

Date of Hearing: April 18, 2016

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Matthew Dababneh, Chair

AB 2751 (Brown) – As Introduced February 19, 2016

**SUBJECT:** Securities: qualification: exemptions

**SUMMARY:** Authorizes three new securities permitting exemptions under California's Corporate Securities Law of 1968. Specifically, **this bill:**

- 1) Exempts from state securities permitting laws all of the following:
  - a) Any offer or sale of any security that meets each of the following criteria:
    - i) The aggregate amount of securities sold to all purchasers by the issuer within any 12-month period does not exceed \$500,000.
    - ii) Sales to non-accredited investors are capped at \$1,000 in the aggregate during a 12-month period, or a greater amount determined by the Commissioner of the Department of Business Oversight (DBO).
    - iii) Sales to accredited investors are capped at 5% of the investor's net worth in the aggregate during a 12 month-period.
    - iv) Issuers may advertise the offering to California investors only, unless the offering complies with the securities laws of other jurisdictions. Issuers must take steps to ensure that any public advertising indicates that the offering is directed at California residents, or that any solicitations made to nonresidents of California comply with applicable laws of other individual states and the United States.
    - v) Specifies that this exemption is unavailable if the issuer fails to file the notice within a time period determined by the Commissioner.
    - vi) The issuer provides to DBO and purchasers and makes available to potential purchasers, all of the following:
      - (1) A cover sheet containing all of the following statements, in bold typeface no smaller than 12-point type: “Investment in a small business is often risky. You should not invest any funds in this offering unless you can afford to lose your entire investment.

Potential purchasers should review information about the enterprise and offering, and consider the terms and risks of this offering before investing. After reviewing the financial information, description of the business, activities, risk factors, and development timeline, potential purchasers should consider whether success of the enterprise is realistic.

No government regulator is recommending these securities. No government

regulator has verified that this document is accurate or determined that it is adequate. No government regulator has recommended or given approval to, any person, security, or transaction associated with this offering.”

- (2) The issuer’s street address; telephone number; person to contact with respect to the offering; type of securities offered; financial terms of the offering; the minimum amount the issuer is seeking to raise; a description of the business of the issuer and how the issuer plans to carry out its activities; a budget for the use of proceeds of the offering; a list of the factors the issuer considers to be the most significant risks to an investor; and a description, in chronological order, of the steps management intends to take to achieve, maintain, or improve profitability during the 36 months following receipt of the offering proceeds.
  - (3) Income tax returns filed by the issuer for the most recent completed year, if any.
  - (4) Specified financial statements of the issuer, prepared in accordance with generally accepted accounting principles, and certified by the principal executive officer of the issuer to be true and complete in all material respects.
  - (5) A written statement of information about any material legal proceedings involving the company or its officers and directors.
- vii) Issuers may not utilize the exemption to raise funds for an enterprise dependent on the creation of a product or technology for which no fully functional prototype has been made in advance of the public offering of securities. Any fully functional prototype must be demonstrated in person to any potential investor upon request, as specified.
- viii) Provides a "bad actor" disqualification.
- b) Any offer or sale of any security in a transaction that meets each of the following criteria:
- i) The aggregate amount of securities sold to all purchasers by the issuer within any 12-month period does not exceed \$2 million.
  - ii) At least 75 percent of amounts raised through the offering will be reserved or allocated to any of the following for agricultural purposes: purchase of fee title to real property, lease of 30 years or more of real property, purchase of an easement on real property, construction of real property, or improvement to real property.
  - iii) The issuer is an agricultural enterprise that is majority-controlled by one or more individuals who will actively farm the agricultural land to be purchased, leased, or improved and who plan to be actively engaged in the agricultural enterprise, the issuer is a nonprofit public benefit corporation, or the issuer is majority-controlled by a nonprofit public benefit corporation.
  - iv) Sales to non-accredited investors are capped at either \$2,000 or \$5,000, depending on whether the purchaser signs a statement verifying that they have a minimum annual gross income of \$100,000 or a minimum net worth of \$200,000, exclusive of home, home furnishings, and automobiles. Sales to accredited investors are capped at 5% of

the investor's net worth. The Commissioner of DBO is allowed to authorize greater purchase amounts for non-accredited investors by rule or order.

