LEGISLATIVE REPORT: ACT 199

AN ACT RELATING TO FURTHERING ECONOMIC DEVELOPMENT

SUSAN L. DONEGAN, COMMISSIONER
VERMONT DEPARTMENT OF FINANCIAL REGULATION

JANUARY 15, 2015

VERMONT

VERMONT

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January 15, 2014

Sen. Kevin Mullin, Chair
Senate Committee on Economic Development, Housing and General Affairs

Sen. Tim Ashe, Chair
Senate Committee on Finance

Rep. Bill Botzow, Chair
House Committee on Commerce and Economic Development

RE: Act No. 199 of 2014

Dear Senators Mullin and Ashe and Representative Botzow:

Please accept this report from the Department of Financial Regulation (DFR) to fulfill the requirements as directed in Act No. 199 of 2014. DFR was instructed to complete several studies, adopt regulations and conduct outreach relating to access to capital and credit. The following sections explain the various topics and actions taken by DFR.

I'd like to thank you and your committee members for your leadership on economic development issues. I also wish to thank Rep. Heidi Scheuermann and former Rep. Paul Ralston for their time and input during the discussions regarding the small business offering exemption. Their insights were helpful.

Sincerely,

Susan L. Donegan
Commissioner

VERMONT

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CROWDFUNDING: INCREASING ACCESS TO CAPITAL FOR VERMONT'S SMALL BUSINESS

OPPORTUNITIES AND LIMITATIONS

SUSAN L. DONEGAN, COMMISSIONER
VERMONT DEPARTMENT OF FINANCIAL REGULATION

JANUARY 15, 2015

ABBREVIATIONS

SEC – U.S. Securities Exchange Commission

DFR – Vermont Department of Financial Regulation

JOBS Act – Jumpstart Our Business Startups Act

VSBOE – Vermont Small Business Offering Exemption

VUSA – Vermont Uniform Securities Act

INTRODUCTION

On June 24, 2014, Gov. Peter Shumlin signed Act 199 of 2014 titled "An act relating to furthering economic development."[1] Section 19 of this law requires the Department of Financial Regulation (DFR) to study the opportunities and limitations for crowdfunding to increase access to capital for Vermont's small businesses.[2] DFR hereby submits this report to the Senate Committee on Economic Development, Housing and General Affairs and the House Committee on Commerce and Economic Development.

This study consists of four sections. Section one provides an overview of the crowdfunding concept. Section two lays out the current securities regulatory frameworks for crowdfunding. Section three presents examples of how crowdfunding is being used in Vermont. Section four concludes this study with recommendations concerning the future crowdfunding in Vermont.

[1] Act 199 of 2014, An act relating to furthering economic development.
[2] *Id.* §19.

SECTION 1

BACKGROUND

Crowdfunding is a method used to raise money or capital in small increments from many people.[3] Traditionally, a small business raises capital by taking loans or selling investments in their company known as securities. As a consequence of the 2008 financial crisis, those financing mechanisms became less available in the capital markets. In order to help small businesses raise needed capital, President Obama signed the Jumpstart Our Business Startups (JOBS) Act in 2012. The JOBS Act created new regulatory framework for startups and small businesses to raise capital on the internet from a wider base of investors – now known as crowdfunding.

The JOBS Act mandated the U. S. Exchange Commission (SEC) to promulgate crowdfunding regulations. The SEC released proposed rules on October, 23, 2013. As of early December 2014, the SEC has now set October 15, 2015, as the target date to take final action on crowdfunding rules, roughly three years overdue. In the meantime, some states have created their own crowdfunding rules.

Types of Crowdfunding

Several different types of crowdfunding have evolved with distinct characteristics. Some crowdfunding programs fall outside the scope of state and federal securities regulation. For example, crowdfunding campaigns based on donations, rewards or pre-purchasing goods do not

[3] *See* SEC Issues Proposal on Crowdfunding, Background, *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540017677#.VGzEyMlwkf5 (Stating that investors could invest small amounts over the internet-based intermediaries).

implicate securities laws. However, crowdfunding campaigns based on lending money or purchasing equity do implicate securities laws.

Crowdfunding Activity that is not Regulated by Securities Laws

Donation Model: A contributor in a donation-based crowdfunding campaign is simply giving money to the raising entity without the expectation of receiving anything in return, financial or otherwise.

Rewards Model: A contributor in a rewards-based crowdfunding campaign is providing money to the raising entity with the expectation of receiving a token reward in return. Generally, the more substantive the monetary contribution, the more substantive the reward. Some reward examples include a contributor appearing in a film, having dinner with a cast member or receiving special thanks in the credits.

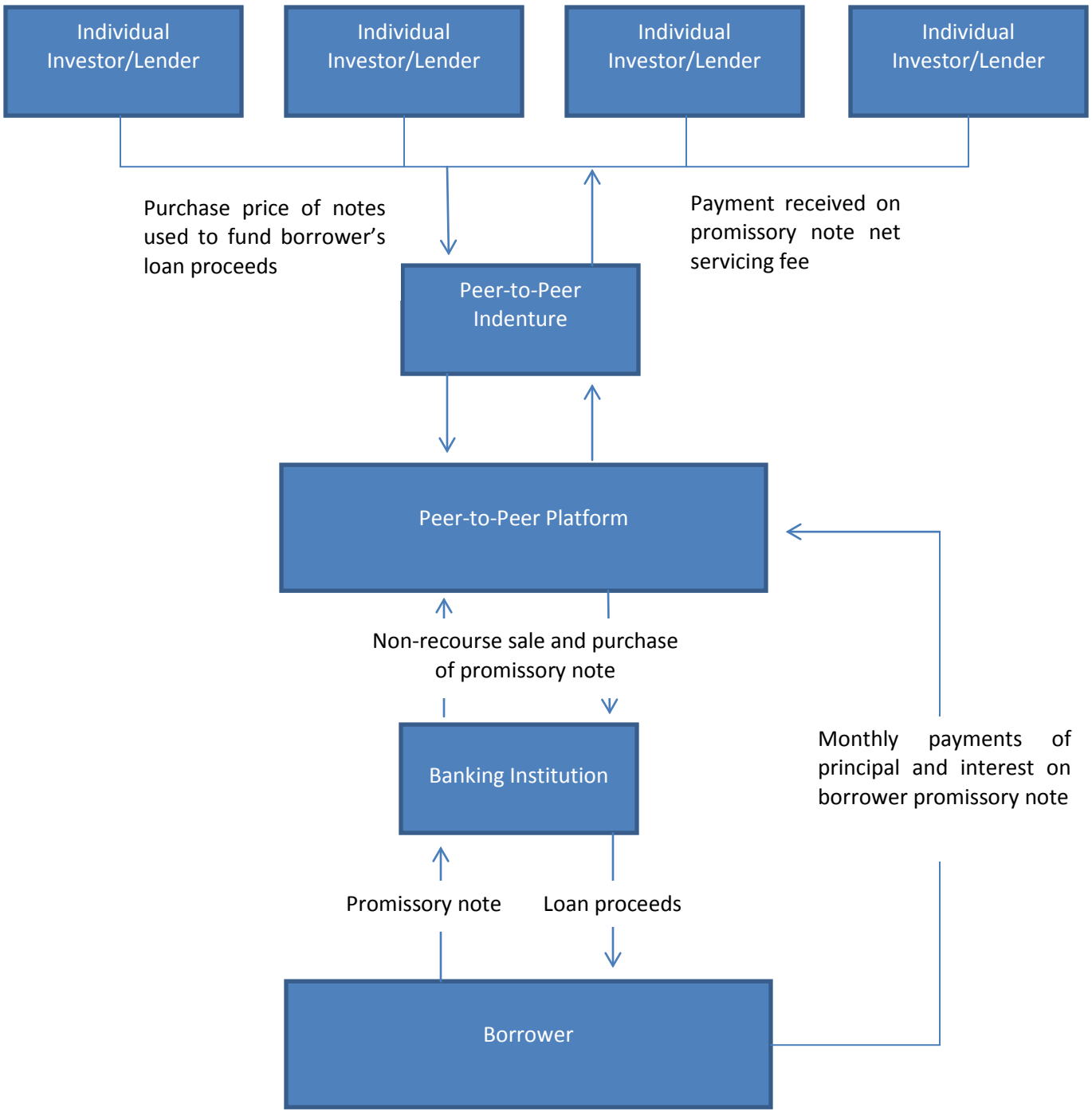
Pre-Purchase of Goods Model: A contributor in a pre-purchase-based crowdfunding campaign is providing money to the raising entity for the opportunity to purchase a product before it is generally available to the public, often below the retail price.

Crowdfunding Activity Regulated by Banking and Securities Laws

Lending Model: A contributor in a lending-based crowdfunding campaign is providing capital to the raising entity with the expectation of receiving regular interest and principal payments in return. Under the lending model a contributor's return on investment in the business comes in the form of principal and any interest payments; he or she does not receive ownership of the business or rights to profits.

A borrower interested in raising capital through this model submits financial information to the prospective lending platform and receives a credit score, which will determine the interest rate to investors. The loan, interest rate, and certain financial information are then posted to the lending platform for perspective investors to peruse. If a loan receives sufficient commitments from investors, the borrower executes a single promissory note and receives the money. The lending platform in turn issues notes to each investor. The borrower makes monthly payments of principal and interest to the lending platform, which then remits payment to the investors minus a servicing fee. The chart below depicts a typical peer-to-peer lending transaction. Depending on how these transactions are structured, they may be dually regulated under banking and securities laws. The borrowing side of the transaction must comply with applicable banking regulations, while the investor side requires registration under securities laws.

