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Making Room for Crowdfunding

>>> *The new trend in raising money from investors.*

By Markley S. Roderick

The JOBS Act signed into law by President Obama creates a new way for companies to raise money: “Crowdfunding.” In fact, the JOBS Act creates two kinds of Crowdfunding. One, a simple evolution of existing law and the other, a new species altogether.

Crowdfunding is going to revolutionize the way companies raise money from investors. Whether you are an entrepreneur looking for capital, a brokerage firm looking for an additional business model, an investor looking for places to invest, or a securities regulator looking for an industry that is likely to be rife with wrongdoing in the early going, you should learn the basics of Crowdfunding.

The kind of Crowdfunding getting the most press is the entirely new species, created by the JOBS Act. In its simplest form (1) a company seeking capital will register with a special kind of Internet

site created for this purpose, referred to as a “portal;” (2) prospective investors will also register with the portal; and (3) if a registered investor likes a registered company, then a marriage is made - all through the portal and all online.

Here are some of the most important rules and limitations:

- This new Crowdfunding will not begin until the SEC issues regulations, expected in January 2013 at the earliest.

- A company may raise only \$1 million from all sources during any 12-month period.

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- The law limits how much any investor can invest: For those whose income or net worth is less than \$100,000, the limit is the greater of \$2,000 or 5 percent; for those earning more, the limit is 10 percent of annual income or net worth, with an upper limit of \$100,000. These limits refer to the total invested in all Crowdfunding investments during any 12-month period.

- The company seeking investors will be required to provide extensive information. The verification of financial information - whether merely certified by the principal officer, reviewed by a CPA firm, or audited by a CPA firm - will depend on the size of the company.

- The portal need not be operated by a registered broker-dealer, but will be required to register with the SEC, become a member of a national securities organization and will be responsible for many aspects of the compliance process.

The other kind of Crowdfunding is a twist - but an important twist - on a method companies have been using to raise money for many years: Namely, the traditional “private placement” transaction. Reversing a basic tenet of the law, the JOBS Act provides that in certain private placement transactions, the company raising money may use “general solicitation” to find investors. That means advertisements, e.g., the internet.

Abuses are sure to occur (are occurring already) and many questions remain to be answered. But Crowdfunding is here to stay and will forever change the landscape of raising money. **NJB**

About the Author

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