



# Ohio Legislative Service Commission

## Bill Analysis

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### H.B. 593

131st General Assembly  
(As Introduced)

**Reps.** Arndt, Brinkman, Thompson

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## BILL SUMMARY

- Permits intrastate equity crowdfunding under certain circumstances.
- Specifies eligibility requirements for all persons conducting an intrastate equity crowdfunding.
- Prohibits an unaccredited investor from purchasing more than \$10,000 in securities with a single offering.
- Requires intermediaries offering securities to provide certain disclosures to investors.
- Requires, for five years, intermediaries to maintain and make available to the Division of Securities specified records.
- Requires the escrow agent used for holding payments for the purchase of securities to be a financial institution or credit union authorized to do business in Ohio.
- Expressly authorizes port authorities and community improvement corporations to act as intermediaries for the offering of securities through such crowdfunding.

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## CONTENT AND OPERATION

### Overview

The bill provides an exemption from registration under the Ohio Securities Law (R.C. Chapter 1707.) for certain securities offered or sold through equity crowdfunding. "Crowdfunding" is an evolving method of using the Internet to raise capital for startups and small businesses. An entity or individual raising funds through crowdfunding typically seeks small individual contributions from a large number of people.<sup>1</sup>

Equity crowdfunding implicates both state and federal security laws, requiring registration under both sets of laws unless an exemption applies. Federal law contains an exemption from registration for *intrastate* offerings.<sup>2</sup> As stated above, the bill, in addition, provides an intrastate crowdfunding exemption within Ohio Securities Laws. To qualify for the Ohio exemption, an offering and sale of securities must meet the bill's requirements for an "OhioInvests offering."<sup>3</sup> It must also qualify for the federal exemption for intrastate offerings.<sup>4</sup> As such, there are limitations as to the issuers that can participate, the offerings that can be made, the individuals that can invest, and the intermediaries that can act as portal operators for purposes of conducting the transactions.

### OhioInvests offerings

#### The issuer

The bill requires that the issuer be an **OhioInvests issuer** on the date its securities are first offered for sale in this offering and continuously through the closing

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<sup>1</sup> U.S. Securities and Exchange Commission, Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers, footnote 2, May 13, 2016, <https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm>, accessed November 6, 2016.

<sup>2</sup> 15 U.S.C. 77c(a)(11).

<sup>3</sup> R.C. 1707.03 and 1707.05(B).

<sup>4</sup> R.C. 1707.051(B).

of the offering.<sup>5</sup> An "**OhioInvests issuer**" is an entity organized under Ohio law, other than a general partnership, that satisfies the requirements under the federal exemption for intrastate offers and sales of securities, and in addition meets all of the following conditions:

- The principal office of the entity is located in Ohio.
- As of the last day of the most recent semiannual fiscal period of the entity, at least 80%, or other threshold permitted under federal law, of the entity's assets were located in Ohio.
- The entity derived at least 80%, or other threshold permitted under federal law, of its gross revenues from the operation of a business in Ohio during the previous fiscal year, if the OhioInvests offering begins during the first six months of the entity's fiscal year, or during the 12 months ending on the last day of the sixth month of the entity's current fiscal year, if the offering begins following the last day. This condition does not apply, however, if the entity's gross revenue during the most recent 12-month period did not exceed \$5,000.
- The entity does not attempt to limit its liability, or the liability of any other person, for fraud or intentional misrepresentation in connection with the offering.
- The entity is not engaged in the business of investing, reinvesting, owning, holding, or trading in securities, but it may hold securities of one class in an entity that is not itself engaged in the business of investing, reinvesting, owning, holding, or trading in securities.
- The entity is not subject to the reporting requirement under federal security laws.<sup>6</sup>

### **Ineligibility for OhioInvests issuer**

Certain issuers or an *affiliated party* (see "**Definitions**," below), however, are not eligible to use the exemption provided by the bill, including those that have previously

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<sup>5</sup> R.C. 1707.051(A).

