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U.S. Securities and Exchange Commission Proposes Rules on Crowdfunding in Furtherance of 2012 JOBS Act

On October 23, 2013, the U.S. Securities and Exchange Commission (SEC) voted to issue proposed rules for crowdfunding under Title III of the JOBS Act. Not yet published in the Federal Register, the proposed rules cover five hundred and eighty five PDF pages as an attachment to the SEC’s official notice on its website. It is a measure of the substance and complexity of the effort that the actual text of the proposed rule begins on page four hundred sixty nine of release with the earlier pages being devoted to a very detailed analysis of the SEC’s thinking in development of the rules. Within that comment section are two hundred and ninety five questions related to crowdfunding on which the SEC solicits comment. Of particular value to interested and affected parties is the section on economic analysis which begins on page three hundred fifteen and provides very useful context for the rules development.

Under the proposed rules companies would be able to raise a maximum aggregate amount of one million dollars through crowdfunding offerings to non accredited investors in a twelve month period. Those investors would be able to invest up to a limit of \$2,000 or five percent of their income or net worth — whichever is greater — if both annual income and net worth are less than \$100,000 or \$100,000 or ten percent of their annual income or net worth – whichever is greater – if either their annual income or net worth is equal to or more than \$100,000.

In its offering a business would be required to disclose (to the SEC, to the intermediary facilitating the offering, and to the investor) information to include: a description of the company’s line of business and the proposed uses of the proceeds of the offering; information about officers and directors and any owners of twenty percent or more of the company; the price to the public of the offered securities; the target amount to be raised, the deadline for reaching that target, and whether the company will accept investments in excess of the targeted amount; the financial condition of the company; audited financial statements of the company and its recent tax returns.

All crowdfunding offerings would be required to take place through an SEC registered intermediary: either a broker-dealer or a new form of registration to be termed a “portal.” Those intermediaries would be required to provide the investor with educational materials, to take measures – such a background checks of principals – to reduce the risk of fraud, to make available information about the offering and the issuer. The SEC is explicit in its comments that it regards the intent of Congress on crowdfunding to be Internet only sales.

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Portals would be prohibited from offering investment advice, soliciting purchases of the securities displayed on its website, compensating individuals for solicitations, and holding or handling investor funds or securities.

Portals would be required to be members of the Financial Industry Regulatory Authority (FINRA) a non-governmental national securities association registered with the SEC. Concurrently with the SEC proposed rulemaking, FINRA has issued its own proposed rulemaking on portals and invited comment by February 3, 2014. Those rules must be approved by the SEC.

Federal Trade Commission (FTC) to Conduct Study of “Patent Assertion Entities” in Response to Concern About “Patent Trolls” in Wireless Communications Sector

It is an accepted and legal process – especially in high technology manufacturing – for manufacturers to acquire patents without the intent to utilize them in their products but instead to hold them to assert against competitors and so to create barriers to entry in the market for a given product. In recent years there has also been growth in the number of entities which do not have products or compete in a marketplace but instead exist only to acquire and assert patents against manufacturers for compensation. Officially called “patent assertion entities” they are often referred to as “patent trolls.”

In December, 2012, the FTC and the U.S. Department of Justice sponsored a workshop to look at the impact of such patent assertion activity in terms of market inefficiencies and potential antitrust harm to competition. Participants at that workshop and members of Congress – including Minnesota’s Senator Amy Klobuchar – recommended that the FTC conduct a study under the investigative authority of the Federal Trade Commission Act’s section 6(b) to obtain information about patent assertion entities’ “acquisition, litigation, and licensing practices.”

The FTC’s overview of its investigative and law enforcement authority notes that such a study may be conducted “to obtain specific answers to antitrust related questions that could not be available by subpoena because there is no document that contains the desired answers.”

On October 3, 2013, the FTC published a notice of its intent to conduct such a study in the wireless communications area. The notice contains the questions to be directed to assertion entities as compulsory process orders and solicits comments from interested and affected parties by December 2, 2013, before the SEC requests Office of Management and Budget review of the compulsory orders under the federal Paperwork Reduction Act.

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The FTC proposes to address questions to patent assertion entities in five areas to “enhance the quality of policy debate”:

- How do patent assertion entities organize their legal structure, including parent and subsidiary entities?
- What types of patents do such entities hold, and how do they organize their holdings?
- How do such entities acquire patents and how do they compensate prior patent owners?
- How do such entities engage in assertion activity (e.g., demand, litigation, and licensing)?
- What does assertion activity cost such an entity?
- What do such entities earn through assertion activities?

The more detailed sub-questions to the above list cover twelve pages.

In seeking comments, the FTC specifically invites comments on whether the proposed information collection is necessary for the functions of the FTC and whether the information will have practical utility; the accuracy of the FTC’s estimate of the burden of information collection, which estimate can be as high as several hundred hours; ways to enhance the clarity, utility, and quality of information collected; and ways to minimize the burden of collecting information.

Full details of responding in hard copy or online are contained in the notice.

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