- v) Issuers may advertise the offering to California investors only, unless the offering complies with the securities laws of other jurisdictions. Issuers must take steps to ensure that any public advertising indicates that the offering is directed at California residents, or that any solicitations made to nonresidents of California comply with applicable laws of other individual states and the United States.
- vi) Requires the issuer to set aside in a separate third-party escrow account all funds raised as part of the offering, to be held in escrow until the issuer has entered into a contract to purchase a property, easement, or equipment, or to lease land. If the issuer does not enter into such a contract within 2 years of the effective date of the offering, the issuer shall return all funds to the purchasers. Only applies to the purchase of farmland equipment or easements where the cost does not exceed \$100,000.
- vii) The issuer provides to DBO and purchasers and makes available to potential purchasers, all of the following:
  - (1) A cover sheet containing all of the following statements, in bold typeface no smaller than 12-point type: “Investment in a small business is often risky. You should not invest any funds in this offering unless you can afford to lose your entire investment.

Potential purchasers should review information about the enterprise and offering, and consider the terms and risks of this offering before investing. After reviewing the financial information, description of the business, activities, risk factors, and development time line, potential purchasers should consider whether success of the enterprise is realistic.

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If the issuer is conducting the offering to raise money for the purchase of farmland, the cover sheet must also state, “The company described in this disclosure form is seeking to purchase farmland. If the sum of the investment commitments received by the company does not amount to a sum sufficient to purchase farmland by [insert date two years after beginning of offering], your investment in the company will be returned to you after 60 days to the most recent address provided.”

- (2) The issuer’s street address, telephone number, person to contact with respect to the offering, type of securities offered, financial terms of the offering, the minimum amount the issuer is seeking to raise, a description of the business of the issuer and how the issuer plans to carry out its activities, a budget for the use of proceeds of the offering, a list of the factors the issuer considers to be the most significant risks to an investor, and a description, in chronological order, or the

steps management intends to take to achieve, maintain, or improve profitability during the 36 months following receipt of the offering proceeds.

- (3) If the intended use of proceeds of the offering is to purchase real property, and the particular property to be purchased has been identified, a description and address of the property, an appraisal completed within the last year, and a description of all improvements to be made on the property in order to make it viable for agricultural use. If the property to be purchased has not been identified, a description of the size, location, estimated costs, and characteristics of the property the issuer is seeking.
  - (4) Income tax returns filed by the issuer for the most recently completed year, if any.
  - (5) Specified financial statements of the issuer, prepared in accordance with generally accepted accounting principles, and certified by the principal executive officer of the issuer to be true and complete in all material respects.
  - (6) A written statement of information about any material legal proceedings involving the company or its officers and directors.
- viii) Issuers may not utilize the exemption to raise funds for an enterprise dependent on the creation of a product or technology for which no fully functional prototype has been made in advance of the public offering of securities. Any fully functional prototype must be demonstrated in person to any potential investor upon request, as specified.
- ix) Provides a "bad actor" disqualification.
- c) Any offer or sale of any security in a transaction that meets each of the following criteria:
- i) At least 75 percent of amounts raised through the offering will be reserved or allocated to the purchase of solar photovoltaic panels, wind turbines, equipment necessary for the generation, storage, and transmission of energy generated by the solar panels or wind turbines, or any labor necessary to install solar panels, wind turbines, or any of the equipment necessary for the generation, storage, and transmission of energy generated by solar panels or wind turbines.
  - ii) The issuer meets any of the following qualifications:
    - (1) The issuer is a cooperative corporation or a nonprofit mutual benefit corporation with the purpose of developing and operating one or more facilities to generate electricity for its members to install solar panels or wind turbines for its members, either by selling or leasing panels to members, or to arrange or allocate net metering credits among members.
    - (2) The issuer is a nonprofit public benefit corporation exempt from federal income taxation pursuant to Sections 501(c)(3) or 501(c)(4) of the Internal Revenue Code and is purchasing solar panels or wind turbines primarily to meet the energy needs of the corporation.