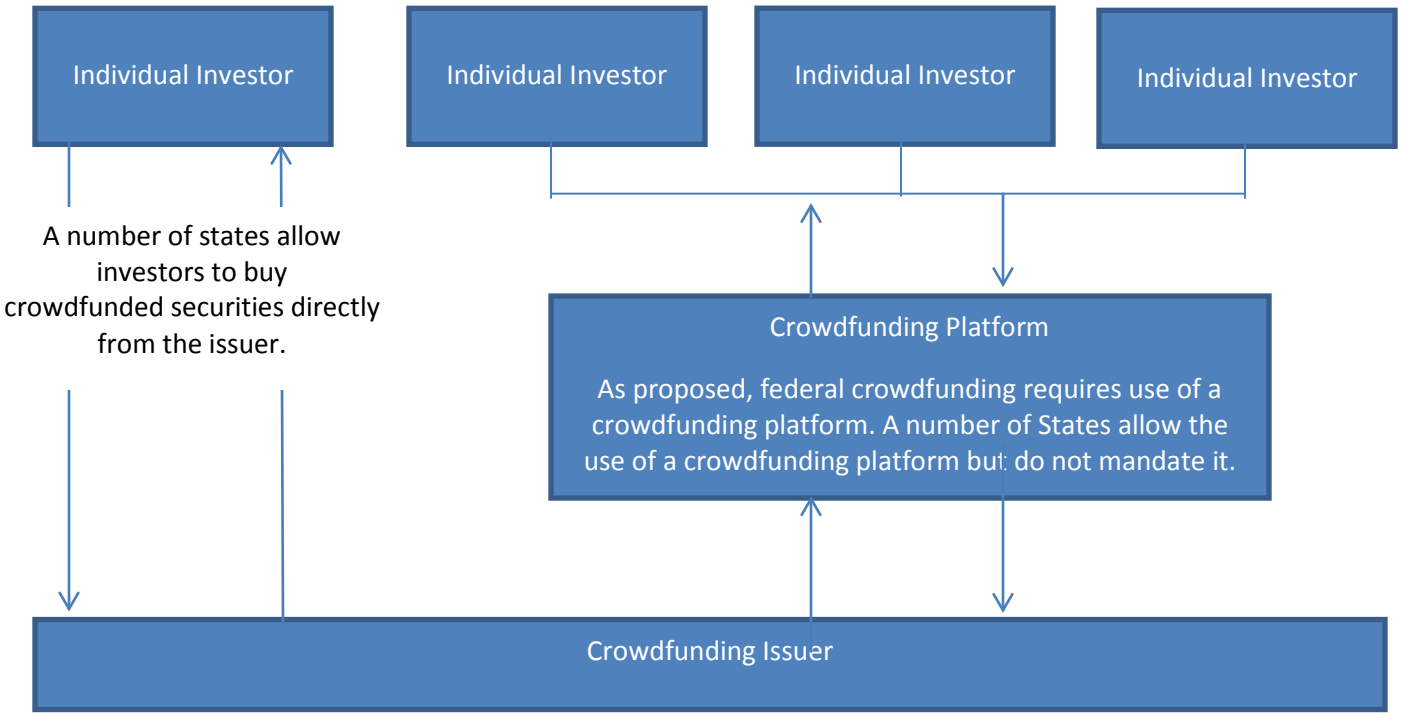
Overview of Peer-to-Peer Lending Model



Crowdfunding Activity Regulated by Securities Laws

Equity Model: A contributor in an equity-based crowdfunding campaign is providing capital with the expectation of receiving an ownership interest in return. Accordingly, a contributor in an equity-based crowdfunding campaign is investing in the business and will share in the financial success or failure of that business. Those investments must comply with state and federal securities laws. The JOBS Act provided an exemption from federal securities registration and largely pre-empted state securities registration requirements. These issues are discussed in the next section.

Equity Crowdfunding Model



SECTION 2

SECURITIES LAWS AND REGULATIONS

Capital markets are regulated by a dual regime of federal and state securities laws.[4] Fundamentally, those who sell securities to the public must register the offer and disclosures material information in order to sell securities.[5] These laws help investors make informed decisions and bolster the integrity of capital markets through anti-fraud enforcement.[6] Securities laws act as a system of accountability intended to protect investors, ensure fair, orderly, and efficient markets, and facilitate capital formation.[7] Vermont currently operates under the Vermont Uniform Securities Act (VUSA) in Title 9 enacted in 2005.[8]

Federal and state laws contain exemptions from certain registration requirements in order to facilitate capital formation.[9] Exemptions are intended to reduce regulatory compliance while keeping investor protections intact.[10] Title III of the JOBS Act mandated that the SEC create a crowdfunding exemption to allow small businesses to sell securities over the internet to "Main

[4] Vt. Stat. Ann. Tit. 9, ch. 150; U.S. Code Ann. Tit. 15, ch. 2A.
[5] 15 U.S.C. § 77e *et seq.*; 9 V.S.A. § 5301 *et seq.*
[6] Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 Harv. L. Rev. 1197, 1211-12 (1999); Elizabeth Glass Geltman, *The Pendulum Swings Back: Why the SEC Should Rethink its Policies on Disclosure of Environmental Liabilities*, 5 Vill. Envtl. L. J. 323, 330 (1994); Joan Macleod Heminway, *What is a Security in the Crowdfunding Era?*, 7 Ohio St. ENTREPRENEURIAL BUS. L.J. (2012); Tamar Frankel, *The Internet, Securities Regulation, and Theory of Law*, 73 CHI.-KENT L. REV. 1319, 1325, n.17 (1998).
[7] *About.* Sec. & Exch. Comm'n, *available at* http://www.sec.gov/about/whatwedo.shtml#intro; 9 V.S.A. § 5608
[8] 9 V.S.A. § 5101 *et seq.*
[9] 15 U.S.C. § 77d; 15 U.S.C. § 77r; 9 V.S.A. § 5201, *et seq*.
[10] *Small Business and the SEC*, SEC.GOV, *available at* http://www.sec.gov/info/smallbus/qasbsec.htm#noreg; 9 V.S.A. §5501 *et seq.*

Street" investors, rather than limiting offers to those with a particular income or net worth – i.e. accredited investors – who are more readily able to participate in the capital markets.[11]

FEDERAL SECURITIES LAWS FOR CROWDFUNDING

Federal securities laws and regulations do not currently prohibit equity crowdfunding. However, the cost of registering a securities offering can outweigh the benefits realized. This is why any crowdfunding rule ultimately issued by the SEC will limit the regulatory responsibilities for certain types of offerings, making them more affordable for small businesses.

There are three criteria that establish what offers would qualify for a federal crowdfunding exemption. First, the offering could not exceed $1 million in a 12-month period.[12] Second, investors would be limited in how much they can invest in offers exempt under crowdfunding during a 12-month period.[13] Third, issuers would have to complete transactions through a "funding portal."[14] Funding portals are defined as an entity acting as an intermediary in a crowdfunding transaction for the account of others.[15] Offers that satisfy these crowdfunding criteria will be exempt from many registration requirements.[16]

CROWDFUNDING AND FEDERAL PREEMPTION

Article 1 § 8 of the U. S. Constitution grants Congress authority to regulate interstate

[11] Crowdfunding *supra* note 3 at 66429 9; 17 C.F.R. § 230.501 (defining Accredited investor as those who make $200,000 per year ($300,000 if married) or has a net worth of $1,000,000 not including primary residence.)
[12] 15 U.S.C. 77d(a)(6)(A).
[13] *Id.* § 77d(a)(6)(B) (defining investor limits as the lesser of $2,000 or 5% of Investor's annual income/net worth if income or net is less than $100,000; $100,000 or 10% of Investor's annual income or net worth of such investor. An investors net worth is measured by the total value of all their assets, except their primary residence, minus the investors total liabilities (debt), except that associated with their primary residence).
[14] *Id.* § 77d(a)(6)(C).
[15] 15 U.S.C. § 78c(a)(80).
[16] 15 U.S.C. § 77d(a); Crowdfunding, *supra* note 3.

Commerce.[17] Where both state and federal governments regulate a particular area of law, the Constitution gives supremacy to federal law.[18] Preemption is the legal concept by which the federal government can lay exclusive regulatory control over a particular subject matter, thus limiting state power to regulate the interstate sale of securities.[19]

In the 1980s, Congress passed the National Securities Market Improvement Act, which designated certain offerings as "covered securities."[20] This designation precludes state regulators from requiring blue-sky registration and merit review of those offerings.[21] Congress used its constitutional preemption power by designating securities sold pursuant to the crowdfunding exemption as covered securities.[22] Therefore, states may not require registration of crowdfunding offerings other than by notice filing.[23] Consequently, states are limited to the information the SEC requires in its registration.

Two exceptions to preemption of state regulatory power exist. First, a state may still require the registration of crowdfunding offerings when that state is the state in which the issuer's principal place of business is located; and/or the state in which the purchasers of 50 percent or more of the dollar amount of the offering reside.[24] Second, as with all covered securities, a state retains all anti-fraud and regulatory enforcement authority over such transactions.[25] These actions often arise from investor complaints of deceit or unlawful conduct in connection with the sale of the investment.

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[17] *See* U.S. CONST., art. I, § 8, cl. 2 (The Commerce Clause).
[18] *See* U.S. Const. art. VI., § 2.
[19] *See* U.S. Const. art. VI., § 2; *See also* 15 U.S.C. §77r(b).
[20] 15 U.S.C. §77r(b).
[21] *Id.*
[22] 15 U.S.C.A. § 77r(b)(4)(C).
[23] *Id.*
[24] 15 U.S.C.A. § 77r(C)(2)(F).
[25] 15 U.S.C.A. § 77r(c).

