

Since the adoption of the initial set of crowdfunding rules by the Texas State Securities Board (the “Board”) in February 2015, the use of crowdfunding portals to raise capital within Texas has not reached the levels seen elsewhere. Confusion over the rules and regulations, competition from other states and national portals like Kickstarter and Indiegogo, and a general lack of critical mass have all contributed to the problem. As of October 2016, eleven crowdfunding portals were registered with the Board, but as of March 2018, only three were registered, illustrating the problem. In order to address one of the obstacles to successful crowdfunding in Texas, the Board has enacted two successive rule changes.

By way of background, the Texas intrastate crowdfunding rules allow Texas companies to raise up to \$1 million in any 12-month period from Texas investors. Unless accredited, an investor may only invest \$5,000 in any one crowdfunding investment. In addition, when the original set of rules was adopted in February 2015, Texas crowdfunding portals were required to engage a third-party escrow agent to maintain and disburse the funds raised in an offering. As a practical matter, companies seeking small amounts of capital found it logistically difficult or cost prohibitive to find a suitable escrow agent (essentially, a bank that was willing to provide the required services at a decent rate).

The Board’s first rule change, effective as of October 20, 2016, allowed the portals to handle funds themselves in segregated accounts for offerings that do not exceed \$100,000. The second rule change, effective as of January 14, 2018, raised this amount to \$1 million, essentially covering all Texas intrastate crowdfunding activity. Therefore, this obstacle is effectively removed for those companies looking for smaller amounts of capital, hopefully leading to more crowdfunding activity within the state.

Interestingly, several crowdfunding portals joined together to request via comment on the proposed 2016 rules that the \$100,000 cap be raised to a range between \$250,000 and \$495,000. This request was denied on the basis that segregated accounts were intended to help only smaller offerings.

However, the Board specifically stated that it might revisit the cap in the future, which, as it turns out, it very quickly did about a year later when it raised the cap all the way to \$1 million. This change of heart was no doubt a reaction to the poor results under the preexisting rules.

When enacting the 2016 rule change, the Board stated that a portal that holds funds in a segregated account assumes a heightened duty of trust and confidence between it, the investors and the issuer. This duty obligates the portal to take care of funds placed in the segregated account for the benefit of the respective parties, who have entrusted the funds to the portal for safekeeping. Conflicts of interest or self-dealing must be avoided, and the portal must remain objective and neutral and act at all times in the best interests of all parties to the transaction.

To this end, the Board set out a number of technical and procedural requirements for segregated accounts:

- The account must be held in a bank located within Texas and subject to U.S. Federal or Texas regulation.
- A separate segregated account must be set up for each offering in which a segregated account is used in order to prevent commingling of funds from different offerings. No other funds can be put in a segregated account (other than the minimal funds needed to maintain the account).
- The portal and the issuer must enter into a written segregated account agreement that identifies the bank and account number. The agreement must be included in the notice filing made with the Texas Securities Commissioner to claim the crowdfunding exemption under the state's securities laws.
- All signatories on the segregated account must be registered with the Texas Securities Commissioner. (Portals should consider providing two signatories as a safeguard, although this is not required under the rules.)
- Portals must disclose on their websites that a segregated account is being used for a given offering and that the portal (i) is responsible for the prudent processing, safeguarding, and accounting for funds entrusted to the portal by the investors and the issuer; (ii) will act to the advantage of and in the best interests of the investors and the issuer; and (iii) will ensure that all

requirements of the written account agreement are met before funds are disbursed from the account.

- Portals must maintain and preserve complete records for segregated accounts for five years after termination of the offering to which they relate, including all relevant contracts and agreements and complete bank ledgers that reflect all pertinent accounting. Bank statements and records should be reconciled every month.
- Disbursements from the segregated account should be made promptly once all conditions for release of the funds have been met based on a standard of reasonableness, including allowing adequate time for funds to clear the bank before disbursing.

These rules and requirements appear reasonable, particularly when combined with the new \$1 million cap. It remains to be seen, though, to what extent the rule revisions help spur crowdfunding activity in Texas. In conjunction with increased investor and entrepreneur awareness and education, the new rules might allow crowdfunding to reach hoped-for levels within the state and become a more viable option for small businesses seeking capital.

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