

## Small Crowdfunding Offering Exemption – Perhaps Now It Will Be The Game-Changer We Hoped

By: Andrea Welter and Herrick Lidstone  
Burns, Figa & Will, P.C.

Previous Colorado Bar Association, Business Law Section newsletter articles have discussed equity crowdfunding in Colorado and SEC Regulation C-F.<sup>1</sup> The Colorado Lawyer has included an article, “*Crowdfunding In Colorado Is Now Available*,”<sup>2</sup> and an article entitled “*Crowdfunding in Colorado – State Rules versus the Federal Rules*” is available online.<sup>3</sup> Other authors have suggested that “*Equity crowdfunding is dead*,”<sup>4</sup> and “*Crowdfunding, Help Wanted*.”<sup>5</sup> At least one has asked, “*What’s Wrong With Crowdfunding?*”<sup>6</sup>

The General Assembly adopted the Colorado Crowdfunding Act (the “CCFA”) in 2015 stating in its legislative declaration (C.R.S. § 11-51-308.5(2)(a)) that “Start-up companies play a critical role in creating new jobs and revenues; and [l]ack of access to capital is an obstacle to starting and expanding small business, inhibits job growth, and has negatively affected the state’s economy.”<sup>7</sup>

---

<sup>1</sup> These are available at [www.cobar.org](http://www.cobar.org), and include the following newsletter articles by Herrick Lidstone:

- “*Is Crowdfunding in Colorado Effective Yet? Maybe*” (August 2014),
- “*Crowdfunding In Colorado Is About To Be Legal*” (April 2015),
- “*Crowdfunding In Colorado Is Now Available: Let the Offerings Roll!*” (August 2015),
- “*Securities Exemptions – Amended and Reinterpreted Amendments to Rule 504 and Intrastate Offerings*” (November 2016),
- *Crowdfunding in Colorado Is Not Working A Solution Proposed* (March 2017).
- “*The Colorado Division of Securities Issues New Rules – Effective July 31, 2018; The Crowdfunding Small Offering Exemption and Other Changes*” (September 2018)

<sup>2</sup> Lidstone, *Crowdfunding In Colorado Is Now Available*, 44 The Colo. L. (CBA) No. 11 at 49 (Nov. 2015).

<sup>3</sup> At <https://ssrn.com/abstract=2689415>.

<sup>4</sup> Caldbeck, Ryan, *Equity crowdfunding is dead*, TechCrunch.com (May 16, 2016), avail. at <https://techcrunch.com/2016/05/16/equity-crowdfunding-is-dead/> (last reviewed March 15, 2016).

<sup>5</sup> Ryan, Vincent, from the Editor, CFO Magazine ([www.cfo.com](http://www.cfo.com)) January-February 2017 at p. 6.

<sup>6</sup> Ryan, Vincent, from the Editor, CFO Magazine ([www.cfo.com](http://www.cfo.com)) January-February 2017 at p. 38, avail. at <http://ww2.cfo.com/capital-markets/2017/02/whats-wrong-crowdfunding/> (last reviewed March 15, 2017).

<sup>7</sup> The entire legislative declaration found at C.R.S. § 11-51-308.5(2) is as follows:  
(2) *Legislative Declaration*. The general assembly hereby:

In the September 2018 Business Law Newsletter,<sup>8</sup> Herrick Lidstone discussed the new rules that the Securities Commissioner adopted in an effort to fulfill the legislative purpose for the CCFA – to make capital raising simpler for small companies. That article described what was then new Rule 51-3.27, entitled *Crowdfunding – Small Offering Exemption*, which contemplated crowdfunding offerings up to \$500,000 and no minimum offering requirement with a minimum amount of regulatory scrutiny. The rule specifically provided for an offering without an online intermediary (otherwise required under the CCFA), but failed expressly to negate the escrow requirement.

---

(a) Finds that:

(I) Start-up companies play a critical role in creating new jobs and revenues; and

(II) Lack of access to capital is an obstacle to starting and expanding small business, inhibits job growth, and has negatively affected the state's economy;

(b) Determines that:

(I) The costs and complexities of state securities registration can outweigh the benefits to Colorado businesses seeking to raise capital by small securities offerings;

(II) The use of crowdfunding, or raising money on-line through small contributions from a large number of investors, is presently restricted by our state securities laws; and

(III) Crowdfunding allows small companies to access the capital they need to start or expand businesses; and

(c) Declares that:

(I) In compliance with exemptions from federal law, the exemption provided by this section applies only if:

(A) The investor is a Colorado resident or is an entity formed pursuant to Colorado laws;

(B) The issuer of the securities is an entity formed pursuant to Colorado laws and doing business in Colorado; and

(C) The issuer intends to use and uses at least eighty percent of the proceeds of the sale of securities in Colorado; and

(II) Creating a Colorado crowdfunding option, with limitations to protect investors, will enable Colorado businesses to obtain capital, democratize venture capital formation, and facilitate investment by Colorado residents in Colorado start-ups, thereby promoting the formation and growth of local companies and the accompanying job creation.

