statements nor ongoing reporting. The only requirement is that offering companies file a Form 1-Z to report the completion of their offering.

3.3.2. Tier 2. Under Tier 2, companies are allowed to raise up to $50 million in a 12-month period and, most importantly, there is no requirement that the offering company register under any state Blue Sky laws because the federal Reg A+ preempts state law. Tier 2 offerings must only be registered with and approved by the SEC. On the other hand, Tier 2 limits investment by non-accredited investors to the greater of 10% of their annual income or net worth, excluding their primary residence, per offering. Tier 2 also includes substantially more onerous reporting requirements than Tier 1.

(a) **Audited Financial Statements.** Tier 2 issuers must provide the SEC with two years of audited financial statements before approval, while Tier 1 issuers only need to provide "reviewed" statements.

(b) **Ongoing Reporting.** After a successful Tier 2 raise, Tier 2 issuers who have 300 or more record holders of the security offered must also file the following ongoing reports:

(i) Detailed annual reports, using Form 1-K;

(ii) Semiannual reports, using Form 1-SA, including unaudited interim financial statements and a management discussion; and

(iii) Current event reports, using Form 1-U, reporting all fundamental changes.

4. How can companies engage in securities crowdfunding today?

4.1. **Title II / Rule 506(c) + State exemption**. The vast majority of companies that sell securities on "crowdfunding" sites like CirculeUp.com and SeedInvest.com rely on Rule 506(c) to advertise their offerings, but they are only permitted to sell their securities to accredited investors. In the view of these authors any many other industry experts, this is not true crowdfunding.

4.2. **Rule 504 + State registration**. Theoretically, a company may legally conduct a small (less than $1 million) crowdfunding campaign in Minnesota by combing a Federal Rule 504 exemption with a Minnesota SCOR offering under Minn. Stat. § 80A.50(b).

4.2.1. **General Solicitation under Rule 504**. Rule 504 allows an issuer to engage in general solicitation to accredited and non-accredited investors if the issuer either:

(a) registers the offering exclusively in one or more states that require a publicly filed registration statement and delivery of a substantive disclosure document to investors; or

(b) registers and sells the offering in a state that requires registration and disclosure delivery and also sells in a state without those requirements, so long as the company delivers the disclosure documents required by the state where the company registered the offering to all purchasers (including those in the state that has no such requirements).

4.2.2. MN SCOR Offering. Minn. Stat. § 80A.50(b) provides a simplified process for "small corporate offering registrations (SCOR)" that otherwise are exempt from Federal registration under Rule 504.

(a) Form U-7. SCOR was developed by the North American Securities Administrators Association (NASAA) to facilitate compliance by smaller companies with state regulations. SCOR allows companies to complete a Form U-7 Disclosure Document in lieu of the expensive and substantial disclosure documents required for a registration statement. The Form U-7 consists of 50 detailed questions designed to provide the state and the investor with important information regarding the company's operations. The questions in the U-7 form consist of items such as the company's history; its business and properties; risk factors facing the company; use of the offering proceeds; description of the securities being offered; dividend history; key personnel; principal stockholders; and pending or threatened litigation. **Instead of filing Form U-7, an issuer may use a different format that complies with all items and instructions of Form U-7 and as provided under Minnesota Rule 2876.3021. If the issuer wishes to use a format other than Form U-7, then it must include a reasonably detailed table of contents and an index indicating where the information required by each item of Form U-7 is located.**

(b) Required Filings. A company seeking to conduct a SCOR offering in Minnesota must submit the following items to the Minnesota Securities Division:

(i) Completed Form U-7 (note that Form U-7 requires the company to attached audited or reviewed financial statements);

(ii) Consent to service of process in MN;

(iii) A specimen of the security being offered (e.g., copy of the stock certificate, if applicable)

(iv) Opinion of counsel concerning the legality of the securities being registered, which states whether the securities, when sold, will be validly issued, fully paid, and nonassessable and, if debt securities, binding obligations of the issuer;

(v) List of other states in which the securities are registered or are being registered;

(vi) A copy of the offering document (i.e., PPM) provided to prospective purchasers; and

(vii) a copy of any other pamphlet, circular, form letter, advertisement, or other sales literature intended as of the effective date to be used in connection with the offering.

4.2.3. Issuer-Operated Portal. Technically, no provision in Chapter 80A prohibits a company who registers its securities as part of a SCOR offering from using the internet to advertise its offering. Therefore, it seems that a company who validly registers its securities through a SCOR offering may own and operate its own "crowdfunding" website.

4.2.4. Third Party Portal. Under current Minnesota statute, for third-parties to act as portals for SCOR offerings, except under limited exceptions, they must be registered with the state as broker-dealers (Minn. Stat. § 80A.41 and § 80A.56).

