**G O O D L O E  L A W**
*2029 CENTURY PARK EAST*
*14TH FLOOR*
*LOS ANGELES, CA 90067*

**CROWDFUNDING MEMO: April 2013**
*Written by Bianca Goodloe*

There are two avenues for crowd funding at present: Donation crowd funding and Equity crowd funding. The current red flags pertinent from a legal perspective associated with Donation crowd funding are the fact that even though the funding is not subject to the U.S. federal or state securities laws, accepting donations in exchange for other value such as walk-on parts (ie. employment) is prohibited by (among other labor code provisions) California Labor Code section 450 (specifically prohibiting any party from charging a fee as a condition precedent to applying for or accepting employment). Moreover, donations are taxable income, as opposed to being a tax free gift, due to the fact that a tax free gift requires that the payment be made out of "detached and disinterested generosity" with no consideration given.

In the common donation crowd funding scenarios that include the provision of capital in exchange for signed 'swag' or other movie-used memorabilia, value is represented as being exchanged which qualifies the donation as taxable event (as opposed to a gift). Furthermore, not only is this event not a tax free exchange, but for the donor, it is not tax deductible either, unless the production entity accepting the donation is a 501(c)(3) entity, which few production companies are. Charitable donations are only deductible if the receiving entity is a 501(c)(3) organization and there is no consideration received by the donor. Finally, in the donor crowd funding world, payments received must be accounted for as gross or adjusted gross proceeds for purposes of calculating guild residuals and participations owed talent, as they are in made often in exchange for DVDs, merchandising, etc. and not as investments on the front-end. Rather, they are pre-payments for the finished products, and to be considered receipts. Filmmakers must view them as such for accounting purposes so as not to run afoul of guild signatory obligations as well as investor entitlements and talent entitled creative corridors.

As regards Equity crowd funding, the hot button issue is that even though Title III of the JOBS Act has created an exemption to federal securities law to permit crowd funding for investment purposes, the SEC rules thereon have not yet been issued (as mandated by the Act), so the interpretation of said rules remains vague. Once the SEC rules are clarified, small businesses and start-ups will be able to raise up to $1 million U.S. Dollars annually via crowd funding through authorized broker/dealers and registered intermediary Web sites called 'funding portals.' The regulation of these will be determinative of the success of this initiative. Should the regulation of these intermediaries become cumbersome and not economically viable, the initiative will be dead in the water for economic reasons.

The exemption rules include the following: for offerings up to $100,000, the issuer must provide its income tax returns for the prior year as well as certified financial statements. For offerings greater than $100,000, but less than $500,000, the issuer must provide financial statements reviewed by an independent public accountant in accordance with professional standards and procedures defined by the SEC. For offerings greater than $500,000, the issuer must provide audited financial statements. Furthermore, regardless of the funding amount, the issuer must provide its name, legal status, address, website address, the names of its officers and directors and any person holding more than 20% of the shares issued, a description of the issuer's business and anticipated business plan, a description of the stated purpose and intended use of the proceeds, the target offering amount, the price to the public of the value of the securities and a description of the ownership and capital structure of the issuer. These requirements also apply to all offerings under Section 4(6) of the 1933 Securities Act, the exemption being provided is not much of a 'short cut' in terms of compliance for filmmakers. Additionally, under the new exemption, issuers are not permitted to advertise the offering (much like offers under Reg. D Rule 506, among others), except directing investors to intermediaries (broker/dealers and funding portals). Another similarity between the new exemption and traditional private placements is that the issuers prohibited from fundraising under Reg. D rules (505 and 506) as also restricted from crowd funding. These include non-U.S. companies, investment companies as defined under the Investment Companies Act), mutual funds, private equity funds, asset management vehicles, business development companies, etc.

The primary distinction between crowd funding under the new exemption and private placements under Reg. D (Rule 506) is that crowd funding may be sought from non-accredited investors (as defined in Rule 501 in Reg. D), but remains regulated nevertheless, as investors with an annual income or net worth of less than $100,000 can invest up to the greater of $2,000 or 5 percent of their annual income or net worth. Investors with an annual income or net worth of $100,000 or more can invest up to 10% of their annual income or net worth that is capped at $100,000. Investor questionnaires must be submitted to the SEC to ensure the aforementioned perimeters are being maintained. Such process is the same for current fundraises under Reg. D rules 505 and 506, and the funding portals must be registered with FINRA (same as broker/dealers under Reg. D Rule 505 and 506).

The more limiting aspect of Equity crowd funding in comparison to funding raising under the current Reg. D options (Rule 505 and 506) is that issuers may not access the funds raised until the target amount is reached in its entirety. Furthermore, the projects' officers and large shareholders must undergo criminal background checks, which may keep individuals away from this crowd funding process for privacy purposes. Finally, although Section 4(6) does not prohibit issuers from concurrently pursuing a donation-based crowd funding raise and equity crowd funding raise, producers doing so may run afoul of federal and state securities laws when combining Equity crowd funding initiatives with other offerings exempted under Reg. D, such as those under Rules 504, 505 and 506, under the Integration Doctrine. By way of example on how this may happen is that although equity crowd funding under the JOBS Act does not limit the number of

non-accredited investors permitted, raises under Rules 505 and 506 do limit the number of non-accredited investors from whom capital may be raised. Another potential conflict exists under Reg. D, Rule 504, which allows for general solicitation, because issuers under Section 4(6) are specifically prohibited from advertising the offering (except to directing investors to intermediaries).

Although the nuances of the Integration Doctrine are beyond the scope of this commentary, the purpose of the Integration doctrine is to determine when to treat separate offerings as part of a single transaction, under a 5 Point Test. Not all 5 Points of the test must be met for offerings to be integrated, which may cause issuers confusion sufficient to stay away from Equity crowd funding altogether due to prospective legal liability risks. The legal and related costs of maintaining compliance under the Equity crowd funding exemption may also prove at the very least impractical if not entirely prohibitive. Such issues shall be decided with the pending SEC clarifications, and ultimately, the market will dictate the popularity of this new crowd funding opportunity, by either embracing this new method of fundraising or rejecting it for the traditional funding avenues (or opting instead for even newer fundraising formats, which may be less regulation driven and more technology driven).