See a February 2017 report from the conservative Heritage Foundation by David Burton entitled *Improving Entrepreneurs' Access To Capital: Vital For Economic Growth* which reached many of the same conclusions. This paper is available at <http://report.heritage.org/bg3182>.

<sup>8</sup> Also available at Lidstone, Herrick K., *The Colorado Division of Securities Issues New Rules - The Crowdfunding Small Offering Exemption and Other Changes* (September 4, 2018), <https://ssrn.com/abstract=3244120>.

### ***Why Should There Be An Escrow Requirement?***

As Herrick Lidstone stated in the September 2018 Business Law Section newsletter, the Small Offering Exemption rule as adopted raised a concern whether the escrow requirements included in the CCFA applied to crowdfunding under the Small Offering Exemption. The escrow requirement is established in the CCFA and the requirements for the escrow agreement in Rule 51-3.24.F. Clearly it makes little sense for the escrow obligation to apply to the Small Offering Exemption when the offering does not include a minimum. As then Securities Commissioner Gerald Rome told the Denver Business Journal, “The banks were asking for pretty significant fees to do that so we relaxed the rule on escrow . . . so small businesses don’t have to use a bank as the escrow agent.”<sup>9</sup>

Unfortunately, as predicted in the September 2018 newsletter, the rule relaxing the escrow requirement was not sufficiently clear and his interpretation did not survive Commissioner Rome’s November 2018 retirement. In a July 2019 filing made under the Small Offering Exemption, the staff asked that the offeror establish an escrow for a small offering under Rule 51-3.27 even though the offeror was not seeking a minimum amount, the offering materials included a risk factor disclosing that, with no minimum offering: “If the Company is unable to meet the maximum offering amount, the Company may not be able to complete the purchase of the Property or the Townhomes Project and there is no requirement that offering proceeds be returned to Investors. The investment objectives of the Company involve a variety of risks and a wide range of assumptions. Investors should not invest in the Units if they do not fully comprehend the nature of these risks and assumptions.”

### ***Waiver of the Escrow Requirement***

The issuer made a request to the Division of Securities for a waiver of the escrow requirement for its small offering filing, and the Division granted that waiver.<sup>10</sup> The Division imposed a condition on the waiver grant, that “[t]he Company will hold all funds in a segregated account at a depository institution authorized to do business in Colorado.”<sup>11</sup> Based on that waiver, we made a written recommendation to the Division of Securities that it consider incorporating the escrow waiver into Rule 51-3.27 at a previously-scheduled rulemaking hearing on October 18, 2019.<sup>12</sup> While this suggestion was approved, the public notice requirements of

---

<sup>9</sup> Monica Vendituoli, *Colorado’s crowdfunding exemption changes could be ‘game change’ for small businesses*, Denver Business Journal, September 28, 2018, available by subscription at <https://www.bizjournals.com/denver/news/2018/09/28/colorados-crowdfunding-exemptionchanges.html>.

<sup>10</sup> Available at [https://drive.google.com/file/d/1rM\\_NWxfRWGyDuIqfoiUlryg3wnsQZu/view](https://drive.google.com/file/d/1rM_NWxfRWGyDuIqfoiUlryg3wnsQZu/view) (last viewed November 14, 2019).

<sup>11</sup> The term “depository institution” is defined in C.R.S. § 11-51-201(5).

<sup>12</sup> Notice of Proposed Rulemaking, Colorado Division of Securities, available at [https://drive.google.com/file/d/1VwKx9IGqJBSaTuOKYi\\_H4F3wWUL6-MGb/view](https://drive.google.com/file/d/1VwKx9IGqJBSaTuOKYi_H4F3wWUL6-MGb/view) (last viewed, November 14, 2019).

that particular amendment were not met and the rule amendment will not become effective. It is our understanding that the Division of Securities will propose the following language amending Rule 51-3.27 for a future rulemaking (with amendment in underlined italics):

Upon approval of the Commissioner, an issuer who files a Form CF-1, a consent to service of process, and a Form CF-2 as required by Rules 51-3.20, 51-3.21 and 51-3.22, pays the required fees, maintains issuer records required by Rule 51-3.23, meets the additional issuer requirements set forth in Rule 51-3.24 and is not disqualified as contemplated in Rule 51-3.30, and the issuer is not seeking to raise not more than \$500,000 in any twelve-month period, the issuer may proceed with the offering under these Rules without imposing a minimum offering and without using an online intermediary. *If the offering is proceeding without imposing a minimum offering, the offering may proceed without requiring that the proceeds be placed in escrow provided that the funds are maintained in a segregated account until spent on a proposed use of proceeds.*

