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PSEUDO-CROWDFUNDING: HOW A SINGLE PROVISION IN THE JOBS ACT HAS OPENED UP NEW SOURCES OF CAPITAL FOR ORGANIZATIONS

Since the enactment of the Jumpstart Our Business Startups Act (cleverly referred to by Congress as the "JOBS Act") last fall, much has been written regarding its impact on private placements of debt and equity securities. Most of the reports, briefings and articles have been accurate, but few have been practical. We find one provision in particular of the JOBS Act that has practical application well beyond "business startups" and in fact presents a serious capital-raising opportunity for health care providers, faith-based organizations, nonprofit entities and other firm clients.

This article does not address the current state of "crowdfunding," an online method used to seek small contributions from many individuals (the "crowd") in an attempt to fund various projects and causes. The JOBS Act directs the U.S. Securities and Exchange Commission ("SEC") to develop rules and regulations for crowdfunding. The regulations currently proposed by the SEC place limits on the amounts that may be raised via crowdfunding as well as the amounts investors may contribute to crowdfunding efforts. While crowdfunding is certainly a valuable tool, we do not believe true crowdfunding will find much traction among the vast majority of companies or organizations.

We do, however, believe a new approach to traditional limited securities offerings has the potential to connect companies and organizations seeking capital directly with potential investors (what we have dubbed "Pseudo-Crowdfunding"). Pseudo-Crowdfunding is essentially a traditional "Rule 506" limited offering of securities coupled, thanks to the JOBS Act, with a new ability for organizations to directly solicit and advertise the offering to certain experienced investors.

The JOBS Act eliminated the long-standing prohibition against "general solicitation" or "advertising" of limited offerings. Prior to the JOBS Act, companies or organizations desiring to raise capital from would-be investors in a limited offering were effectively prohibited from contacting investors through advertisements or general solicitation. Rather, the company or organization could only offer the securities through direct solicitation with previously identified potential investors. Under these prior rules, a company or organization would potentially run afoul of the securities law if it promoted a security in a newspaper advertisement or on a website. The JOBS Act eliminated such prohibitions on direct solicitation and advertising in certain exempt securities offerings limited to "accredited investors."[1]

In response, internet sites dedicated to connecting investors with investment opportunities have begun to proliferate. Television and radio advertisements touting investment opportunities are becoming more common, and organizations have embarked on marketing campaigns specifically crafted to reach their targeted audience. While still in its infancy, we believe such efforts will become more common and this provision of the JOBS Act will prove invaluable for those seeking to raise capital, including health care providers, private schools, faith-based organizations and other entities.

Consider, for example, the faith-based organization that may now directly solicit its members to invest in mission-critical facilities, the private school that may now directly solicit its alumni to purchase bonds or the local health system that may now engage in a community-wide marketing campaign soliciting investments in its new outpatient or community health center. These and other organizations may now engage in such Pseudo-Crowdfunding with or without the involvement of a traditional broker-dealer and with the assistance of online investor portals designed to connect would-be investors directly with investment opportunities.

This is not to say that Pseudo-Crowdfunding is free from regulatory or legal constraints. Traditional and long-standing rules and law relating to limited offerings under Rule 506 continue to apply. Moreover, the authority to engage in general solicitation and advertising is limited to offerings made only to accredited investors and requires the issuer to take reasonable steps to ensure only accredited investors purchase the securities offered. Anti-fraud provisions of securities laws, requirements related to disclosure of the investment, the filing of information with the SEC and restrictions on the sale and re-sale of the securities all continue to apply and require careful consideration and the assistance of professionals in the field.[2]

This enhanced ability to raise capital directly and efficiently from an organization's most natural investor base presents a significant opportunity for many and one that should be considered as part of any capital strategy.

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[1]Among other entities, "Accredited Investors" include persons with net worth exceeding $1,000,000 (excluding the value of one's primary residence) or income in excess of $200,000 in each of the two most recent years.

[2] We also note that offerings made by a 501(c)(3) organization to fund its charitable purposes have always enjoyed other securities law exemptions. However the new rules associated with Pseudo-Crowdfunding provide guidance and a secondary source of securities exemption for organizations that choose to utilize them.

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