4.3. Federal intrastate exemption + State exemption (i.e., *MNVest*).

4.3.1. Section 3(a)(11) and Rule 147. Another lesser known Federal securities exemption is the "intrastate" exemption embodied by Section 3(a)(11) of the Securities Act and Rule 147 promulgated by the SEC. Generally speaking, Section 3(a)(11) exempts from SEC registration any offering that is confined to the borders of a single state. To qualify for this exemption, the company must meet requirements of Rule 147, which include:

(a) The company must be incorporated in the state in which it is offering the securities;

(b) The company must only sell the securities to individuals residing in that state;

(c) 80% of the company's consolidated gross revenues must be derived from the state in which the offering is conducted;

(d) 80% of the company's consolidated assets must be located within the state in which the offering is conducted; and

(e) 80% of the offering's net proceeds must be intended to be used, and actually used, in connection with the operation of a business or real property, the purchase of real property located in, or the rendering of services, within the state in which the offering is conducted.

4.3.2. General Solicitation in Intrastate Crowdfunding Offerings. There is no prohibition in Section 3(a)(11) or Rule 147 regarding general solicitation as long as such solicitation (1) complies with applicable state law and (2) does not result in an offer or sale to nonresidents of such state.

(a) **SEC Guidance on Online Advertising**. In recent months, the SEC has provided guidance on how intrastate issuers can use the internet to publicize their offerings without having those online advertisements result in an offer or sale to nonresidents of that state.

(i) **Limiting Access to Out of State Residents**. In April 2014, the SEC clarified in Questions 141.03–141.05 that issuers hoping to utilize the Rule 147 exemption could use the Internet for general advertising and solicitation if they implemented measures to limit the offers to people within the issuer's state. In the context of an offering conducted within state crowdfunding requirements, those measures have to include:

(1) limiting access to information about a specific investment opportunity to persons who confirm they are residents of the relevant state "(for example, by providing a representation . . . such as a zip code or residence address)" and

(2) providing a disclaimer and restrictive legend clarifying "that the offer is limited to residents of the relevant state under applicable law." (Question 141.04).

(ii) **IP Address Blocking**. In recent months, the SEC suggested what might be a simpler method of limiting the offer to those within the relevant state. The issuer can "implement technological measures" that limit any offers to persons with an IP address originating within the issuer's state and prevent offers to any individuals outside of the issuer's state (Question 141.05). However, the offer should still contain a disclaimer and restrictive legend. Presumably, this clarification allows issuers to skip the opt-in step where the viewer must verify they are residents of the relevant state before viewing the solicitation or advertisement. The simplification could greatly increase the number of views and potentially improve the effectiveness of the communication.

4.4. **MNvest.** New intrastate crowdfunding system for accredited and non-accredited investors. The MNvest system is codified in Minn. Stat. § 80A.461. However, MNvest offerings cannot yet be conducted until the Minnesota Department of Commerce releases final rules and regulations (expected shortly).

4.4.1. Generally: MNvest offerings are exempted from registration under the Minnesota blue sky laws, included in statute sections 80A.49 to 80A.54. Minn. Stat. § 80A.461, Subd. 2. MNvest provides for a system of state-registered portals offering private securities for sale.

4.4.2. Intrastate Exemption Track. Securities offered under Section 3a(11) of the Securities Act of 1933 and Rule 147.

(a) Issuer must comply with the various Rule 147 restrictions (*see above*). Minn. Stat. § 80A.461, Subd. 3(2). This creates issues/ambiguity regarding use of the internet for advertising.

(b) Company may raise up to $2 million with audited or reviewed financial statements (or up to $1 million with by providing internally prepared financial statements). Minn. Stat. § 80A.461, Subd. 3(5).

(c) Notice filing required. Minn. Stat. § 80A.461, Subd. 3(11)(i).

4.4.3. SCOR (Small Corporate Offering Registration) Track. Issuers who register their securities with the Department of Commerce via a SCOR offering may sell those securities through a MNvest Portal. Minn. Stat. § 80A, Subd. 1(d). The requirements of the SCOR registration (described above) are set forth in Minn. Stat. 80A.50.

(a) No restrictions on company use of proceeds, assets, or revenues.

(b) Company may only raise up to $1 million.

(c) Longer and more detailed offering memorandum in conjunction with Form U-7.

(d) Company may seek coordinated review to sell in multiple Midwest states.

4.4.4. Portals. *See generally* Min. Stat. § 80A.461, Subd. 7.

(a) Broker dealers and non-broker dealers may seek to register as MNvest portals.

(b) Broker dealers may accept transaction based compensation and offer investment advice.

(c) Non broker dealers may not offer investment advice and may only charge flat or fixed monthly fees.

(d) Issuers may apply to become portals, however with more scrutiny from the state.

4.4.5. Escrow. Funds raised in connection with a MNvest offering must be deposited in escrow with a qualified escrow agent until the aggregate capital deposited into escrow from all purchasers is equal to or greater than the stated minimum offering amount. Minn. Stat. § 80A.461, Subd. 3(8).

4.4.6. Investor Caps. Non-accredited investors may only invest up to $10k per offering, while accredited investors may invest an unlimited amount. Minn. Stat. § 80A.461, Subd. 3(7).