Nevertheless, issues may proceed under the Small Offering Exemption seeking a waiver similar to that identified in note 10, above. With that waiver and the proposed rule amendment, the Small Offering Exemption under the Colorado crowdfunding rules may finally prove to be the boon to small businesses raising \$500,000 or less that the legislature hoped when it adopted the CCFA in 2015 and that Commissioner Rome predicted in his comments to the Denver Business Journal in September 2018.

### ***The Small Offering Exemption Is Not A Panacea For Small Businesses***

It remains important to note, however, that the Small Offering Exemption is not a panacea for small businesses. Under that exemption and the Division's rules and forms, small businesses can raise funding, but there remain a number of considerations:

*First*, and perhaps the most important, strict compliance with the Colorado rules does not necessarily constitute compliance with the federal securities laws. Each offering must continue to find an exemption from the registration requirements under federal law. Issuers will typically use Securities Act Rules 504, 147, or 147A.<sup>13</sup>

*Second*, as in any securities offering, an exemption only exempts the offering from the registration requirements of the Colorado Securities Act<sup>14</sup>; it does not exempt the issuer from disclosure requirements which must meet Colorado's anti-fraud rules.<sup>15</sup> Accurate

---

<sup>13</sup> These are discussed in Lidstone, Herrick K., "Securities Exemptions - Amended and Reinterpreted" (November 22, 2016), available at <https://ssrn.com/abstract=2874004>.

<sup>14</sup> C.R.S. § 11-51-301.

<sup>15</sup> C.R.S. § 11-51-501.

and complete disclosure of material information is necessary in connection with any offering of securities.

*Third*, as stated in a prior article,<sup>16</sup> “[t]he good thing about crowdfunding . . . is that an issuer can raise capital from a number of people, from tens to hundreds to perhaps a greater number. The bad thing about crowdfunding is that an issuer can raise capital from a number of people, from tens to hundreds to perhaps a greater number.”

Investors have a belief that they should be kept informed about the progress of the business – and the rules of the CCFA require that be done. The Colorado Small Offering Exemption continues to require that the issuer meet the reporting requirements in the CCFA. The CCFA requires that the issuer “maintain all records with respect to any offering conducted pursuant to the [CCFA] as the securities commissioner may by rule require.”<sup>17</sup> The CCFA also requires that the issuer provide a quarterly report “free of charge” to all investors.<sup>18</sup>

Raising the funds through a Small Offering Exemption without an online intermediary or an escrow may be the easy part. Continuing to meet the statutory and regulatory requirements following the completion of the offering will likely prove to be more difficult and should be carefully considered before a small business attempts raising capital through the crowdfunding Small Offering Exemption.

Typically, a business lacks the time, money or knowledge to conduct a capital-raising campaign or manage an owners-base that involves a large number of people – especially where a \$100,000 offering with a minimum investment of \$100 could result in 1,000 investors. Will the issuer, with its staff oriented toward business operations, be able to manage the investors, meet the regulatory requirements for delivering reports, and otherwise respond to investor issues? An online intermediary or other service-provider can be hired to provide these services to the small business, but at an additional cost. Karl Dakin ([www.InvestLocalColorado.com](http://www.InvestLocalColorado.com), an online intermediary) has stated that the removal of the intermediary may only work for those businesses with a good management team that can build and manage a crowd of investors or which is willing to incur the added expense of hiring an experienced professional to help the issuer manage the crowd of investors following the completion of the campaign – and perhaps during the Small Offering Exemption campaign.

### ***Conclusion.***

With a waiver of the escrow requirement under the Small Offering Exemption added to the rules under the Colorado Crowdfunding Act, small offerings should be easier to accomplish.

---

<sup>16</sup> Lidstone, Herrick K., “The Colorado Division of Securities Issues New Rules - the Crowdfunding Small Offering Exemption and Other Changes” (September 4, 2018), <https://ssrn.com/abstract=3244120>.

<sup>17</sup> C.R.S. § 11-51-308.5(3)(a)(IV)(E).

<sup>18</sup> C.R.S. § 11-51-308.5(3)(a)(XIII). The Commissioner has expanded and explained these requirements in Rule 51-3.23 (Crowdfunding – Issuer Records) and Rule 51-3.24.I (Additional Issuer Requirements) by requiring that the report be provided within 45 days after the end of each quarter.

Meeting the disclosure and the post-offering requirements will, however, remain extremely important.