- (3) The issuer is a cooperative corporation that is operated on a cooperative basis in accordance with Subchapter T of the Internal Revenue Code and the issuer is purchasing solar panels or wind turbines primarily to meet the energy needs of the corporation.
  - (4) The issuer is a California nonprofit public benefit corporation, mutual benefit corporation, or cooperative with the purpose of developing and operating one or more facilities to generate electricity in a single county and intended customers within that county, or within a similarly limited geographic area approved by the Commissioner.
  - (5) The issuer is an entity owned or entirely controlled by tenants in multitenant housing, and the issuer has entered into a contract with the owner of the property to install solar panels on the property on which the multitenant housing is located.
- iii) The aggregate amount of securities sold to all purchasers by the issuer within any 12-month period does not exceed \$2 million.
  - iv) Issuers may advertise the offering to California investors only, unless the offering complies with the securities laws of other jurisdictions. Issuers must take steps to ensure that any public advertising indicates that the offering is directed at California residents, or that any solicitations made to nonresidents of California comply with applicable laws of other individual states and the United States.
  - v) Sales to non-accredited investors are capped at either \$2,000 or \$5,000, depending on whether the purchaser signs a statement verifying that they have a minimum annual gross income of \$100,000 or a minimum net worth of \$200,000, exclusive of home, home furnishings, and automobiles. Sales to accredited investors are capped at 5% of the investor's net worth. The Commissioner of DBO is authorized to authorize greater purchase amounts by rule or order.
  - vi) The issuer provides to DBO and purchasers and makes available to potential purchasers, all of the following:
    - (1) A cover sheet containing all of the following statements, in bold typeface no smaller than 12-point type: "Investment in a small business is often risky. You should not invest any funds in this offering unless you can afford to lose your entire investment.

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- (2) The issuer’s street address, telephone number, person to contact with respect to the offering, type of securities offered, financial terms of the offering, the minimum amount the issuer is seeking to raise, a description of the business of the issuer and how the issuer plans to carry out its activities, a budget for the use of proceeds of the offering, a list of the factors the issuer considers to be the most significant risks to an investor, and a description, in chronological order, of the steps management intends to take to achieve, maintain, or improve profitability during the 36 months following receipt of the offering proceeds.
- (3) Specified financial statements of the issuer, prepared in accordance with generally accepted accounting principles, and certified by the principal executive officer of the issuer to be true and complete in all material respects.

vii) Issuers may not utilize the exemption to raise funds for an enterprise dependent on the creation of a product or technology for which no fully functional prototype has been made in advance of the public offering of securities. Any fully functional prototype must be demonstrated in person to any potential investor upon request, as specified.

viii) Provides a "bad actor" disqualification.

- 2) Expands an existing exemption for nonprofit organizations to include debt securities, not just equity securities.

#### **EXISTING FEDERAL LAW:**

- 1) Provide for the Securities Act of 1933, which establishes a framework for regulating the offer and sale of securities and ensuring the protection of investors that purchase those securities. Generally speaking, the Securities Act of 1933 requires the offer or sale of all securities to be registered with the Securities and Exchange Commission (SEC) and to be structured as prescribed in federal law and regulation, unless the offer or sale is covered by an exemption. This federal act also require those who offer (i.e., market) and sell securities to be licensed as investment advisers or broker-dealers, unless either the transaction or the activity being undertaken is exempt.
- 2) Provides for Regulation D, one of the regulations promulgated by the SEC to implement the Securities Act of 1933. Regulation D authorizes a series of exemptions from the registration requirements of the Securities Act of 1933 and includes eight rules, denoted Rules 501 through 508, which are codified as 17 CFR 230.501 through 230.508.