STATE CROWDFUNDING EXEMPTIONS

States have begun to allow equity crowdfunding by promulgating their own securities registration exemptions.[26] The majority of states that exempt crowdfunding transactions to date have relied on the Intrastate Offering Exemption.[27] Under the Intrastate Offering Exemption, transactions between a business and investors only residing in the same state are completely exempt from federal securities registration.[28] No offer or transaction can cross state lines.[29] For example, an entrepreneur's wealthy aunt in another state may not invest in an offering if the business relies on the Intrastate Offering Exemption.

The State of Maine, therefore, took a unique approach. Maine relied on the SEC Regulation D Rule 504 exemption in order to promulgate their crowdfunding exemption.[30] Rule 504 exempts interstate offerings of less than $1 million from full registration.[31] Issuers must only comply with state rules for registration and solicitation.[32] Therefore, Maine companies may offer up to $1 million in securities across state borders.[33]

What often makes these provisions crowdfunding exemptions are the ability to transact offerings through internet-based platforms, like a funding portal. This ability prompts questions about the

[26] Dane Stangler, *State Equity Crowdfunding Policies Hold Promise*, FORBES, *available at* http://www.forbes.com/sites/kauffman/2014/05/28/state-equity-crowdfunding-policies-hold-promise/ (May 28, 2014).
[27] Andrew Stephenson, *Rethinking Section 3(a)(11) for State Crowdfunding*, JOEWALLIN.COM, *available at* http://joewallin.com/2014/12/12/rethinking-section-3a11-state-crowdfunding/.
[28] 15 U.S.C. § 77c(a)(11).
[29] *Id.*
[30] 32 M.R.S.A. § 16304(6-A).
[31] 17 C.F.R. § 230.504
[32] 17 C.F.R § 230.504
[33] 32 M.R.S.A. § 16304(6-A). California has a proposed exemption that also relies on Rule 504, A.B. 2096 2013-14 Sess. (Ca. 2014).

viability of some state crowdfunding should the SEC preempt state law in terms of when they promulgate their final crowdfunding rule.[34]

Eighteen states and the District of Columbia effected exemptions for crowdfunding offerings.[35] Nine states have exemptions pending in their legislature or administrative rule making process.[36] The chart below captures a snapshot of enacted state exemptions and their key provisions.[37]

[34] It is unlikely that intrastate offerings would be preempted because the Commerce Clause of the U.S. Constitution limits federal authority to regulating interstate commerce. The federal government, however, may exercise commerce clause power over 1. Instrumentalities of interstate commerce; (2) Channels of interstate commerce (such as the internet); and (3) activities that have a substantial effect on interstate commerce. Therefore, all interent-based transactions may fall under the preemptive power of the federal government. *U.S. v. Lopez*, 514 U.S. 549, 558 (1995).
[35] State Crowdfunding Chart, N. Am. Sec. Adm'r Ass'n, NASAA.ORG, *available* at http://www.nasaa.org/wp-content/uploads/2014/01/CHART-State-Crowdfunding-Bills-Current-as-of-12-22-2014.pdf.
[36] *Id.*
[37] *Id.*

State	Federal Exemption	Aggregate Offering Amount	Cap for Individual Investors	Funding Portals	State Filing
Alabama	Intrastate	$1,000,000	$5,000 unless Accredited	Allowed	Form CF 10 days prior to General Solicitation; 15 days prior to first sale
Arkansas	Crowdfunding	$1,000,000	$2,000 or 5% of Investor's annual income/net worth if income or net is less than $100,000; $100,000 or 10% of Investor's annual income or net worth of such investor.	Required	Notice Filing
D.C.	Intrastate	$500,000 w/3 years of financial statements; $1,000,000 w/financial review; $2,000,000 w/audit	$10,000 unless Accredited	Allowed	Notice Filing
Georgia	Intrastate	$1,000,000	$10,000 unless Accredited	Silent	Notice Filing
Idaho	Intrastate	$2,000,000	$2,500 unless Accredited	Silent	Notice Filing
Indiana	Intrastate	$1,000,000; $2,000,000 w/audit	$5,000 unless Accredited	Required; must be an IN company	Notice Filing
Kansas	Intrastate	$1,000,000	$5,000 unless Accredited	Silent	Notice Filing
Maine	Rule 504	$1,000,000	$5,000	Silent	Short Form Registration
Maryland	Intrastate	$100,000 (Debt offering only)	$100	Silent	Notice Filing
Michigan	Intrastate	$1000,000; $2,000,000 w/audit	$10,000 unless Accredited	Allowed	Notice Filing
Tennessee	Intrastate	$1,000,000	$10,000 unless Accredited	Silent	Notice Filing
Texas	Intrastate	$1,000,000	$5,000 unless Accredited	Required; must be TX company	Notice Filing
Washington	Intrastate (1 year lockup)	$1,000,000	$2,000 or 5% of Investor's annual income/net worth if income or net is less than $100,000; $100,000 or 10% of Investor's annual income or net worth of such investor.	Allowed	Notice Filing
Wisconsin	Intrastate	$1,000,000; $2,000,000 w/audit	$10,000 unless Accredited or Certified	Required	Notice Filing

SECTION 3

CROWDFUNDING IN VERMONT

Vermont law does not currently provide a specific crowdfunding exemption. The Vermont Small Business Offering Exemption (VSBOE), however, is a regulation exempting securities sold by Vermont companies to only Vermont investors that could be used in crowdfunding transactions.[38] Since its original adoption in 2000, issuers have offered securities under VSBOE only 14 times. The low offering and investor thresholds contained in the rule simply did not meet the needs of an evolving market. Therefore, in June 2014, the VSBOE regulation received a much-needed update.[39] DFR raised the maximum offering amount to $1 million and $2 million if the issuer can provide audited financial statements.[40] DFR also replaced the investor protection provision of capping the number of investors to 50 with a $10,000 cap on the amount any non-accredited investors can spend.[41] This change still limits the risk of investment for Vermonters while opening up the pool of potential investors.[42]

The changes to VSBOE prompted small businesses to consider using the exemption to raise capital in Vermont (during the past six months, 14 potential issuers made inquiries with DFR), however, the rule only allows for Vermont-based activity.[43] Raising capital across Vermont's borders is equally important to take full advantage of crowdfunding's potential.

[38] Vt. Dep't Fin. Reg. Rule No. S-2014-1, *available at* http://www.dfr.vermont.gov/reg-bul-ord/rule-providing-vermont-small-business-offering-exemption.
[39] *Id.*
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *Id.*

VERMONT COMPANIES USING CROWDFUNDING TECHNIQUES

Vermont's entrepreneurs face challenges raising enough capital to grow their businesses, which can translate into jobs and tax revenue. Donative and reward-based crowdfunding are already playing a part in solving this problem. In fact, Vermont is among the top five states for densest per capita donative/reward crowdfunding projects.[44]

As securities based crowdfunding begins to work its way through the national and states' capital markets, participants in the Vermont small business ecosystem have a unique perspective on raising capital and how crowdfunding could fit into the proverbial tool box of capital formation. The following is the narrative description of several Vermont business founders, each of whom talked to DFR to share their experiences raising capital.

Winter Moose

Winter Moose is a Vermont startup in its nascent phase with the ultimate goal of manufacturing "field to runway" fashion. Ishana Ingerman hopes that one day her daughter and she can make their living creating locally-sourced high fashion and textiles. Ms. Ingerman currently produces art out of the Little Oaks Studio in Burlington, Vermont.

To start Winter Moose, Ms. Ingerman initiated a $62,000 reward-based crowdfunding campaign through Kickstarter. This fund-raising goal was not met. Ms. Ingerman attended a Start-Up Vermont event and changed her fund-raising tactic. She lowered her fund-raising goal to $3,700 and created a new pitch video.

[44] Rodrigo Davies, *Civic Crowdfunding: Partricipatory Communities, Entrepreneurs and the Political Economy of Place*, (Mass. Inst. Tech. Dep't of Comp. Media Stud. Master's Thesis, 2014), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2434615.

Assuming Winter Moose reaches its fund-raising goal, those funds will be used to pay the legal and filing fees associated with incorporation and intellectual property, rewards associated with the Kickstarter campaign, and purchase materials to create samples, test dyes, and conduct research and development. Ms. Ingerman has identified resources and labor in Vermont to complete most of these tasks.[45]

Wintersmiths

Chris and Pat Little began Wintersmiths in the Summer of 2013. After a trip to Tokyo, the brothers set out to design a product that would produce a crystal clear ice ball for whiskey. They invested roughly $15,000 of their own money to establish an initial prototype and explore whether there was a market for their product. That summer, they initiated a Kickstarter pre-purchase campaign with a goal of raising $25,000. The campaign was successful beyond expectations and raised $170,000. The money from this campaign went to developing the mold for the ice-ball, fulfill the 3,000 pre-purchase orders and produce retail inventory.
During the summer of 2014, Wintersmiths initiated a second Kickstarter campaign. Their goal was $40,000. In August, they closed the campaign after raising $241,000. The funds from this second crowdfunding campaign went into developing other whiskey related products, research and development, employing a public relations firm, and developing their packaging.[46]

Bitybean

Douglas Hartwell started Bitybean in 2012 with a mission of helping families get outside and explore the world together. Bitybean manufactures child carriers that easily pack away when not

[45] Interview with Ishana Ingerman, Founder, Winter Moose (Dec. 11, 2014).
[46] Interview with Chris Little, Co-founder, Wintersmiths (Dec. 18, 2014).

in use. Mr. Hartwell invested personal funds, including retirement, for initial startup capital. He also engaged in two rounds of traditional capital raising. First, Bitybean offered convertible debt notes. Currently, Bitybean is raising capital with a seed investment from venture capitalists.

