



2015-2016 General Assembly

SENATE BILL 481: Fund Small Businesses/Department of Revenue Rulings/City Rights of Way, Part I: North Carolina Providing Access to Capital for Entrepreneurs and Small Business Act

Committee:
Introduced by:
Analysis of: Part I of S.L. 2016-103

Date: August 9, 2016
Prepared by: Greg Roney
Staff Attorney

OVERVIEW: *Part I of S.L. 2016-103 enacts the North Carolina Providing Access to Capital for Entrepreneurs and Small Business Act (NC PACES) that allows North Carolina investors to buy equity or debt offerings from North Carolina issuers if the transaction meets requirements for registration, disclosure, reporting, offering limit, and investment limit. The filing fee for an exemption notice is \$150 and will be used by the Securities Division of the Department of the Secretary of State to administer and enforce the NC PACES Act.*

This part became effective July 22, 2016.

BILL ANALYSIS:

Part I of S.L. 2016-103 enacts the NC Providing Access to Capital for Entrepreneurs and Small Business Act (NC PACES) that exempts certain transactions from the North Carolina Securities Act (Chapter 78A of the General Statutes). The new exemption allows "crowdfunding" transactions where in-state businesses can sell securities to in-state investors, called an intrastate transaction. The amounts of securities that can be sold by NC issuers and bought by NC investors are limited.

New G.S. 78A-17.1, titled Invest NC exemption, allows NC investors to buy equity or debt offerings from NC issuers if the transaction meets the following registration, disclosure, reporting, offering limit and investment limit:

Registration Requirements

The issuer must be a business entity formed in NC or registered in NC. The investor must be a NC resident.

At least 10 days before issuance or promotion of the offering, the business must file the following with the Securities Division of the NC Department of the Secretary of State ("Securities Division"): a notice of offering, \$150 filing fee, and a copy of the disclosure statement given to prospective investors. The Securities Division is authorized to use the filing fee to pay the cost of administration and enforcement.

The proceeds of the offering must be deposited under an escrow agreement with a bank or depository institution in NC (or approved by the Securities Division). The proceeds will be released to the issuer when the capital raised from all investors equals the target offering amount. Investors may cancel their commitments to invest if that target offering amount is not raised by the time stated in the disclosure document. The bank or depository institution must notify the Securities Division of the receipt of payments for securities and the identity and residence of the investors.

Karen Cochrane-Brown
Director



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Disclosure Requirements

The issuer must disclose the following to prospective investors:

- Description of the company including type of entity, address, telephone number, history, and business plan.
- Intended use of the offering proceeds including any amounts to be paid to any owner, executive officer, director, or managing member.
- All 10% owners of the company.
- Identity, titles, and prior experience of the executive officers, directors, and managing members.
- Terms of the securities being offered and any outstanding securities of the company.
- Minimum and maximum amount of securities being offered.
- Either the percentage ownership of the company represented by the offered securities (equity offering) or the valuation of the company implied by the price of the offered securities (debt offering).
- Identity and amount paid to any person retained by the issuer to assist in conducting the offering.
- Description of any litigation involving the company or its management.
- Escrow agreement with a bank or depository institution located in NC or approved by the Securities Division.
- Certification by each purchaser in writing "I understand and acknowledge that:
 - I am investing in a high risk, speculative business venture. I may lose all of my investment, and I can afford the loss of my investment.
 - This offering has not been reviewed or approved by any state or federal securities commission or other regulatory authority and that no such person or authority has confirmed the accuracy or determined the adequacy of any disclosure made to me relating to this offering.
 - The securities I am acquiring in this offering are illiquid, that there is no ready market for the sale of such securities, that it may be difficult or impossible for me to sell or otherwise dispose of this investment, and that, accordingly, I may be required to hold this investment indefinitely.
 - I may be subject to tax on my share of the taxable income and losses of the company, whether or not I have sold or otherwise disposed of my investment or received any dividends or other distributions from the company."
- Display the following legend conspicuously on the cover page of the disclosure document: IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE TERMS OF THE OFFERING, INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE. THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON

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TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE SECURITIES ACT OF 1933, AS AMENDED, AND THE APPLICABLE STATE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. INVESTORS SHOULD BE AWARE THAT THEY WILL BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME.

Reporting Requirements

The issuer must provide a free, quarterly report to investors and the Securities Division until no securities issued under the Invest NC exemption are outstanding. The report must contain the amount of compensation received by directors and executive officer, an analysis of the business operations, and a statement of financial condition.

Offering Limit

The offering is limited to \$1,000,000 for a business without a current audit or review and \$2,000,000 for a business with a current audit or review.

Investment Limit

Non-accredited investor may purchase \$5,000 in any 12-month period. Accredited investor may purchase an unlimited amount, subject to the limit on offering size. These limits are indexed for inflation.

BACKGROUND:

At the state level, 30 states permit some type of intrastate crowdfunding, including Alabama, Florida, Georgia, Kentucky, Mississippi, South Carolina, Tennessee, Texas, and Virginia.¹

At the national level, the federal Jumpstart Our Business Startups (JOBS) Act of 2012 added Securities Act Section 4(a)(6) that provides an exemption from registration for certain crowdfunding transactions. In 2015, the US Securities and Exchange Commission ("SEC") adopted Regulation Crowdfunding to implement the crowdfunding exemption, effective May 16, 2016. The following chart compares the federal Regulation Crowdfunding and the Invest NC exemption:

	<u>Regulation Crowdfunding (US)</u>	<u>Invest NC Exemption</u>
Applicability	Interstate	Intrastate (NC issuer selling to NC resident investor)
Effective Date	5/16/16	7/22/16
Offering Limit (12-month period)	\$1 million	\$1 million (if no audit or review) \$2 million (if audit or review)
Investment Limit (12-month period)	\$2,000 to \$100,000 for all issuers combined as follows: <u>Income or net worth < \$100,000</u> : greater of \$2,000 or 5% of lesser of income or	\$5,000 per issuer if non-accredited Unlimited if accredited

¹ Source: <https://crowdfundinglegalhub.com/2015/01/16/state-of-the-states-list-of-current-active-and-proposed-intrastate-exemptions/> (as of April 2016).

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	net worth <u>Income or net worth > \$100,000:</u> 10% of the lesser of income or net worth <u>\$100,000 Cap:</u> 12-month cap of \$100,000 for all Regulation Crowdfunding offerings	
Intermediary Requirement	Required Regulation Crowdfunding offering exclusively conducted through online platform registered with the SEC and FINRA	Optional

EFFECTIVE DATE: Part 1 of S.L. 2016-103 became effective July 22, 2016.