Rule 501 of Regulation D defines accredited investors as, among other things, financial institutions, securities broker-dealers, large pension plans, corporate entities with assets in excess of \$5 million, and other large, financially sophisticated entities. An accredited investor also includes:

- a) Any natural person whose individual net worth, or joint net worth with that person’s spouse, exceeds \$1 million at the time of their purchase of securities, exclusive of their primary residence; or

- b) Any natural person with an individual income in excess of \$200,000 in each of the two most recent years, or joint income with that person's spouse in excess of \$300,000 in each of those years, together with a reasonable expectation of reaching the same income level in the current year.
- 3) Provides a "bad actor" disqualification that states no exemption shall be available for a sale of securities if the issuer; any predecessor of the issuer; any affiliated issuer; any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer; any beneficial owner of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; any promoter connected with the issuer in any capacity at the time of such sale; any investment manager of an issuer that is a pooled investment fund; any person that has been or will be paid (directly or indirectly) remuneration for solicitation of purchasers in connection with such sale of securities; any general partner or managing member of any such investment manager or solicitor; or any director, executive officer or other officer participating in the offering of any such investment manager or solicitor or general partner or managing member of such investment manager or solicitor:
- a) Has been convicted, within ten years before such sale (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor, as specified;
- b) Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before such sale that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice, as specified; or,
- c) Is subject to a final order of a state securities commission (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that, as specified. [Title 17 of Code of Federal Regulations (CFR), Section 230.506, subdivision d]
- 4) Pursuant to the Jumpstart Our Business Startups (JOBS) Act (Public Law 112-106), authorizes the use of general solicitation and general advertising in certain circumstances not previously authorized. Title II of the JOBS Act, operative September 23, 2013, lifted the restriction against use of general solicitation and general advertising, when sales are made only to accredited investors and other requirements are met.

**EXISTING STATE LAW:**

- 1) Provides that it is unlawful for any person to offer or sell any security in this state, unless such offering or sale has been qualified by the commissioner, as specified, or unless the offering or sale is covered by an express exemption. [Corporations Code, Section 25110]
- 2) Provides under the Corporate Securities Law of 1968 exemptions from qualification for certain securities transactions. [Corporations Code, commencing with Section 25000]

- 3) Provides that the Commissioner of DBO shall approve all securities offered or sold in California. [Corporation Code, Section 25100]
- 4) Requires all purchasers to have either a preexisting personal or business relationship with the offeror or any of its partners, officers, directors or controlling persons, or managers (as appointed or elected by the members) if the offeror is a limited liability company, or by reason of their business or financial experience or the business or financial experience of their professional advisers who are unaffiliated with and who are not compensated by the issuer or any affiliate or selling agent of the issuer, directly or indirectly, could be reasonably assumed to have the capacity to protect their own interests in connection with the transaction. [Corporations Code, Section 25102 (f)]
- 5) Defines "issuer" as any person who issues or proposes to issue any security, except that:
  - a) With respect to certificates of deposit, voting trust certificates or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors or persons performing similar functions or of the fixed, restricted management or unit type, "issuer" means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which the security is issued. However, with respect to equipment-trust certificates or like securities, "issuer" means the person by whom the equipment or property is to be used.
  - b) With respect to certificates of interest or participation in oil, gas or mining titles or leases or in payments out of production under those titles or leases, "issuer" means the person or persons in active control of the exploration or development of the property who sell those interests or participations or payments or any person or persons who subdivide and sell those interests or participations or payments. The determination of the person or persons in active control of the exploration or development of the property shall be made on the basis of the actual relationship of the parties and not on the basis of the legal designation of a person's interest.
  - c) With respect to a fractional or pooled interest in a viatical or life settlement contract, "issuer" means the person who creates, for the purposes of sale, the fractional or pooled interest. In the case of a viatical or life settlement contract that is not fractionalized or pooled, "issuer" means the person effecting the transactions with the investors in those contracts.
  - d) In the case of an unincorporated association which provides by its articles for limited liability of any or all of its members, or in the case of a trust, committee, or other legal entity, the trustees or members thereof shall not be individually liable as issuers of any security issued by the association, trust, committee, or other legal entity. [Corporations Code, Section 25010]
- 6) Authorizes several exemptions from the requirement to obtain a securities permit from DBO prior to offering or selling securities in this state. Two of the most relevant exemptions for purposes of this bill include Corporations Code Sections 25102(f) and 25102(n).