In planning Bitybean's corporate financing, Mr. Hartwell considered Kickstarter, Indiegogo, Ibank, and a loan from a local Vermont bank. Bitybean initiated a Kickstarter campaign with a fund-raising goal of $15,000. Bitybean raised only half of the fund-raising goal, resulting in no capital raised due to Kickstarter's "all or nothing" requirements. Bitybean used Indiegogo's "flexible funds" campaign, which resulted in a capital raise of roughly $2,200. Since September 2014, Bitybean is involved in an equity-based crowdfunding under Circle-Up, which is only available to accredited investors.

Bitybean intends to use any capital raised for general operations and to incrementally expand the company's work force.[47]

Hermit Thrush

The owners of Hermit Thrush started brewing beer in 2002. Their initial startup capital was a $40,000 loan from the city of Brattleboro. To date, they have tried Kickstarter, Indiegogo, and municipal borrowing to fund their business ventures. With regards to the most former, Hermit Thrush set a fundraising goal of $20,000. However, they did not meet their Kickstarter goal and only raised $6,000. The funds would have gone to general company expenses.[48]

[47] Interview with Douglas Hartwell, Founder, Bitybean (Dec. 23, 2014).
[48] Interview with Christophe Gagné, President and Brewmaster, Hermit Thrush Brewery (Aug. 28, 2014).

SECTION 4

OPPORTUNITIES AND LIMITATIONS FOR CROWDFUNDING IN VEMONT

Crowdfunding has filled the gap in helping small businesses and startup entrepreneurs keep up with contemporary capital demands. Equity-based crowdfunding holds real opportunity for Vermont businesses and investors. Vermont's small businesses employ roughly three-fifths of the state's private workforce.[49] Usually, business owners raise capital from people they know or via accredited investors.[50] According to the U. S. Census Bureau, between 3.7 and 4.1 percent of Vermonters satisfy the definition of accredited investor by earning $200,000 a year ($300,000 if married) or possessing a net worth of $1 million not including the primary residence.[51] That represents at most 10,000 out of 250,000 Vermont households. Despite this small number of households, there may be Vermonters with investable wealth who do not satisfy the definition.[52]

Crowdfunding is an opportunity for entrepreneurs to access capital through many smaller investments rather than from a few large investments, while giving regular "Main Street" investors the opportunity to participate more readily in the capital markets. Crowdfunding, in theory, is a symbiotic method of capital formation that will grow both small business capital

[49] Vermont Small Business Profile, U.S. Small Business Administration, sba.gov, *available at* https://www.sba.gov/sites/default/files/files/Vermont13%281%29.pdf
[50] 17 U.S.C. 77c(a)(2); *See also Sec. & Exch. Comm'n v. Ralston Purina Co*, 346 U.S. 119, 124-26 (1953).
[51] U.S. Census Bureau, Survey of Income Program Participation, CENSUSS.GOV, *available at* http://www.census.gov/sipp/; 17 C.F.R. § 230.501.
[52] Interview with Ken Merritt, Managing Director, Merritt & Merritt & Moulton (Dec. 21, 2014).

formation and capital gains for regular Vermonters. Each, in turn, will improve Vermont's economy.[53]

Crowdfunding also has potential limitations. Some of these limitations include issues in capital structure, valuation, governance, and market saturation. Concerns over capital structure arise when a crowdfunded entity enters into later rounds of capital raising. The number of shareholders after a crowdfunding offering could create issues when a business later seeks to raise money through venture capital or traditional public offerings, resulting in a complex capital structure that may be unattractive to certain investors.[54] Industry experts suggest, however, that there may be ways around this.[55] In the United Kingdom, for example, equity crowdfunding laws allow for special purpose vehicles to encapsulate crowdfunding investors, thus negating the complexity of having a large number of shareholders with small stakes in the company.[56] Similarly, legal counsel and venture capital firms are equipped to creatively solve issues arising from complex capital structures.[57]

Another concern is the value of shares sold.[58] Similar to the issues surrounding capital structure, valuation can complicate later offerings. Determining a value for a share of an entrepreneurial business can be difficult. Companies that over value their stock in a crowdfunding transaction may find it difficult to bring in new investment at a later date without diminishing the value of crowdfunding investments.[59]

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[53] Interview with David Bradbury, President, Vermont Center for Emerging Technology (Dec. 11, 2014).
[54] Interview with Cairn Cross, General Partner, Fresh Tracks Capital (Dec. 9, 2014); Bradbury, *supra* note 53.
[55] Interview with Richard Swart, Director of Research University of California, Berkley (Dec. 19, 2014).
[56] *Id.*
[57] Merritt, *supra* note 52; Swart, *supra* note 55.
[58] Merritt *supra* note 52.
[59] *Id.*

Governance issues, such as ownership and control or investor relations create challenges for small businesses. Issuers are reluctant to use crowdfunding for fear that they would lose too much ownership and control over their businesses.[60] Crowdfunding by its very nature offers equity in a company to a large number of people. This is particularly disconcerting for companies with a certain mission or set of social values; the larger the number of shareholders, the harder it may be to maintain that mission. Business founders need to be wary not to sell too much of their business that they may be overruled by the crowd.[61] Issuers must also consider their investor relations. As companies expand the number of shareholders, it is important that they uphold shareholder rights, and foster meaningful investor communication, which can be expensive and time consuming.[62]

Finally, market saturation could limit the opportunities of intrastate crowdfunding for Vermont. Vermont's population is the second lowest in the nation.[63] There is a limit to the number of investors from which Vermont issuers can raise capital. Too many crowdfunding offerings in relation to the number of investors is going to impact the success rate of offerings.

Issuers and regulators must consider these limitations as they take advantage of the opportunities of crowdfunding to facilitate corporate finance and capital formation.

[60] Gagné, *supra* note 48; Ingerman, *supra* note 45; Little, *supra* note 46.
[61] Merritt, *supra* note 52; Swart, *supra* note 55.
[62] Cross, *supra* note54; Swart, *supra* note 55.
[63] U.S. Census Bureau, *State & County QuickFacts*, CENSUS.GOV, *available at* http://quickfacts.census.gov/qfd/states/50000.html

DFR's NEW SMALL BUSINESS INVESTMENT REGULATION

As part of facilitating access to capital for small business and entrepreneurs, DFR crafted a new regulation that incorporates both VSBOE (intrastate) and interstate offering options. The new rule, Exemption for Small Business (ESB), will contain two exemptions. The first exemption amends certain VSBOE provisions. The second exemption establishes an interstate exemption relying on SEC Rule 504. Creating a bifurcated exemption may help solve the potential challenge of market saturation by allowing businesses to access investors outside Vermont. It will capture the best of state trends by giving businesses the option of forming capital interstate or intrastate, an option no other state offers.

The new regulation will allow small businesses to raise up to $1 million in capital. Under the VSBOE intrastate option, businesses that have audited financial statements would retain the ability to raise up to $2 million currently available. Both exemptions would limit the amount certain investors could invest. ESB also establishes a third tranche of investors called "certified investors." This new investor classification would bridge the gap between the limited number of accredited investors and other "Main Street" investors. "Main Street" investors could invest up to $10,000, certified investors could invest up to $25,000, and accredited investors could invest an unlimited amount. Creating a new investor classification may help address issues of market saturation, governance, and capital structure complexity.

In order to allow for online funding portals, the new rule would not prohibit compensation to intermediaries for effectuating internet based transactions under these provisions. This measure will give small businesses the option of effecting crowdfunding offers (i.e. over the internet) or more traditional offers.

These offers, though exempt from full registration, would still require some filing to DFR. In order to protect investors, small businesses relying on this new exemption would still file their offering document with the commissioner. In order to reduce the regulatory burden of this process, the offer will automatically become effective if DFR does not comment on the filing within a specified time. This provision is a preliminary safeguard for investors while facilitating capital formation through a clear and simple filing process.

DFR will promulgate this rule through the Vermont Administrative Procedure Act rulemaking process during 2015. A proposed draft follows.

LEGISLATIVE REPORT: ACT 199 – JANUARY 15, 2015

PROPOSED REGULATION

EXEMPTION FOR SMALL BUSINESS (ESB)

SUSAN L. DONEGAN, COMMISSIONER
VERMONT DEPARTMENT OF FINANCIAL REGULATION

JANUARY 15, 2015

PROPOSED REGULATION

Exemption for Small Business (ESB)

Issuers seeking to utilize this exemption must comply with either subsection (a) or (b) as well as the general provisions found in subsection (c):

(a) *Vermont Small Business Offering Exemption (VSBOE)*

(1) *Intrastate Eligibility*. The offer or sale of a security by an issuer shall be exempt from the requirements of 9 V.S.A. §§ 5301-05 and 9 V.S.A § 5504, if the offer or sale is conducted in accordance with each of the following requirements:

(A) The issuer of the security shall be an entity formed under the laws of the State of Vermont and registered with the Secretary of State;

(B) Sales shall only be made to residents of Vermont; and

(C) The offering shall meet all other requirements of the federal exemption for intrastate offerings pursuant 15 U.S.C. § 77c(a)(11).

(2) *Aggregate Offering Limit.* The maximum aggregate amount in cash and other consideration from all sales of the security sold under this exemption within any twelve (12) month period must not exceed:

(A) One million dollars ($1,000,000), if the issuer has not undergone and made available to each prospective investor and the Commissioner the documentation resulting from a financial audit with respect to its most recently completed fiscal year and meeting generally accepted accounting principles.

(B) Two million dollars ($2,000,000), if the issuer has undergone and made available to each prospective investor and the Commissioner the documentation resulting from a financial audit with respect to its most recently completed fiscal year and meeting generally accepted accounting principles.

