Posted on: May 15, 2015

CROWDFUNDING ARRIVES IN BRITISH COLUMBIA

Richards Buell Sutton Securities Law Update

By: Joe Chan and RBS Lawyers

On and effective May 14, 2015, British Columbia joined Saskatchewan, Manitoba, Quebec, New Brunswick and Nova Scotia in adopting rules allowing for start-up crowdfunding for private companies. A summary follows below.

Start-Up Crowdfunding Prospectus Exemption

As a general rule, a company must file a prospectus with the securities regulatory authority in each province or territory in which it intends to distribute securities. Filing a prospectus is both costly in terms of time and money, and fortunately many exemptions from this rule exist.

In the very recent past, crowdfunding has become a much-discussed method of raising capital online. To date, start-up companies have not been able to sell equity to investors through crowdfunding, due to the prospectus rule described above, and the registration rule described below.

Under the new Start-Up Crowdfunding prospectus exemption, non-reporting issuers (in general vernacular, private businesses which have not previously filed a prospectus) will be allowed to offer residents in British Columbia, Saskatchewan, Manitoba, Quebec, New Brunswick and Nova Scotia, the following types of securities through online crowdfunding portals, without having to file a prospectus:

- Common shares;
- Non-convertible preferred shares;
- Securities convertible into common shares or non-convertible preferred shares;
- Non-convertible debt securities linked to a fixed or floating interest rate (eg. debentures); and
- For limited partnerships, its units.

Under this new exemption, individual investors will not be allowed to invest more than $1,500 in reliance on this exemption. The non-reporting issuer will be allowed to raise a maximum of $250,000 per distribution, twice a calendar year (for an aggregate maximum total of $500,000). These maximum limits must include any other amounts raised by affiliates of the non-reporting issuer by way of this Start-Up Crowdfunding exemption, and also any other amounts raised by any other issuer (i) that is engaged in a common enterprise with that non-reporting issuer or its affiliates, or (ii) whose business is founded or organized, directly or indirectly, by the same person or persons (these affiliates and related issuers are, along with the non-reporting issuer, referred to as an "**issuer group**"). Each distribution period cannot be for longer than 90 days.

The non-reporting issuer will be required to provide a basic offering document through the funding portal. The offering document must disclose information regarding the business, management, the securities being offered, the intended use of funds, risk factors, and any commissions or fees being paid. No commissions or fees can be paid to the issuer group, nor any of their principals, employees or agents.

As a measure of investor protection, each investor must also be given contractual rights to withdraw its investment within 48 hours of the initial subscription. In turn, the funding portal will be required to return that investor's money within 5 business days of receiving notice of the withdrawal. Additionally, if the non-reporting issuer is unable to raise its stated minimum in offering proceeds within the 90 day period, the funding portal will be required to return all funds collected within 5 business days. (In contrast, the funding portal must pay out all funds to the non-reporting issuer within 48 hours of the close of a successful offering.) The issuer group and the funding portal cannot have common principals.

After the successful completion of an offering, the non-reporting issuer must report to its investors within 30 days, including disclosure regarding the amount raised and the total commission or fees paid with respect to the offering. In addition, a report must be filed with the applicable securities regulatory authority.

New Considerations For Startups

The opportunity to raise capital in this fashion will no doubt be very enticing to many startups and early stage growth companies. It will also add new considerations for founders to weigh. Companies that take advantage of this opportunity may tap into a new source of capital. However, the investors secured will be very different from those that typically fund startups through Seed and Series A rounds. Accordingly the rights attached to securities offered in a crowdfunding round should be very different from those offered to Angels, VCs or even friends and family. Consideration should also be given to the impact a crowdfunding round may have on the interest of other potential investors to back the company.

This is an exciting opportunity for startups, but one that needs to fit within the company's larger fundraising plans. It is also one that should be considered at the earliest stages to ensure the startup's capital structure is conducive to a crowdfunding round.

Funding Portal Registration Exemption

Online funding portals have similarly faced another restrictive rule. In general, no person can "trade" (which includes any activities in furtherance of a trade, such as providing an online funding portal) in securities without having registered with the applicable securities regulatory authorities. Again, registration is both costly in terms of time and money.

Under the new Start-Up Crowdfunding registration exemption, an exemption is provided to online funding portals from this requirement. To qualify, the online funding portal must meet the following requirements and criteria:

- 30 days prior to facilitating its first crowdfunding distribution, the portal and each of its principals must file forms with the applicable securities regulatory authorities, and successfully pass a review. This review will involve, among other things, a review of each principal and his or her integrity, financial responsibility, and relevant knowledge or expertise;
- The head office of the funding portal must be in Canada, and the majority of its directors Canadian residents;
- The funding portal must maintain accurate books and records, detailing its financial affairs and client transactions, for a period of 8 years from the date each record is created;
- The funding portal must not already be registered under Canadian securities law as a dealer, advisor or otherwise;
- The funding portal must not provide investment advice to an investor, or recommend or represent that the investment is suitable, or any information about the merits of the investment;
- Prior to allowing any person entry to its website, the funding portal must require that person to acknowledge that the funding portal is not registered under Canadian securities law, and that the funding portal will not provide advice regarding the investment. Further, the funding portal must take "reasonable measures" to ensure that the issuer and each investor are residents of British Columbia, Saskatchewan, Manitoba, Quebec, New Brunswick or Nova Scotia;
- The funding portal must make the issuer's offering document (described above) available to each investor, and must also notify the investor of its 48 hour contractual right of rescission (described above). Prior to that investor making an investment through the funding portal, it must also require confirmation from that person that they have read and understood the offering document of the issuer, and all risk warnings;
- The website must disclose, for each principal, his or her full legal name, municipality and jurisdiction of residence, business mailing and email address, and business telephone number;
- The funding portal cannot receive a commission or fee from the investor, and must hold all funds received separate and apart from its own property, in trust for that investor and, in the case of cash,

in a designated trust account with a Canadian financial institution;

- All payments by the investor must be taken electronically through the funding portal's website and strict timelines apply to any returns to the investor or payments to the issuer.

This is an exciting opportunity for private companies. We encourage all private company clients to contact us for further information, including advice on how best to take advantage of this new financing opportunity.