- a) 25102(f) provides an exemption for any offer or sale of any security in a transaction that meets all of the following criteria: i) sales of the security are made to an unlimited number of accredited investors and up to 35 other persons, who are not accredited investors; ii) all purchasers either have a pre-existing personal or business relationship with the offeror, or can reasonably be assumed to have the capacity to protect their own interests in connection with the transaction, by reason of their business or financial experience, or the business or financial experience of their professional advisers; iii) each purchaser represents that he or she is purchasing for his or her own account, and not with a view to or for sale in connection with any distribution of the security; and iv) the offer and sale of the security is not accomplished through the publication of any advertisement.
- b) 25102(n) provides an exemption for any offer or sale of any security in a transaction that meets all of the following criteria: i) the issuer is not a blind pool issuer, as that term is defined by the commissioner; ii) sales of securities are made only to qualified purchasers or other persons the issuer reasonably believes to be qualified purchasers; iii) each purchaser represents that he or she is purchasing for his or her own account, and not with a view to or for sale in connection with any distribution of the security; iv) each natural person purchaser is provided with a disclosure statement that meets the disclosure requirements of federal Regulation D, at least five business days before they purchase or commit to purchase the security; v) the offer and sale of the security is made by way of a general announcement, whose content is strictly limited; and vi) telephone solicitation by the issuer is not permitted, until and unless the issuer determines that the prospective purchaser being solicited is a qualified purchaser.

Qualified purchasers are those who meet one or more of several criteria listed in subdivision (n). Generally speaking, these criteria describe persons with some degree of financial sophistication, though the qualified purchaser bar is lower than the accredited investor bar. As an example, an individual is a qualified purchaser if that person individually, or jointly with their spouse, has a minimum net worth of \$250,000 and had, during the immediately preceding tax year, gross income in excess of \$100,000, and reasonably expects gross income in excess of \$100,000 during the current tax year. Alternately, the term applies to individuals who have a minimum net worth of \$500,000, exclusive of their home, home furnishings, and automobiles. Natural persons are limited to investing no more than 10% of their net worth in any 25012(n) investment.

**FISCAL EFFECT:** Unknown.

**COMMENTS:**

**Need for the bill:**

According to the sponsor, the Sustainable Economies Law Center,

*"Investors are increasingly interested in putting their money in local, community based enterprises instead of investing in the stock market through distant financial institutions. However, California securities law makes it very expensive and time-consuming for a small business to obtain the permit necessary to legally communicate about its investment needs to a broad audience. AB 2751 will create modest exemptions from those requirements for small businesses that comply with reasonable disclosure requirements and restrictions on the amount*

*of money they can accept per year. We are especially excited that the bill recognizes the need to develop more small-scale farms and community-owned renewable energy enterprises in California by designating unique exemptions designed for those types of enterprises in particular."*

**Background:**

Under existing law, there are only three ways to qualify a securities offering, all of which require significant review of the offering by either the SEC or DBO. Those three ways include coordination (Corporations Code Section 25211; involves offerings registered under the Federal Securities Act of 1933); notification (Section 25212; involves securities registered under Section 12 of the Securities Exchange Act of 1934 or investment companies registered under the Investment Company Act of 1940); and permitting (a rigorous and often costly process in which applicants apply to DBO for a permit that is good for one year).

