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The rebirth of crowd funding in Australia!

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Introduction

In December 2015, the *Corporations Amendment (Crowd-sourced Funding) Bill 2015 (2015 Bill)* was introduced into Federal Parliament but the calling of the federal election prevented the 2015 Bill from being passed.

In November 2016, the Federal Treasurer (Honourable Scott Morrison MP) introduced a revamped version of the 2015 Bill into the House of Representatives called the *Corporations Amendment (Crowd-sourced Funding) Bill 2016 (2016 CSF Bill)*.

This initiative has been anxiously awaited by start ups and small to medium sized businesses. This article explains crowd sourced funding and how the 2016 CSF Bill will work, if and when it commences.

What is crowd sourced funding (CSF)?

CSF is the colloquial term for the process whereby small unlisted public companies can raise capital in exchange for the issue of fully paid ordinary shares. The 2016 CSF Bill is designed to facilitate that process as well as to put protective measures in place for investors.

Which companies will be allowed to participate in CSF?

There are eligibility requirements governing which companies can participate. Basically to participate:

1. A CSF company has to be an unlisted public company limited by shares.

The company cannot be a subsidiary or related body corporate of a listed company. Proprietary limited companies are not eligible. However, a proprietary limited company can convert to a public company limited by shares and become eligible.

2. A CSF company will only be allowed to issue fully paid ordinary shares i.e., other classes of shares, debt securities and options are expected not to be permitted but supporting Regulations are expected to clarify the position.
3. The CSF company making the issue of shares (or a related company) cannot be a general investment company or invest in managed investment schemes.
4. A CSF company must have consolidated gross assets below \$25 million and must have consolidated annual revenue less than \$25 million. These tests must be satisfied immediately before making crowd funding offers. Annual revenue applies to the 12 months period before the offers are made.
5. Unless supporting Regulations alter the scenario, the maximum amount that a CSF issuer can raise in any 12 months period will be \$5 million. This \$5 million limit also covers money raised from exempt offers made to 20 personally known investors (under s 708(1) of the *Corporations Act 2001* (Cth) (**Corporations Act**)) and offers made by an Australian Financial Services Licence (**AFSL**) holder (under s 708(1) of the Corporations Act).

How are CSF offers to be made and regulated?

In addition to being a public company eligible to make CSF offers, a CSF participant:

1. Will need to engage a licensee holding an ASFL with a specific authorisation authorising the AFSL holder to provide a crowd funding service.

2. Will be restricted to using that AFSL holder as the conduit for making CSF offers on the platform operated on the AFSL holder's website. That AFSL holder will have a number of imposed obligations to oversee the offers being made and to allow prospective investors to communicate by means such as published posts on the website (supporting Regulations are expected to detail what is exactly required). The AFSL holder also will have the power to close or suspend the CSF offers as well as to ensure investors are made aware of their cooling off right i.e. to withdraw from the investment within 48 hours of applying for shares. The AFSL holder will have an obligation to ensure investors are aware of attendant investor risks and complete a risk acknowledgement statement. In addition, the AFSL holder is expected to make checks against the CSF issuing company and its directors (details of which are to be set out in the supporting Regulations).

Does a CSF offer require an offer document?

A CSF does require an offer document, but the offer document contemplated under the 2016 CSF Bill is not a prospectus. The content of the CSF offer document is to be set out in supporting Regulations. A CSF offer can only be open for a maximum of three months.

Are there similarities with prospectuses?

There are similarities with the regime for regulated disclosure documents like prospectuses i.e.:

1. ASIC will have a stop order power.
2. CSF issuers will have a liability for false and misleading statements or omissions and to make corrective disclosure for new circumstances.



3. Supplementary and replacement offer documents are to be allowed.
4. Offences will arise through non compliance.

Of some concern are the available defences for CSF companies making offers and their directors. The 2016 CSF Bill only contains two defences for criminal liability and liability for financial loss namely:

1. The defence where a person associated with the CSF offer document did not know the document was defective; and
2. Where a person placed reasonable reliance on information given by another (but not someone who is an employee, agent or director).

The Explanatory Memorandum for the 2016 CSF Bill offers no clues as to why there is no '*due diligence*' defence (see Corporations Act s 731). Perhaps this will be eventually explained.

How does the 2016 CSF Bill protect potential investors?

To understand the proposed protective measure, one has to appreciate that:

1. The 2016 CSF Bill has a primary function of creating a legitimate means to facilitate small unlisted public companies raising capital for expansion or to develop new ideas; and

2. The 2016 CSF Bill adopts a light touch regulatory approach so that CSF companies are not hindered and frustrated by the full regulatory regime under the Corporations Act that normally applies to fund raising by public companies.

The '*trade off*' is that potential investors know the challenges and risks that confront companies attempting speculative or innovative ventures that could cost the investor all of his or her investment. To balance the competing forces, the 2016 CSF Bill adopts these protective measures:

1. It limits the maximum amount an investor can invest under a CSF offer in any issuer to \$10,000 within 12 months.
2. It allows an investor to change his or her mind about the CSF investment and to withdraw their investment within 48 hours of first investing through the relevant platform used by the FSL intermediary.
3. It requires each investor to sign a risk acknowledgement at or before the time they apply for CSF shares.

These are the main protections. The AFSL intermediary assisting the CSF issuer has the responsibility for dealing with the investors, the processing of applications and receipt of funds.

Concessions for CSF issuers

To further assist prospective CSF issuers from being bound up with '*red tape*', the 2016 CSF Bill will provide temporary relaxations or concessions to CSF issuers for up to five years. These relaxations or concessions will only be available from when the new legislation commences and applies to:

1. Companies that incorporate or register as public companies after the commencement date; and
2. Proprietary limited companies that convert to a public company after the commencement date.

Additionally, to remain eligible, those companies must successfully complete a CSF offer within 12 months of registration or conversion and to have not undertaken any fundraising triggering the Corporations Act disclosure requirements. For those companies, these concessions are to last five years:

1. No requirement to hold an annual general meeting.
2. Financial reports can be provided to shareholders online.

The need to appoint an auditor and to produce audited financial statements is to be deferred until the company has raised \$1 million or more from CSF offers.

Observations

The 2016 CSF Bill has opted for a higher financial eligibility limit than the 2015 Bill predecessor and would seem compatible with the critique of the 2015 Bill predecessor the Senate's Economics Legislation Committee.

Even though we do not yet know the content of the supporting regulations for the 2016 CSF Bill, the CSF fundraising process should provide AFSL intermediaries who provide a crowd funding service with new business opportunities. These intermediaries will not have any fee restrictions under the 2016 CSF Bill, though all fees they impose must be disclosed.

For prospective CSF issuers, the regulatory detail affecting offer documents will be anxiously awaited. It is possible that the absence of a '*due diligence*' defence in the 2016 CSF Bill may cause concern but this is one of those issues that hopefully will be debated in Federal Parliament. The alternative view is that the due diligence defence was deliberately omitted.

If the 2016 CSF Bill passes through both Houses of Parliament and gains assent, a new type of fundraising will be facilitated bringing Australia into line with New Zealand, the USA, the UK and Canada (Ontario).

Further information

This newsletter is only intended to cover the main features of the 2016 CSF Bill. The newsletter is, therefore, not an exhaustive summary. Persons seeking more information on the coverage of the 2016 CSF Bill should obtain a copy of it and follow the passage of the 2016 CSF Bill through the legislative process.

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