Crowd-sourced funding (CSF) is almost a reality for proprietary companies. Businesses in Australia will soon be able to access CSF without needing to convert into or incorporate an unlisted public company. If you caught our earlier article, you’ll know the existing CSF regime will extend to proprietary companies. In this article, we look at how it is different to crowd-source fund as a proprietary company and what are some obligations in undertaking CSF as a proprietary company.

**History of crowdfunding at a glance**

The concept of ‘crowdfunding’ is nothing new. Examples of debt-based, reward-based, donation-based crowdfunding are numerous.

They include:

- the Irish loan fund established in the early 1700s to provide loans to the poor in Dublin as a form of microcredit, which led to approximately 300 loan funds in Ireland by the 1800s;
- the precursors of cooperatives and credit unions seen in Germany in mid-19th century, that extended microloans from members to those in need in rural communities;
- the Statue of Liberty in late-19th century that raised funds via donations from citizens of France who paid for the statue and citizens of the United States who paid for the pedestal;
- the pioneer of modern microfinancing, whose research project in 1976 to provide banking opportunities to underprivileged individuals, led to the Grameen Bank in Bangladesh; and
- the emergence of Artistshare, Indiegogo and Kickstarter in the creative industry in 2000s.

**What is CSF?**

Equity-sourced crowdfunding is different. It is a type of fundraising, typically online, that allows a large number of individuals (or the ‘crowd’ at large) to make small financial contributions towards a company in exchange for an equity stake in the company.

In the US, the Jumpstart Our Business Start-ups Act was enacted in 2012 under the presidency of Barack Obama.

In Australia, the CSF legislation took effect on 29 September 2017, but only for unlisted public companies that wish to
raise up to $5 million in 12 months through
an AFS licensed intermediary who is
authorised to provide CSF services. On 12
September this year, the Senate passed
the bill that extended the CSF regime to
proprietary companies in Australia. The
Corporations Amendment (Crowd-sourced
Funding for Proprietary Companies) Bill
2017, introduced by the former Treasurer
(now Prime Minister) Scott Morrison to the
Lower House in 2017 (Bill), will become
law within 28 days after it receives the
royal assent. See our previous thinking on
the Bill.

As of August this year, the total number
of companies registered in Australia is
2,634,282. Most of these are proprietary
companies. CSF is an alternative way to
raise funds, especially for innovative and
early-stage or growth-stage companies
that may not have the access to debt
funding (via banks and other financial
intermediaries) or equity funding.

CSF for proprietary companies

So how does CSF work differently for a
proprietary company?

Here is a summary of some key features:

- More than 50 non-employee
  shareholders

A proprietary company must have no
more than 50 non-employee shareholders
under the Corporations Act 2001 (Cth)
(Act). But for the new law, this requirement
meant proprietary companies could not
undertake CSF if it attracted a large
number of small-sale investors that would
result in this cap being exceeded.

Once the Bill becomes law, a proprietary
company will continue to have a maximum
of 50 non-employee shareholders but
CSF shareholders will not count towards
that cap. The restriction on the number
of shareholders of a proprietary company
is removed in respect of CSF offers
under which a person will become a CSF
shareholder of the company.

Accordingly, a proprietary company will
no longer have to convert into an unlisted
public company (limited by shares) in order
to avoid this cap if it wants to raise funds
the CSF way.

- Takeover rules exemption

An unlisted company with more than 50
shareholders is subject to takeover rules
under Chapter 6 of the Act. Proprietary
companies that use CSF would generally
be subject to the takeover rules as they are
likely to have more than 50 shareholders.
The takeover rules are restrictive on
fundraising structures and exit options as
they apply in relation to the acquisition of
control up to and/or beyond 20% of a
compamy’s voting shares.

To avoid triggering the takeover rules, the
Bill provides that a proprietary company
with CSF shareholders will be exempt
from the takeover rules in Chapter 6 of
the Act as long as it meets the conditions
(if any) prescribed in the regulations.
The Exposure Draft and the Explanatory
Statement of the regulations as released
by the Government for consultation
provide some further details on the likely
conditions. These conditions are aimed to
limit the exemption from takeover rules to
proprietary companies so long as they are
eligible to make a CSF offer.

This exemption is provided in order to
reduce compliance costs and avoid unduly
restricting companies from adjusting their
capital structure as they use CSF to grow
their business.

- Cooling off period for
  supplementary or replacement
  offer

Currently, a CSF intermediary must give
written notice to all applicants about a
one month cooling-off period where a
supplementary or replacement CSF offer
document is published. The Bill provides
for a shorter cooling-off period of 14
days if CSF offers are made after the Bill
becomes law.

This is when the CSF intermediary
becomes aware, while a CSF offer is open,
that the CSF offer document is defective
and for the purpose of correcting the
defect, the company making the CSF
offer provides the CSF intermediary with
a supplementary or replacement CSF offer
document. This cooling off period should
not be confused with the unconditional
cooling-off period of five business days
applicable to a CSF offer by an unlisted
public company to retail investors.

Reducing the minimum amount of time
that a CSF offer has to be open from
one month to 14 days will provide more
certainty for the company making the
CSF offer and other applicants about the
outcome of the CSF offer.

Corporate governance

Under the Bill, proprietary companies with
one or more CSF shareholders will be
subject to additional obligations. These
obligations are not ordinarily imposed on
small proprietary companies.

They include obligations to:
- have at least two directors;
- prepare financial and directors’
  reports in accordance with accounting
  standards;
- audit financial statements if proprietary
  companies raise $3 million or more from
  CSF offers;
- obtain the required shareholders’
  approval for any related party
  transactions under Chapter 2E of
  the Act; (as under the Bill, Chapter
  2E of the Act will apply to proprietary
  companies with one or more CSF
  shareholders); and
- maintain more comprehensive company
  registers, including details about the
  CSF offer and the CSF shareholders as
  part of the company registers.
ASIC levy

Further, CSF intermediaries, unlisted public companies and large proprietary companies will be subject to the ASIC levy as part of the ASIC Industry Funding.

According to ASIC’s Cost Recovery Implementation Statement: Levies for ASIC industry funding (2017–18) as at May 2018:

- ASIC intends to publish specific guidance to help CSF intermediaries comply with their obligations. For the 2017-2018 year, ASIC is not expecting to allocate any regulatory costs to the subsector affecting CSF intermediaries, and regulatory costs will consist of implementation costs allocated proportionally across all subsectors.

The CSF intermediaries subsector falls within the industry sector of investment management, superannuation and related services.

- Annual flat levies apply to unlisted public companies and large proprietary companies. This annual levy is the ASIC regulatory costs for the subsector shared equally between all unlisted public companies or large proprietary companies (as the case may be) in the financial year. There is no specific subsector for small proprietary companies on the other hand. A small proprietary company that does not fall within any of the subsectors is not subject to an annual flat levy as ASIC regulatory costs are recovered through an increase to the annual review fee.

A good legal adviser will guide you through the detailed rules, procedures and obligations both fundraisers and intermediaries must meet when conducting CSF offers.

In the UK market, CSF has generated a cumulative £634 million during the period of 2011 to 2016. In the US market, the total amount of funds raised through CSF was approximately US$753 million as of March 2015. Here in Australia, CSF for eligible public companies is in its infancy but is an alternative to traditional fundraising that may be attractive to innovative early-stage or growth-stage companies. So if you would like to find out more about CSF or different fundraising options and strategies available to your business, please contact us to discuss.