(b) *Interstate Exemption*

(1) *Interstate Eligibility*. The offer or sale of a security by an issuer shall be exempt from the requirements of 9 V.S.A. §§ 5301-05 and 9 V.S.A § 5504, if the offer or sale is conducted in accordance with each of the following requirements:

(A) The issuer of the security shall be an entity formed under the laws of any State of the United States and be registered with the Secretary of State as an entity formed under the laws of Vermont or authorized to transact business within Vermont; and

(B) The offering shall meet all other requirements of the federal exemption for

limited offerings and sales of securities not exceeding $1,000,000 in 17 C.F.R. § 230.504.

(2) *Aggregate Offering Limit.* The maximum aggregate amount in cash and other consideration from all sales of the security sold under this exemption within any twelve (12) month period must not exceed one million dollars ($1,000,000).

(c) *General Requirements*

(1) *Individual Investment Limit.* Consideration received from any purchaser shall conform to the following limitations:

(A) Accredited Investors have no investment limit;

(B) Vermont Certified Investors shall be limited to twenty-five thousand dollars ($25,000) per offering; and

(C) All other purchasers shall be limited to ten thousand dollars ($10,000) per offering.

(2) *Minimum Offering Raise*. The issuer sets aside in a separate bank account all funds raised as part of the offering to be held until such time as the minimum offering amount is reached. If the minimum offering amount is not met within one year of the effective date of the offering, the issuer must return all funds to investors. The minimum offering amount shall be no less than 30% of the maximum offering amount set by the issuer and disclosed in the registration statement.

(3) *Escrow and Impoundment*. As a condition of registration, the issuer must set aside in a separate account held by a depository institution all funds raised as part of the offering. The escrow and impoundment of funds are subject to the following conditions:

(A) All funds from purchasers shall be made payable to the depository impound account and shall be delivered to the depository institution within three (3) business days after receipt by the issuer, the selling agent or their respective agents. The depository shall receive at the time of deposit a copy of the subscription agreement setting forth the names, addresses, and respective amounts paid by each investor whose funds comprise each deposit.

(B) All funds set aside shall be held by the depository until the earliest of the following:

i. The total amount deposited reaches at least the minimum offering amount;

ii. The Administrator has, by order, suspended or revoked the registration; or

iii. Twelve months have expired from the effective date of the offering

without the minimum offering amount having been received by the depository.

(C) If the minimum offering amount is not received by the depository within the twelve month impoundment period, the depository institution, upon notice from the issuer, shall refund to the investors the full amount of their respective investment amounts, as shown by records furnished to the depository. Such refunds shall be made not more than 30 days following receipt of notification from the issuer.

(D) Until such time as the minimum offering amount is met and funds are released to the issuer, the issuer may not issue any securities to purchasers pursuant to the offering.

(E) A copy of the fully executed agreement shall be filed with the Commissioner by the issuer before commencement of the offering, as a condition to effectiveness of the registration statement.

(4) *Filing Requirements*.

(A) *Offering Materials*. Prior to an offering's commencement, the issuer must file the following with the Commissioner:

i. A certificate of good standing issued by the issuer's domiciliary state; and if the issuer is not domiciled in Vermont, a certificate of authority issued by the Vermont Secretary of State, both of which shall have been issued within thirty (30) days of their filing with the Commissioner;

ii. A copy of the offering document;

iii. Name, address, telephone number and social security number for any of the issuer's officers, directors, partners, members, ten percent shareholders and promoters presently connected with the issuer in any capacity;

iv. The primary contact person for communication with the Department and that person's phone number and e-mail address;

v. The name of the bank or other depository institution in which investor funds will be deposited; and

vi. The filing fee prescribed in 9 V.S.A. § 5305(k).

An offering will become effective fifteen (15) business days after the issuer files all required documents with the Commissioner unless the Commissioner provides comments on the offering materials, in which case, the offering will become effective when the Commissioner has no further comments.

(B) *Advertising Materials*. Prior to the commencement of any advertising, the issuer shall file with the Commissioner any advertising materials intended for publication or mass distribution. The issuer may commence their advertising if the offering is effective and it has not received comments to the advertising materials within five (5) business days of filing with the Commissioner.

(5) *Offering Period*. The offering period must not exceed twelve months. An issuer may extend the offering in twelve (12) month increments by refilling its updated offering materials, including payment of a renewal fee as specified in 9 V.S.A. § 5305(k).

(6) *Offering Document*. An issuer must deliver an offering document to each offeree at least twenty-four (24) hours prior to any sale of securities under this exemption. The offering document does not have a prescribed format; however, an issuer must fully disclose all material information and not make any factual misstatements. Further, an issuer must attempt to balance any discussion of the potential rewards of the offering with a discussion of possible risks. The offering document must meet the following requirements:

(A) The offering document must contain a legend, which substantially conforms to the following:

(i) INVESTMENT IN THESE SECURITIES INVOLVES SIGNIFICANT RISKS AND IS SUITABLE ONLY FOR PERSONS WHO HAVE NO NEED FOR IMMEDIATE LIQUIDITY IN THEIR INVESTMENT AND WHO CAN BEAR THE ECONOMIC RISK OF A LOSS OF THEIR ENTIRE INVESTMENT. INVESTORS SHOULD BE AWARE THAT THEY MAY BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME.

(ii) IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE TERMS OF THE OFFERING INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

(iii) THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE SECURITIES ACT OF 1933 AND THE VERMONT UNIFORM SECURITIES ACT PURSUANT TO REGISTRATION OR

EXEMPTION THEREFROM.

(B) A duly authorized representative of the issuer must sign the offering document and thereby certify that the issuer made reasonable efforts to verify the material accuracy and completeness of the information contained therein.

(7) *Limitation on Use*. [VSBOE] is unavailable for:

(A) An issuer disqualified as a Bad Actor;

(B) Offerings in which it is proposed to issue stock or other equity interest in a development stage company without a specific business plan or purpose, or in which the issuer has indicated that its business is to engage in a merger or acquisition with an unidentified company or companies, or other unidentified entities or persons, or without an allocation of proceeds to sufficiently identifiable properties or objectives (i.e., "blind pool" or "blank check" offerings);

(C) Offerings involving petroleum exploration or production, mining, or other extractive industries; and

(D) Offerings involving an investment company as defined and classified under Section 4 of the Investment Company Act of 1940.

(8) *Anti-Fraud Provisions*. Nothing in this regulation relieves issuers, Broker-Dealers and their Agents, or Investment Advisors and their Representatives from the Anti-Fraud and enforcement provisions of 9 V.S.A. §§ 5501-10, federal securities laws, or the securities laws of other states.

(9) *Investor Knowledge*. An issuer and any agents must reasonably believe that the purchaser, either alone or through a representative, has sufficient knowledge or is capable of evaluating the merits and the risks of the investment.

(10) *Reporting to the Department*. Within thirty calendar days after the expiration of the offering, an issuer must file a sales report with the Commissioner, indicating the aggregate dollar amount of securities sold and the number of investors. The Commissioner may require any issuer to file periodic reports to keep reasonably current the information contained in the notice and to disclose the progress of the offering.

(d) *Use of the Internet or Third Party Portal*. An issuer's use of the internet or a third party portal to conduct, or help facilitate their offering is voluntary; however, when using the internet an issuer must be mindful of the advertising rules set forth in [Securities Bulletin [*]]. Further, when engaging a third party portal, an issuer must ensure the third party portal is properly registered with the state.

(1) *Third Party Portal Registration*. A third party portal shall register with the Commissioner by filing:

(A) A certificate of good standing issued by the Vermont Secretary of State within thirty (30) days of the filing indicating the third party portal is an entity formed under the laws of any State of the United States and authorized to transact business within Vermont;

(B) Name, address, telephone number and social security number for any of the third party portal's officers, directors, partners, members, ten percent shareholders and promoters presently connected with the issuer in any capacity.

(C) The primary contact person for communication with the Department and that person's phone number and e-mail address;

(D) Except as provided below in subsection (d)(2) & (3), evidence that the third party portal is registered as a broker-dealer under 9 V.S.A. § 5406; and

(E) If the third party portal is exempt under subsection (d)(2) & (3), the filing fee prescribed in 9 V.S.A. § 5410(a).

(2) *Non-Broker-Dealer Third Party Portals*. A third party portal is not required to register as a broker-dealer under 9 V.S.A. § 5406 if all of the following apply with respect to the third party portal:

(A) It does not offer investment advice or recommendations;

(B) It does not solicit purchases, sales, or offers to buy the securities offered or displayed on the Internet site;

(C) It does not compensate employees, agents, or other persons for the solicitation or based on the sale of securities displayed or referenced on the Internet site;

(D) It is not compensated based on the amount of securities sold, and it does not hold, manage, possess, or otherwise handle investor funds or securities;

(E) The fee it charges an issuer for an offering of securities on the Internet site is a fixed amount for each offering, a variable amount based on the length of time that the securities are offered on the Internet site, or a combination of such fixed and variable amounts;

(F) Neither the third party portal, nor any director, executive officer, general partner, managing member, or other person with management authority over the third party portal, is disqualified under V.S.R. § 5-15.

(3) *Federally Registered Broker-Dealers or Funding Portal*. A third party portal is not required to register as a broker-dealer under 9 V.S.A. § 5406 if the third party portal is:

(A) Registered as a broker-dealer under the 15 U.S.C. § 78o; or

(B) A funding portal registered under 15 U.S.C. § 77d-1 and the Securities and Exchange Commission has adopted rules under authority of U.S.C. § 78c(h) governing funding portals.