<sup>6</sup> R.C. 1707.05(A) and 15 U.S.C. 78m and 78o(d).

violated state or federal securities laws.<sup>7</sup> For example, the bill specifies that an issuer or an affiliated party is not eligible if subject to any of the following:

***Felony or misdemeanor conviction:*** An issuer or an affiliated party is not eligible for the OhioInvests exemption if the issuer or affiliated party has been convicted before the offering of any felony or misdemeanor (1) in connection with the purchase or sale of any security, (2) involving the making of any false filing with the Securities and Exchange Commission (SEC) or a state securities commissioner, or (3) arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser, or paid solicitor of purchasers of securities. For any issuer, predecessor to the issuer, or any affiliated issuer, the conviction cannot be within *five* years before the offering, and for any other affiliated party, the conviction cannot be within *ten* years before the offering.

***Other court order, judgment, or decree:*** An issuer or an affiliated party is not eligible for the OhioInvests exemption if the issuer or affiliated party has been subject to a court order, judgment, or decree within *five* years before the sale, that at the time of the sale prohibits the person from engaging in any conduct or practice described in the preceding paragraph.

***Final order:*** An issuer or an affiliated party is not eligible for the OhioInvests exemption if the issuer or affiliated party was subject to a final order from a state or federal agency (1) that at the time of the offering, prohibits the person from associating or engaging in the business of securities or insurance, or engaging in specified financial institution activities, or (2) that is based on a violation of a law or regulation that prohibits fraudulent, manipulative, or deceptive conduct entered within ten years before the offering.

***SEC order:*** An issuer or an affiliated party is not eligible for the OhioInvests exemption if the issuer or affiliated party is subject to an SEC order that, at the time of the offering, does any of the following:

- Suspends or revokes the person's license or registration as a broker, dealer, municipal securities dealer, or investment adviser;
- Places limitations on the activities, functions, or operations of the person;
- Bars the person from being associated with any entity or from participating in the offering of any penny stock.

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<sup>7</sup> R.C. 1707.058.

**SEC order or a state securities commissioner order:** An issuer or an affiliated party is not eligible for the OhioInvests exemption if the issuer or affiliated party was subject to an SEC order or a state securities commissioner order that involves an order entered within five years before the sale that, at the time of the sale, orders the person to *cease and desist* from committing or causing a violation or future violation of any federal security laws related to antifraud or interstate sales of securities.<sup>8</sup>

An issuer or an affiliated party also is not eligible for the OhioInvests exemption if the issuer or affiliated party filed as a registrant or issuer, or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the SEC or a state securities commissioner, and within five years before the sale was subject to an order relating to an offering that was the subject of a *refusal order, stop order, or order suspending* the Regulation A exemption, or if at the time of the sale, the subject of an investigation or proceeding to determine whether a stop order or a suspension order.

**Trade group association suspension or debarment:** An issuer or an affiliated party is not eligible for the OhioInvests exemption if the issuer or affiliated party was subject to a suspension, expulsion, or debarment from membership or association with a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade.

**U.S. Postal Service action:** An issuer or an affiliated party is not eligible for the OhioInvests exemption if the issuer or affiliated party was subject to a U.S. Postal Service action that was of the following:

- A false representation order entered within five years before the offering;
- A temporary restraining order or preliminary injunction with respect to conduct alleged by the U.S. Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.<sup>9</sup>

### **Limitation on ineligibility**

The ineligibility conditions stated above do not apply to any conviction, order, judgment, decree, suspension, expulsion, or bar that was issued *before September 23,*

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<sup>8</sup> 15 U.S.C. 77e.

<sup>9</sup> R.C. 1707.058(B).