In addition, California provides under specified circumstances, the ability for an issuer to claim an exemption without qualification with the DBO. Rather than having to qualify with DBO which can be costly and time consuming, AB 2751 creates exemptions from qualification. Currently, the most widely used exemptions under Corporations Code, Section 21502 are:

1) Section 25102(f) "friends & family":

Under Section 25102(f), which is referred to as the Limited Offering Exemption, most issuances to the company's founders, as well as friends and family of any of its directors and officers will be exempt from the registration requirements of California's securities laws.

The key aspect of this exemption is the existence of a prior personal or business relationship between the purchaser of the security (i.e. the investor or lender) and the company's leadership. The exemption is destroyed if there are more than 35 people purchasing securities, or if there is general advertising or publication of the securities.

2) Section 25102(o) "employees and consultants":

Under Section 25102(o), an issuance of stock options to employees and consultants is exempt from the registration requirements of California's securities laws if it satisfies the equivalent federal exemption under Rule 701 (which does not preempt state securities laws). To satisfy Rule 701, an issuance must be made pursuant to an approved option plan, and a company cannot issue more than the greatest of the following in any 12-month period: \$1,000,000, 15% of its total assets, or 15% of the outstanding amount of that class of securities.

AB 2751 allows issuers to raise money utilizing forms of general advertising and general solicitation from accredited and non-accredited investors. Under AB 2751, if an issuer wanting to utilize one of the exemptions under this measure the issuer would have to comply with a set of specific rules specific to the exemption. This measure places a cap on the total amount that can be raised and requires specified disclosures to prospective investors. The three new exemptions in this measure include:

- 1) **Small Investments:** Any California business would be able to raise up to \$500,000 per year. Non-accredited investors would be limited to investing no more than \$1,000 each in one offering. Accredited investors would be limited to 5% of their net worth in an offering.
- 2) **Farms and Agricultural Land Trusts:** This bill would allow a farm enterprise or agricultural land trust to raise up to \$2,000,000 per year for the purchase of land, long-term leasing of land, purchase of an easement, construction on farmland, or improvement of real property to be used for agriculture purposes. The issuers using this exemption must be farmers who will actively farm the land or issuers must be an agricultural land trust or other nonprofit organization. Under this exemption, the limits on each individual's investment amount would be as follows: Any individual investor could invest up to \$2,000. An investor could invest up to \$5,000 if the investor has an annual gross income of at least \$100,000 or a total net worth of at least \$200,000. Accredited investors would be limited to investing no more than 5% of their net worth.
- 3) **Renewable Energy Projects:** Similar to the farm and land trust exemption in the previous paragraph, the bill would allow nonprofits, cooperatives, and groups of tenants to raise up to \$2,000,000 to purchase solar panels or wind turbines, and equipment necessary for the storage or transmission of the energy produced by the panels or turbines. The same limits per investor as in the farmland exemption above would apply to these renewable energy projects.

Additionally, this bill would expand an existing exemption for nonprofit organizations in California Corporations Code Section 25100(j) to include debt securities, not just equity securities.

Because this measure creates exemptions, the burden of complying with these rules specified in the bill falls directly on the investor rather than the DBO. Keep in mind, this measure allows issuers to solicit to both accredited and non-accredited investors. Most often, non-accredited investors are less sophisticated to the rules and regulations that should be followed.

### **Crowdfunding:**

Crowdfunding is a collective cooperation of people who network and pool their money and resources together, via the internet, to support efforts initiated by other organizations. Crowdfunding literally attracts a “crowd” of people, each of whom takes a small stake in a business idea by contributing towards an online funding target. Crowdfunding has become a popular and alternative method of raising finance for a business, real estate investments, projects or ideas and has become popularized online by sites such as Kickstarter, Wefunder, Crowdfunder and RockthePost.

Crowdfunding is a means to raise money by attracting relatively small individual contributions from a large number of people. In recent years, crowdfunding websites have proliferated to raise funds for charities, artistic endeavors and businesses. These sites did not offer securities, such as an ownership interest or share of profits in a business; rather, money was contributed in the form of donations, or in return for the product being made. Federal Crowdfunding expands securities to equity-based crowdfunding. The public most often views crowdfunding as donation based.