(4) *Records*. The third party portal shall maintain records of all offers and sales of securities effected through the Internet site and shall provide ready access to the records to the Commissioner, upon request. The Commissioner may access, inspect, and review any Internet site registered under this subsection as well as its records.

(Authorized by 9 V.S.A. §§ 5605(a); implementing 9 V.S.A. § 5202(13)(C))

[See Addendum for Definitions]

Addendum to Proposed Rule

[VSBOE] Definitions

"*Bad Actor*" shall mean any issuer; any predecessor of the issuer; any affiliated issuer; any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer; any beneficial owner of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; any promoter connected with the issuer in any capacity at the time of such sale (including any director, executive officer, other officer participating in the offering, general partner or managing member of the promoter); any investment manager of an issuer that is a pooled investment fund; any general partner or managing member of any such investment manager or solicitor; or any director, executive officer or other officer participating in the offering of any such investment manager or solicitor or general partner or managing member of such investment manager or solicitor who:

(1) Has been convicted, within ten years before such sale (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor:

(A) In connection with the purchase or sale of any security;

(B) Involving the making of any false filing with the Department or the SEC; or

(C) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(2) Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before such sale, that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:

(A) In connection with the purchase or sale of any security;

(B) Involving the making of any false filing with the Department or the SEC; or

(C) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(3) Is subject to a final order of a state securities administrator (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

(A) At the time of such sale, bars the person from:

(i) Association with an entity regulated by such commission, authority, agency, or officer;

(ii) Engaging in the business of securities, insurance or banking; or

(iii) Engaging in savings association or credit union activities; or

(B) Constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct entered within ten years before such sale;

(4) Is subject to an order of the SEC entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b) or 78o-4(c)) or section 203(e) or (f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(e) or (f)) that, at the time of such sale:

(A) Suspends or revokes such person's registration as a broker, dealer, municipal securities dealer or investment adviser;

(B) Places limitations on the activities, functions or operations of such person; or

(C) Bars such person from being associated with any entity or from participating in the offering of any penny stock;

(5) Is subject to any order of the SEC entered within five years before such sale that, at the time of such sale, orders the person to cease and desist from committing or causing a violation or future violation of:

(A) Any scienter-based anti-fraud provision of the federal securities laws, including without limitation section 17(a)(1) of the Securities Act of 1933 (15 U.S.C. 77q(a)(1)), section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and 17 CFR 240.10b-5, section 15(c)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)(1)) and section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6(1)), or any other rule or regulation thereunder; or

(B) Section 5 of the Securities Act of 1933 (15 U.S.C. 77e).

(6) Is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade;

(7) Has filed (as a registrant or issuer), or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the SEC that, within five years before such sale, was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such sale, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued; or

(8) Is subject to a United States Postal Service false representation order entered within five years before such sale, or is, at the time of such sale, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

(i) Paragraph (h) shall not apply:

(1) Upon a showing of good cause and without prejudice to any other action by the Commissioner, if the Commissioner determines that it is not necessary under the circumstances that an exemption be denied;

(2) If, before the relevant sale, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing (whether contained in the relevant judgment, order or decree or separately to the Commissioner) that disqualification under paragraph (h) should not arise as a consequence of such order, judgment or decree; or

(3) If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed under paragraph (h).

Instruction to paragraph (i)(3): An issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

"*Third Party Portal*" shall mean a Vermont-only dealer, able to utilize the exclusion from federal registration available to dealers whose business is exclusively intrastate. The portal's activities would be limited to operating an Internet website for [VSBOE] offerings.

"*Vermont Certified Investor*" shall mean any person who comes within any of the following categories, or who the issuer reasonably believes comes within any of the following categories, at the time of the sale of the securities to that person:

(1) Any plan established and maintained by a state, its political subdivisions, or any agency or instrumentality of a state or its political subdivisions, for the benefit of its employees, if such plan has total assets in between $2,500,000 and $5,000,000; any employee benefit plan within the meaning of the Employee Retirement Income Security Act of 1974 if the investment decision is made by a plan fiduciary, as defined in section 3(21) of such act, which is either a bank, savings and loan association, insurance company, or registered investment adviser, or if the employee benefit plan has total assets in between 2,500,000 and $5,000,000 or, if a self-directed plan, with investment decisions made solely by persons that are certified investors;

(2) Any organization described in section 501(c)(3) of the Internal Revenue Code, corporation, Massachusetts or similar business trust, or partnership, not formed for the specific purpose of acquiring the securities offered, with total assets in between $2,500,000 and 5,000,000;

(3) Any natural person whose individual liquid net worth, or joint net worth with that person's spouse, exceeds $500,000.

(A) Except as provided in paragraph (3)(B) of this section, for purposes of calculating net worth under this paragraph (3)(A):

(i) The person's primary residence shall not be included as an asset;

(ii) Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability (except that if the amount of such indebtedness outstanding at the time of sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and

(iii) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities shall be included as a liability;

(B) Paragraph (3)(A) of this section will not apply to any calculation of a person's net worth made in connection with a purchase of securities in accordance with a right to purchase such securities, provided that:

(i) Such right was held by the person on July 20, 2010;

(ii) The person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and

(iii) The person held securities of the same issuer, other than such right, on July 20, 2010.

(4) Any natural person who had an individual income in excess of $100,000 in each of the two most recent years or joint income with that person's spouse in excess of $150,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

(5) Any trust, with total assets in between $2,500,000 and $5,000,000, not formed for the specific purpose of acquiring the securities offered, whose purchase is directed by a sophisticated person as described in 17 C.F.R. § 230.506(b)(2)(ii); and

(6) Any entity in which all of the equity owners are Vermont Certified Investors.

LEGISLATIVE REPORT: ACT 199 – JANUARY 15, 2015

VERMONT SMALL BUSINESS OFFERING EXEMPTION (VSBOE)

RULE NO. S-2014-1 EFFECTIVE JUNE 16, 2014

AND

SECURITIES DIVISION BULLETIN NO. 14-01-S

SUSAN L. DONEGAN, COMMISSIONER
VERMONT DEPARTMENT OF FINANCIAL REGULATION

JANUARY 15, 2015

Vermont Department of Financial Regulation

Rule No. S-2014-1

Rule providing for the Vermont Small Business Offering Exemption

Effective: June 16, 2014

Vermont Small Business Offering Exemption ("VSBOE")

(a) VSBOE is available under Sections 5202(13)(C) and 5203 of the Vermont Uniform Securities Act (the "Act"). Pursuant to VSBOE, the offer or sale of a security by an issuer shall be exempt from the requirements of 9 V.S.A. §§ 5301 - 5305 and 9 V.S.A §5504, and each individual who represents an issuer in an offer or sale shall be exempt from the requirements of 9 V.S.A. § 5402(a) if the offer or sale is conducted in accordance with each of the following requirements:

(1) The issuer of the security shall be a business entity formed under the laws of the State of Vermont and registered with the Secretary of State;

(2) The transaction shall meet the requirements of the federal exemption for intrastate offerings in section 3(a)(11) of the Securities Act of 1933, 15 U.S.C. § 77c(a)(11), and SEC Rule 147, 17 C.F.R. 230.147; and

(3) The issuer shall not accept more than ten thousand dollars ($10,000) from any single purchaser unless the purchaser is an accredited investor as defined by rule 501 of SEC regulation D, 17 C.F.R. 230.501.

(b) VSBOE is unavailable for the following types of offerings:

(1) Offerings in which it is proposed to issue stock or other equity interest in a development stage company without a specific business plan or purpose, or in which the issuer has indicated that its business is to engage in a merger or acquisition with an unidentified company or companies, or other unidentified entities or persons, or without an allocation of proceeds to sufficiently identifiable properties or objectives (i.e., "blind pool" or "blank check" offerings);

(2) Offerings involving petroleum exploration or production, mining, or other extractive industries; and

(3) Offerings involving an investment company as defined and classified under Section 4 of the Investment Company Act of 1940.

(c) No commission, fee or other remuneration shall be paid or given, directly or indirectly, to any person for soliciting any prospective purchaser in reliance upon VSBOE.

(d) The sum of all cash and other consideration to be received for all sales of the security in reliance upon this exemption does not exceed the cap provided in this subdivision.

(1) One million dollars ($1,000,000), if the issuer has not undergone and made available to each prospective investor and the Commissioner the documentation resulting from a financial audit with respect to its most recently completed fiscal year and meeting generally accepted accounting principles.

(2) Two million dollars ($2,000,000), if the issuer has undergone and made available to each prospective investor and the Commissioner the documentation resulting from a financial audit with respect to its most recently completed fiscal year and meeting generally accepted accounting principles.

(e) All funds received from investors shall be deposited into a federally insured depository institution located within Vermont, and all the funds shall be used in accordance with representations made to investors.

(f) VSBOE is not available if the issuer or its affiliates have previously sold securities of such issuer or affiliate under the provisions of Sections 5303 or 5304 of the Act (registration by coordination or qualification) or under the provisions of the securities laws of any other state which pertain to registration by qualification or coordination.

(g) The duration of the offering period shall not exceed twelve months, although the issuer may extend the offering in one year increments by amending its initial filing (including payment of a renewal fee) in conformance with requirements of the Act.