2013. In addition, even if subject to the ineligibility conditions stated above, an issuer or an affiliated party may still be eligible for the exemption if any of the following apply:

- (1) Upon a showing of good cause and without prejudice to any other action, the SEC or state securities commissioner determines that it is not necessary under the circumstance that an exemption be denied;
- (2) If, before the relevant offering, the relevant court advises in writing that the disqualification should not be a consequence of court action;
- (3) If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed.<sup>10</sup>

Events relating to any affiliated issuer that occurred before the affiliation arose will not be considered disqualifying if the affiliated entity is not in control of the issuer, or under common control with the issuer by a third party that was in control of the affiliated entity at the time of the events.<sup>11</sup>

### **The offering**

An OhioInvest offering, defined as an offer, or an offer and sale, of securities by an OhioInvests issuer that is exempt from registration under the bill, must meet the requirements under the federal exemption for intrastate offerings and all of the following conditions:

- It expires within 12 months.
- In any 12-month period, the issuer does not raise more than \$5 million in connection with one or more OhioInvests offerings.
- The issuer uses at least 80% of the offering's net proceeds in connection with the operation of its business in Ohio.
- All payments for the purchase of securities are held in escrow until the aggregate capital deposited into escrow from all purchasers is equal to or greater than the stated minimum offering amount. If the minimum offering amount is not raised by the stipulated expiration date, all purchasers receive a return of all their subscription funds.<sup>12</sup>

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<sup>10</sup> R.C. 1707.058(C).

<sup>11</sup> R.C. 1707.058(D).

<sup>12</sup> R.C. 1707.05(B) and 1707.051(C) to (E) and (I).

Not less than ten days before the beginning of an OhioInvests offering, the issuer must provide the Division of Securities with (1) a notice of a claim of exemption from registration, (2) a copy of the disclosure document that will be given to prospective purchasers (see below), and (3) a \$300 filing fee.<sup>13</sup>

### **Advertisement**

An OhioInvests offering can be advertised only if the advertisement complies with all applicable Ohio and federal law and contains disclaiming language clearly stating that the advertisement is not the actual offering, the offering is being made in reliance on the exemption provided under the bill, the offering is directed only to Ohio residents, all offers and sales are made through an OhioInvests portal (see below), and the Department of Commerce is the state securities regulator. The only other information that can be included in the advertisement is (1) the issuer's name and contact information, (2) a brief description of the type of business conducted by the issuer, (3) the minimum offering amount the issuer is attempting to raise, (4) a description of how the funds raised will be used, (5) how long the offering will remain open, (6) the issuer's logo, and (7) a link to the issuer's website and the OhioInvests portal through which the offer is being made.<sup>14</sup>

### **The investors**

Only Ohio residents can purchase securities offered in an OhioInvests offering. In addition, no single purchaser can purchase more than \$10,000 in securities of the issuer in connection with a single OhioInvests offering unless the purchaser is an accredited investor under the federal securities law.<sup>15</sup>

### **The intermediary**

The sale of the securities must be conducted exclusively through an **OhioInvests portal**.<sup>16</sup> An "OhioInvests portal" is defined as a website that is operated by a portal operator for the offer or sale of securities of an OhioInvests issuer. But, the website cannot use the word "OhioInvests" in its Internet address. A "**portal operator**" is an entity, including an issuer, that is authorized to do business in Ohio *and* is registered

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<sup>13</sup> R.C. 1707.051(J).

<sup>14</sup> R.C. 1707.051(K).

<sup>15</sup> R.C. 1707.051(F).

<sup>16</sup> R.C. 1707.051(G).

with the Division of Securities in accordance with the bill<sup>17</sup> or is a licensed dealer under the Ohio Securities Law.<sup>18</sup>

An entity, other than a licensed dealer, that would like to act as a portal operator must file a registration application with the Division of Securities, pay a \$200 filing fee, and provide a copy of the articles of incorporation or other documents that indicate the entity's form of organization. If the Division approves the registration, it will provide a certificate of registration, valid for one year. The entity may submit a renewal application annually with a \$200 renewal fee.<sup>19</sup>

When conducting an OhioInvests offering, the portal must implement steps to limit website access to only Ohio residents. Additionally, it cannot allow the offering to be viewed by a prospective purchaser until (1) the portal operator verifies, through its exercise of reasonable steps, that the prospective purchaser is an Ohio resident and (2) the prospective purchaser makes an affirmative acknowledgment, electronically through the portal, of the following:

"I UNDERSTAND AND ACKNOWLEDGE THAT:

If I make an investment in an offering through this OhioInvests portal, it is very likely that I am investing in a high-risk, speculative business venture that could result in the complete loss of my investment, and I need to be able to afford such a loss.