### **General Solicitation & General Advertising:**

As their names imply, general solicitation and general advertising are not targeted. They reach an audience that includes both accredited and non-accredited investors. According to the SEC, general solicitation includes advertisements published in newspapers and magazines, public websites, communications broadcasted over television and radio, and seminars where attendees have been invited by general solicitation or general advertising. Use of an unrestricted, and therefore publicly available, website also constitutes general solicitation. General advertising is general solicitation made by means of an advertisement.

### **Federal Crowdfunding Act:**

On April 5, 2012, President Obama signed landmark legislation, H.R. 3606, the JOBS Act. The JOBS Act makes it easier for startups and small businesses to raise funds. This legislation passed Congress through a 73-26 Senate vote and a 380-41 House vote. As far as, AB 2178 is concerned, Title III of the JOBS Act required the SEC to develop new rules permitting capital raising by “crowdfunding.”

In October of 2013, the SEC issued the proposed crowdfunding rules in a 585 page document. The SEC struggled to create the final rules that respected the flexible and democratic nature of crowdfunding (which makes it so appealing to very small and early stage start-up companies) while also implementing sufficient regulation to satisfy consumer and investor protection critics who fear that investment crowdfunding is far too open to abuse and fraud.

On October 30, 2015, the SEC adopted final rules under Title III of the JOBS Act. The JOBS Act provided for a new exemption under the Securities Act of 1933 that will permit securities-based crowdfunding by private companies without registering the offering with the SEC. The final rules become effective in May 2016 except that the forms enabling funding portals to register with the SEC became effective on January 29, 2016. Additionally, the SEC staff must submit a report to the SEC no later than three years following the effective date of crowdfunding on the impact of the regulation on capital formation and investor protection.

Key features of the SEC’s final rules:

- A company will only be able to raise a maximum aggregate amount of \$1 million through crowdfunding offerings per 12-month period.
- Companies raising less than \$500,000 through crowdfunding within any 12-month period will need to share financial statements and income-tax returns with their investors and those raising more than \$500,000 will be obligated to provide audited financial statements to investors.
- Investors with an annual income or net worth of less than \$100,000 will be permitted to invest a maximum of \$2,000 or 5% of their annual income or net worth (whichever is greater) per 12-month period.
- Investors with an annual income or net worth equal to or greater than \$100,000 will be permitted to invest up to 10% of their annual income or net worth (whichever is greater) per 12-month period up to a total maximum of \$100,000 in securities.

- Companies conducting a crowdfunding offering will need to file certain information with the SEC, the relevant intermediary facilitating the crowdfunding offering and potential investors.
- Private crowdfunding offerings will be conducted exclusively online through a registered broker or funding platform (portal). Funding platforms will be required to register with the SEC. Non-US crowdfunding platforms will be able to register with the SEC, subject to an on-site examination.
- Private crowdfunding offerings will be conducted exclusively online through broker or funding platforms developed in partnership with the Financial Industry Regulatory Authority (FINRA) and registered with the SEC.

**Related Legislation:**

AB 2178 (Chiu) creates a new qualification by permit under California's Corporate Securities Law of 1968 to allow equity-crowdfunding. Pending in the Assembly Appropriations Committee.

**Previous Legislation:**

SB 577 (Hueso) (2015 Legislative Session) would have authorized three new securities permitting exemptions, as specified, and increase, from \$300 to \$1,000, the maximum allowable aggregate investment of any shareholder in shares of a consumer cooperative corporation or member in memberships of a consumer cooperative corporation. Died in the Senate Judiciary Committee.

AB 722 (Perea) (2015 Legislative Session) would have authorized a new form of securities offering in California to facilitate crowdfunding as an alternative to a similar authorization in federal law under the JOBS Act. Died in the Assembly Appropriations Committee.