(h) No exemption under VSBOE shall be available for a sale of securities if the issuer; any predecessor of the issuer; any affiliated issuer; any director, executive officer, other officer participating in the offering, general partner or managing member of the issuer; any beneficial owner of 20% or more of the issuer's outstanding voting equity securities, calculated on the basis of voting power; any promoter connected with the issuer in any capacity at the time of such sale (including any director, executive officer, other officer participating in the offering, general partner or managing member of the promoter); any investment manager of an issuer that is a pooled investment fund; any general partner or managing member of any such investment manager or solicitor; or any director, executive officer or other officer participating in the offering of any such investment manager or solicitor or general partner or managing member of such investment manager or solicitor:

(1) Has been convicted, within ten years before such sale (or five years, in the case of issuers, their predecessors and affiliated issuers), of any felony or misdemeanor:

(A) In connection with the purchase or sale of any security;

(B) Involving the making of any false filing with the Department or the SEC; or

(C) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(2) Is subject to any order, judgment or decree of any court of competent jurisdiction, entered within five years before such sale, that, at the time of such sale, restrains or enjoins such person from engaging or continuing to engage in any conduct or practice:

(A) In connection with the purchase or sale of any security;

(B) Involving the making of any false filing with the Department or the SEC; or

(C) Arising out of the conduct of the business of an underwriter, broker, dealer, municipal securities dealer, investment adviser or paid solicitor of purchasers of securities;

(3) Is subject to a final order of a state securities administrator (or an agency or officer of a state performing like functions); a state authority that supervises or examines banks, savings associations, or credit unions; a state insurance commission (or an agency or officer of a state performing like functions); an appropriate federal banking agency; the U.S. Commodity Futures Trading Commission; or the National Credit Union Administration that:

(A) At the time of such sale, bars the person from:

(i) Association with an entity regulated by such commission, authority, agency, or officer;

(ii) Engaging in the business of securities, insurance or banking; or

(iii) Engaging in savings association or credit union activities; or

(B) Constitutes a final order based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct entered within ten years before such sale;

(4) Is subject to an order of the SEC entered pursuant to section 15(b) or 15B(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b) or 78o-4(c)) or section 203(e) or (f) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-3(e) or (f)) that, at the time of such sale:

(A) Suspends or revokes such person's registration as a broker, dealer, municipal securities dealer or investment adviser;

(B) Places limitations on the activities, functions or operations of such person; or

(C) Bars such person from being associated with any entity or from participating in the offering of any penny stock;

(5) Is subject to any order of the SEC entered within five years before such sale that, at the time of such sale, orders the person to cease and desist from committing or causing a violation or future violation of:

(A) Any scienter-based anti-fraud provision of the federal securities laws, including without limitation section 17(a)(1) of the Securities Act of 1933 (15 U.S.C. 77q(a)(1)), section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78j(b)) and 17 CFR

240.10b-5, section 15(c)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(c)(1)) and section 206(1) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-6(1)), or any other rule or regulation thereunder; or

(B) Section 5 of the Securities Act of 1933 (15 U.S.C. 77e).

(6) Is suspended or expelled from membership in, or suspended or barred from association with a member of, a registered national securities exchange or a registered national or affiliated securities association for any act or omission to act constituting conduct inconsistent with just and equitable principles of trade;

(7) Has filed (as a registrant or issuer), or was named as an underwriter in, any registration statement or Regulation A offering statement filed with the SEC that, within five years before such sale, was the subject of a refusal order, stop order, or order suspending the Regulation A exemption, or is, at the time of such sale, the subject of an investigation or proceeding to determine whether a stop order or suspension order should be issued; or

(8) Is subject to a United States Postal Service false representation order entered within five years before such sale, or is, at the time of such sale, subject to a temporary restraining order or preliminary injunction with respect to conduct alleged by the United States Postal Service to constitute a scheme or device for obtaining money or property through the mail by means of false representations.

(i) Paragraph (h) shall not apply:

(1) Upon a showing of good cause and without prejudice to any other action by the Commissioner, if the Commissioner determines that it is not necessary under the circumstances that an exemption be denied;

(2) If, before the relevant sale, the court or regulatory authority that entered the relevant order, judgment or decree advises in writing (whether contained in the relevant judgment, order or decree or separately to the Commissioner) that disqualification under paragraph (h) should not arise as a consequence of such order, judgment or decree; or

(3) If the issuer establishes that it did not know and, in the exercise of reasonable care, could not have known that a disqualification existed under paragraph (h).

Instruction to paragraph (i)(3): An issuer will not be able to establish that it has exercised reasonable care unless it has made, in light of the circumstances, factual inquiry into whether any disqualifications exist. The nature and scope of the factual inquiry will vary based on the facts and circumstances concerning, among other things, the issuer and the other offering participants.

(j) For purposes of paragraph (h), events relating to any affiliated issuer that occurred before the affiliation arose will be not considered disqualifying if the affiliated entity is not:

(A) In control of the issuer; or

(B) Under common control with the issuer by a third party that was in control of the affiliated entity at the time of such events.

(k) The issuer shall reasonably believe that the purchaser either alone or by or through a representative has such knowledge as to be capable of evaluating the merits and the risks of the investment.

(l) An offering document shall be delivered to each offeree twenty four hours prior to any sale of securities in reliance upon VSBOE which meets the following requirements:

(1) The offering document must contain a legend which substantially conforms to the following:

(A) INVESTMENT IN THESE SECURITIES INVOLVES SIGNIFICANT RISKS AND IS SUITABLE ONLY FOR PERSONS WHO HAVE NO NEED FOR IMMEDIATE LIQUIDITY IN THEIR INVESTMENT AND WHO CAN BEAR THE ECONOMIC RISK OF A LOSS OF THEIR ENTIRE INVESTMENT. INVESTORS SHOULD BE AWARE THAT THEY MAY BE REQUIRED TO BEAR THE FINANCIAL RISKS OF THIS INVESTMENT FOR AN INDEFINITE PERIOD OF TIME.

(B) IN MAKING AN INVESTMENT DECISION INVESTORS MUST RELY ON THEIR OWN EXAMINATION OF THE ISSUER AND THE TERMS OF THE OFFERING INCLUDING THE MERITS AND RISKS INVOLVED. THESE SECURITIES HAVE NOT BEEN RECOMMENDED BY ANY FEDERAL OR STATE SECURITIES COMMISSION OR REGULATORY AUTHORITY. FURTHERMORE, THE FOREGOING AUTHORITIES HAVE NOT CONFIRMED THE ACCURACY OR DETERMINED THE ADEQUACY OF THIS DOCUMENT. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

(C) THESE SECURITIES ARE SUBJECT TO RESTRICTIONS ON TRANSFERABILITY AND RESALE AND MAY NOT BE TRANSFERRED OR RESOLD EXCEPT AS PERMITTED UNDER THE SECURITIES ACT OF 1933 AND THE VERMONT UNIFORM SECURITIES ACT PURSUANT TO REGISTRATION OR EXEMPTION THEREFROM, and

(2) The offering document must be signed by a duly authorized representative of the issuer who by such action shall certify that the issuer has made reasonable efforts to verify the material accuracy and completeness of the information therein contained.

(m) Nothing in this regulation alters the obligation of issuers under Section 5501(2) of the Act, which renders it unlawful to "make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading." In addition, issuers must otherwise comply with the antifraud provisions of the Act, as well as any applicable federal and state securities laws. With the exception of the legend requirement, no format for disclosure is prescribed. However, issuers should attempt to balance any discussion of the potential rewards of the offering with a discussion of possible risks. Issuers should take care to ensure that oral statements to prospective purchasers about the offering are consistent with the disclosures contained in the offering

document. The Department of Financial Regulation retains the right to comment upon and require revisions to the offering document.

(n) The issuer or applicant shall file with the Commissioner no later than ten calendar days prior to the commencement of any offering made in reliance on VSBOE:

(1) A notice which includes the name, address, telephone number and social security number for any of the issuer's officers, directors, partners, members, ten percent shareholders, promoters presently connected with the issuer in any capacity, a brief and general description of its business and products, and its intended use of the proceeds of the proposed offering;

(2) A consent to service of process which is duly executed and acknowledged by the issuer and accompanied by a properly executed corporate resolution, if applicable; and

(3) Included with the initial notice shall be the filing fee prescribed at Section 5305(k) of the Act payable to the Vermont Department of Financial Regulation.

(o) The issuer or applicant shall file with the Commissioner no later than five business days prior to initial use in Vermont, a copy of all advertising intended for publication or mass distribution including the script of any radio or television broadcast to be made. Such advertising should, to the extent practicable, conform to a standard "tombstone" format and limit the information provided to the name of the issuer of the security, the name and address of the person(s) from whom an offering document may be obtained, the full title and a description of the security and the amount being offered, a brief indication of the general type of business of the issuer, the price of the security and, in the case of a debt security, the yield or interest rate. No advertisement may be published or distributed if the issuer has been notified by the Commissioner not to use such material.

(p) The issuer or applicant shall file with the Commissioner no later than thirty calendar days after the expiration of the offering a sales report on a form prescribed by the Commissioner. The Commissioner may require any issuer to file periodic reports to keep reasonably current the information contained in the notice and to disclose the progress of the offering.

(q) A broker-dealer that does not have a place of business in Vermont shall be exempt from the registration requirements of Sections 5401 of the Act to the extent such broker-dealer limits its activities in Vermont to such transactions.

Vermont Department of
Financial Regulation

Securities Division Bulletin 14-01-S

Guidance on Preparing Offering Documents under
the Vermont Small Business Offering Exemption ("VSBOE")

This Bulletin is designed for small businesses that may be considering raising capital through a VSBOE offering. It is intended to provide clarification primarily as to the contents of an offering document, certain financial disclosures and other disclosure requirements and aims to summarize other key considerations. It is not intended to be comprehensive or cover every topic relevant to a securities offering.

VSBOE was designed as a user friendly way for Vermont businesses to raise money directly from fellow Vermonters. In that spirit, the Securities Division of the Department of Financial Regulation (the "Securities Division") has issued this Bulletin in an effort to help guide small business owners in preparing their VSBOE offering documents.