This offering has not been reviewed or approved by any state or federal securities commission or division 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.

If I make an investment in an offering through this OhioInvests portal, it is very likely that the investment will be difficult to transfer or sell and, accordingly, I may be required to hold the investment indefinitely.

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<sup>17</sup> See R.C. 1707.054.

<sup>18</sup> R.C. 1707.05(C) and (D).

<sup>19</sup> R.C. 1707.054.



By entering into this transaction with the company, I am affirmatively representing myself as being an Ohio resident at the time that this contract is formed, and if this representation is subsequently shown to be false, the contract is void."<sup>20</sup>

## **Disclosures**

The portal operator must make available to each prospective purchaser a copy of the issuer's balance sheet and income statement for the issuer's most recent fiscal year, if the issuer was in existence for that period, and a downloadable disclosure document that contains certain information, including the following:

--Specific information about the issuer, such as the type of entity it is, the address and telephone number of its principal office, formation history for the previous five years, the identity of all persons owning more than 10% of any class of equity interest in the issuer, the identity and experience of its members and executive management, the material facts of its business plan and capital structure, any material risks unique to the issuer, and its intended use of the offering proceeds;

--Specific information regarding the securities being offered, such as the terms and conditions of the securities, the price per share, unit, or interest of the securities, a description of any outstanding securities of the issuer, the minimum and maximum amount being offered, any restrictions on the transfer of the securities, and the date on which the offering will expire;

--Either the percentage of economic ownership of the issuer represented by the offered securities or the valuation of the issuer implied by the price of the offered security;

--A description of investor exit strategies;

--The identity of and consideration payable to any person who has been retained by the issuer to assist in conducting the offering and sale, including a portal operator;

--A description of any pending material litigation or regulatory action involving the issuer;

--A copy of the escrow agreement between the escrow agent, the issuer, and, if applicable, the portal operator;

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<sup>20</sup> R.C. 1707.05(C), 1707.051(H)(3), and 1707.053.

--A statement that the securities have not been registered under federal or state securities law and that the securities are subject to limitation on resale, and that any future issuance of securities might dilute the value of the securities being offered.

--A statement, printed in boldface type of the minimum size of ten points, as follows (for reference, the statement below is in ten point type, rather than the analysis' normal 12 point type):

"IN MAKING AN INVESTMENT DECISION, PURCHASERS 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 DIVISION OR OTHER 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 TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED BY 17 C.F.R. 230.147(e) AND THE APPLICABLE STATE SECURITIES LAWS, PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM. PURCHASERS SHOULD BE AWARE THAT THEY WILL BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME."<sup>21</sup>

#### **Investment advice; compensation; fees**

The bill prohibits a portal operator that is *not* a licensed dealer under the Ohio Securities Law from doing any of the following:

--Offering investment advice or recommendations. This does not include selecting, performing due diligence with respect to, issuers or offerings to be listed or providing general investor education materials.

--Providing transaction-based compensation to employees, agents, or other persons for securities sold unless those persons are licensed under the Ohio Securities Law and are permitted to receive such compensation;

--Charging a fee to the issuer for an offering of securities on the portal unless the fee is (1) a fixed amount for each offering, (2) a variable amount based on the length of

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<sup>21</sup> R.C. 1707.051(H) and 1707.052.

time the securities are offered on the portal, or (3) a combination of such fixed or variable amounts;

--Handling purchaser funds or securities, unless the portal operator is the issuer.<sup>22</sup>