AB 2096 (Muratsuchi) (2014 Legislative Session) would have created a new way in which a person seeking to offer or sell securities could qualify their offering, by authorizing the “qualification by notification” of offers or sales of securities advertised by means of general solicitation and general advertising, as specified. Died in the Senate Appropriations Committee.

AB 783 (Daly) (2013 Legislative Session) provides that an issuer can offer or sell securities using any form of general solicitation or general advertising. Died in the Assembly Banking and Finance Committee.

AB 2081 (Allen) (2012 Legislative Session) provides that an issuer can offer or sell securities using any form of general solicitation or general advertising. Died on the Senate Floor.

SB 875 (Price) (2010 Legislative Session) would have exempted from qualification offerings or sales of securities using a general solicitation or general advertising, provided the transaction meets specified requirements, including a requirement that the sales are made to accredited investors. Died in Senate Banking and Financial Institutions.

AB 1644 (Campbell & Briggs) (2001 Legislative Session) would have exempted from qualification offerings or sales of securities using a general solicitation or general advertising,

provided the transaction meets specified requirements, including a requirement that the sales are made to accredited investors. Failed passage in Assembly Banking and Finance Committee.

### Questions & Concerns:

- 1) The economy is continuing to recover, the unemployment rate is down, the federal government acted, is there still a need to act on a statewide level to produce what could be perceived as "risky" ways to raise capital? The U.S. Treasury gave the California State Treasurer a total of \$168 million in federal funds from the JOBS Act to provide access to capital to small businesses through the California Pollution Control Financing Authority and the California Infrastructure and Economic Development Bank. The programs guarantee loans made by banks to small businesses that otherwise couldn't be made either for lack of collateral or lack of credit history. California received more money than any other state with the final \$57 million provided in August, 2015. Are small businesses capitalizing on these funds?
- 2) In the committee background received, it states, "AB 2751 seeks to provide opportunity for entrepreneurs and investors who are more comfortable with more personalized communication methods compared to a website. In some investment offerings we believe that more open and personalized communication opportunities may enhance consumer protection because it would allow an investor and entrepreneur to develop more of a relationship before the investor makes an investment decision. Furthermore, it would enable investment offerings to be made at meetings of community groups that focus on local investing, where investors often discuss offerings amongst each other in a supportive environment among peers where they can learn from each other and are more likely to detect suspicious activity before investments are made." This statement goes against all the protections that the SEC created around the JOBS Act as well as current state law. How are the current securities exemptions insufficient and why should California open up the floodgates to allow issuers to solicit accredited and non-accredited investors to invest in farm land or renewable energy projects?
- 3) This measure lacks investor protections and if adopted in its current form, would leave Californians vulnerable to potential bad actors due to the limited oversight over these types of securities transactions. This measure has no limits on general solicitation and general advertising; therefore, an issuer could go door to door. Due to all of the historic changes made surrounding securities, why does California need additional exemptions now, which could potentially lead to fraud and taking thousands from consumers with little recourse?

### Recommended Amendments:

This committee recently heard and passed out AB 2178 which created a new permit process for crowdfunding. This measure also tries to implement a new crowdfunding process by way of a securities exemption. Based on the recent and supportive action by this committee on AB 2178, the committee is recommending deleting from this measure the general exemption due to the similar intent and nature. In addition, AB 2178 carried more investor protections and vetting process through DBO rather than a pure exemption as this measure attempts.

- 1) On page 26, delete (r) starting on line 22- to page 29, line 2.

**REGISTERED SUPPORT / OPPOSITION:**

**Support**

California Farmlink  
Cutting Edge Capital  
Food Access Coalition  
Greenhorns  
Humboldt Food Policy Council  
Local Clean Energy Alliance  
New Hope Farms  
Peak Agency  
Roots of Change  
Slow Money South Bay  
Sustainable Economies Law Center  
The Farmers Guild  
4 Individuals

**Opposition**

Public Investors Arbitration Bar Association (PIABA)

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