### **Examination of records; recordkeeping**

A portal operator must provide the Division of Securities with read-only access to the administrative sections of its OhioInvests portal. It must also furnish, upon the Division's request, any of the records the bill requires the portal operator to maintain in relation to issuers, purchasers, and offerings.<sup>23</sup> However, failure of a portal operator that is not the issuer to comply with the recordkeeping requirements *does not* affect the OhioInvests issuers' exemption from registration under the bill.<sup>24</sup>

A portal operator must maintain and preserve, for a period of at least five years, records in a way that (1) allows for the immediate location of the document, (2) retains the documents exclusively in a nonrewriteable, nonerasable format, (3) verifies automatically the quality and accuracy of the storage recording process, (4) serializes the originals, and (5) allows indexes and records preserved to be downloaded to an acceptable medium. If the records retention system commingles records required to be retained with other records, the Division can review all of the commingled records.

The operator must maintain all of the following records in the manner described above:

- The name of each issuer whose securities have been listed on its OhioInvests portal and the full name, residential address, Social Security number, date of birth, and copy of a state-issued identification of all owners with greater than 10% voting equity in the issuer;
- Copies of all offering materials that have been displayed on its OhioInvests portal;
- The names and other personal information of each purchaser who has registered at its OhioInvests portal. (A portal operator is prohibited from disclosing personal (identifying) information without the written or electronic consent of the prospective purchaser or purchaser. This

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<sup>22</sup> R.C. 1707.055.

<sup>23</sup> R.C. 1707.056 and 1707.057.

<sup>24</sup> R.C. 1707.057(C).

confidentiality requirement does not apply with respect to records required to be furnished pursuant to law or to the disclosure of personal information to an OhioInvests issuer relating to its OhioInvests offering.)

- Any agreements and contracts between the portal operator and an issuer;
- Any information used to establish that a prospective purchaser or purchaser of securities through its OhioInvests portal is a resident of Ohio and that an issuer whose securities are listed on the portal has its principal office in Ohio;
- Any other records the Division requires by rule to be maintained and preserved.<sup>25</sup>

### **Escrow agent and agreement**

The escrow agent used for holding payments for the purchase of securities must be a financial institution or credit union authorized to do business in Ohio. The escrow agent's duty is only to the party establishing the account unless set forth in the escrow agreement or other contract. Before contracting with an issuer, the escrow agent must search the issuer and its executive management against the Specifically Designated Nationals List (SDN) maintained by the Office of Foreign Assets (OFAC) of the U.S. Department of the Treasury. Under existing federal law, the OFAC publishes a list of SDNs, which are individuals and companies owned or controlled by terrorists and narcotics traffickers. SDN's assets are blocked and U.S. persons are generally prohibited from dealing with them.<sup>26</sup>

### **Local government entities as portal operators**

The bill expressly permits port authorities and community improvement corporations to act as portal operators for purposes of an OhioInvests offering.<sup>27</sup>

### **Definition**

"**Affiliated party**" means any (1) predecessor to the issuer, (2) affiliated issuer, (3) director, executive officer, other officer participating in the offering, general partner,

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<sup>25</sup> R.C. 1707.056(B) and 1707.057.

<sup>26</sup> R.C. 1707.051(I) and U.S. Department of the Treasury, Resource Center, <https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx>, accessed November 6, 2016.

<sup>27</sup> R.C. 1724.02, 4582.06, and 4582.31.

or managing member of the issuer, (4) beneficial owner of 20% of more of the issuer's outstanding voting equity securities, calculated on the basis of voting power, (5) promoter connected with the issuer in any capacity at the time of the sale, (6) investment manager of an issuer that is a pooled investment fund, (7) general partner or managing member of any investment manager participating in the offering, (8) director, executive officer, or other officer participating in the offering of any investment manager or general partner or managing member of the investment manager participating in the offering.<sup>28</sup>

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## HISTORY

| ACTION     | DATE     |
|------------|----------|
| Introduced | 08-31-16 |

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<sup>28</sup> R.C. 1707.058(A).