The purpose of the VSBOE offering document is to provide potential investors with material information concerning one's business and the offering so that they have information necessary to evaluate the offering in deciding whether to invest. In conducting VSBOE offerings, it is important to remember that it is unlawful to "make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they are made, not misleading." (See VSBOE § (m)). Practically speaking, this means that misrepresenting, concealing or failing to disclose information that a reasonable investor would consider material in making the decision to invest may constitute securities fraud. Because of this, full and accurate disclosure is critical.

We encourage those contemplating a VSBOE offering to consult legal counsel and/or contact the Division early in their planning process to discuss questions and concerns.

I. Disclosure of Financial Statements

VSBOE requires that companies raising between one million and two million dollars disclose audited financial statements to each prospective investor; however, the Division wishes to provide guidance as to the proper financial disclosure for those companies seeking to raise one million dollars or less.

As outlined below, the appropriate level of financial disclosure depends on the operational history of the company and the nature of the fund raise.

(1) Companies with less than a year of operating history: Companies with very limited or no operational history obviously will be unable to provide historical financial statements. However, the Division still would expect these companies to provide a balance sheet

listing their assets and liabilities in their offering document. The balance sheet need not be audited and may be prepared internally.

(2) Companies with more than a year of operating history: Companies with more than a year of operating history should provide balance sheets and income statements for the three most recent fiscal years in which they operated. These balance sheets and income statements need not be audited and may be prepared internally; however, the Securities Division expects a company with audited or unaudited financial statements prepared by a third party to include them with the company's offering document.

(3) Companies issuing preferred stock or debt instruments: Companies wishing to offer preferred stock or issue debt instruments under VSBOE shall include, in addition to balance sheets and income statements, statements of cash flow for the three previous fiscal years.

Companies who do not have a full year of operational history or are unable to show either (i) that "Net Cash Provided by Operating Activities" was positive for the last fiscal year or (ii) that "Adjusted Net Earnings" for the last fiscal year are sufficient to pay the company's dividend or interest obligations, should not make a preferred stock or debt offering.

Further, in connection with preferred stock offerings, a company must disclose:

- Whether dividends on the preferred stock are cumulative;
- The risks of failure to declare or pay dividends on the preferred stock; and
- The equity characteristics of any convertible preferred stock being offered.

II. Financial Condition Discussion

In addition to financial statements, companies making an offering under VSBOE should provide a narrative discussion of their financial condition. This discussion should address, to the extent material, the company's historical results of operations in addition to its liquidity and capital resources. If a company does not have a prior operating history, the discussion should focus on financial milestones and operational, liquidity and other challenges. If a company has a prior operating history, the discussion should focus on whether historical earnings and cash flows are representative of what investors should expect in the future. A company's discussion of its financial condition should take into account the proceeds of the offering and any other known or pending sources of capital. Companies also should discuss how the proceeds from the offering will affect their liquidity and whether these funds and any other additional funds are necessary to the viability of the business. In addition, companies should describe the other available sources of capital to the business, such as lines of credit or required contributions by principal shareholders.

III. Other Disclosure Items

Companies making a VSBOE offering should also disclose the following information in their offering documents:

- a description of the business of the company and the anticipated business plan of the company;
- a description of the stated purpose and intended use of the proceeds of the offering sought by the company with respect to the target offering amount;
- a description of the ownership and capital structure of the company including the company's existing debt;
- a description of the specific and general potential risks facing the company;
- a description of the potential risks of investing in the offering;
- the name, legal status and physical address of the company;
- the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the company;
- prominent disclosure that the offering is only available for Vermont residents;
- prominent disclosure that the maximum investment per person is $10,000; unless the person is an accredited investor;
- whether the offering has a minimum raise amount, the deadline for reaching that goal and what will happen if the goal is not reached; and
- the price to the of the securities and the method for determining the price.

IV. Plain English Disclosure

The Division does not prescribe a set format for the offering document; however, companies should strive to write such documents in plain English.

Plain English writing does not mean deleting complex information to make the offering document easier to understand. For investors to make informed decisions, disclosure documents must sometimes impart complex information. Using plain English assures the orderly and clear presentation of complex information so that investors have the best possible chance of understanding it.

While not required under Vermont law, issuers may wish to consult the U.S. Securities and Exchange Commission's ("SEC['s]") Plain English Writing Handbook (the "Handbook") for additional tips and guidance on drafting plain English disclosures. If you wish to consult the Handbook, it can be located at: https://www.sec.gov/pdf/handbook.pdf.

V. Jurisdictional and Investor Requirements

Intrastate Offering / SEC Rule 147 / Vermont Residency

VSBOE offerings are exempt from federal securities registration under the "intrastate offering exemption." See SEC Rule 147, 17 C.F.R. § 230.147. This exemption facilitates the financing of local business operations. Therefore, your company must:

- be organized in Vermont;
- carrying out a significant amount of its business in Vermont; and
- making offers and sales only to residents of Vermont.

If a company holds significant assets outside of Vermont, or derives a substantial portion of its revenues outside Vermont, it may have difficulty qualifying for the exemption. Accordingly, one should consult with legal counsel to ensure the requirements of Rule 147 are met.

Further, a company must determine whether each investor is a resident of the State of Vermont. Accordingly, a company should clearly outline the residency requirement in its offering documents and obtain a certification from each investor that they are a resident of the State of Vermont. Typically, this certification, and the ones below, would be made in the investor's subscription documents and would be kept by the issuer in case the issuer is later asked to produce it.

Knowledgeable Investor Standard

VSBOE requires that an investor possesses such knowledge, either alone or through a representative, to be capable of evaluating the merits and the risks of their investment. Accordingly, a company should clearly outline the knowledge requirement in its offering documents and obtain a certification from each investor that they have read and understood the offering document and the risks associated with their investment and are capable of making such determinations.

Accredited Investor

VSBOE limits the amount an individual can invest in a VSBOE offering to $10,000 unless an investor qualifies as an accredited investor. An accredited investor is able to invest any amount and theoretically could fund the entire offering. The definition of an accredited investor can be found on the SEC's website here: https://www.sec.gov/answers/accred.htm.

Accordingly, a company should clearly outline the individual investment limit of $10,000 in its offering documents and obtain a certification from each accredited investor, if any, seeking to make an investment over $10,000 that they qualify under the SEC's definition as an accredited investor.

VI. Use of Websites and Social Media

Vermont law allows the use of websites and social media to promote a VSBOE offering; however, the Securities Division provides the following guidance to ensure an offer does not inadvertently run afoul of federal securities laws.

The SEC has issued recent guidance outlining their requirements regarding general advertising or solicitation of offerings through websites and social media for intrastate offerings such as VSBOE. Under the SEC guidance, general advertising or solicitation of

one's offering through websites and social media may be permissible; however, SEC requires the following:

- **before** investors can access offering documents, subscription agreements, fact sheets etc., located on a company's website or social media accounts, the prospective investor must certify they are a resident of Vermont (e.g., via check box certification on a landing page); and

- the website and social media must clearly indicate that the offer is only available to residents of Vermont (e.g., on the landing page and other pages pertaining to the offering).

Failure to follow the above, could, in principle, subject the issuer to the SEC's enforcement authority.

Please note that the positions stated above do not necessarily contain a fully discussion of all material considerations necessary when preparing an offering document. We encourage those contemplating a VSBOE offering to contact legal counsel and/or the Division early in their planning process to discuss questions and concerns. Questions and concerns may be directed to Michael Pieciak, Deputy Commissioner of Securities at Michael.Pieciak@state.vt.us.

Dated at Montpelier, Vermont this 16th day of June, 2014.

SUSAN L. DONEGAN, Commissioner

LEGISLATIVE REPORT: ACT 199 – JANUARY 15, 2015

SUMMARY OF SMALL BUSINESS ISSUER EDUCATION AND OUTREACH

SUSAN L. DONEGAN, COMMISSIONER
VERMONT DEPARTMENT OF FINANCIAL REGULATION

JANUARY 15, 2015

Act No. 199
Summary of DFR's Small Business Issuer Education and Outreach

Public Events	Location	Date	Topic/Audience
Windham Co. Bar Association Meeting	Brattleboro	May 29, 2014	Discuss VSBOE with approximately 20 attorneys from Windham County area
Downs Rachlin Martin Business Law Group Meeting	Burlington	July 15, 2014	Discuss VSBOE, S.U.N. Exemption and other securities exemptions with the business law group of DRM
Seminar: Raising Capital in Vermont	St. Johnsbury	August 21, 2014	Conduct seminar for approximately 15 small business owners on how to raise capital in Vermont. Hosted by NVDA
Vermont Bar Association Annual Meeting	Killington	September 19, 2014	Present VSBOE to approximately 25 business attorneys at business law breakout session of VBA annual meeting
Seminar: Integrating Mission into Ownership	Burlington	October 16, 2014	Present VSBOE and other securities exemptions to approximately 80 small business owners and professionals. Sponsored by VBSR
Farm to Plate Conference - Financing the Food System	Killington	October 24, 2014	Present VSBOE and other securities exemptions to approximately 30 farmers and agriculture entrepreneurs
Vermont Economic Development Summit	Burlington	October 28, 2014	Present VSBOE and other securities exemptions to approximately 30 small business owners and professionals. Sponsored by ACCD
Vermont Venture Network Meeting	Burlington	October 30, 2014	Present VSBOE and other securities exemptions to approximately 30 small business owners and professionals. Sponsored by Merritt, Merritt and Moulton
Vermont Working Landscape Conference	Middlebury	November 6, 2014	Deliver keynote address regarding VSBOE to approximately 75 small business owners, professionals and agriculture entrepreneur
Annual Meeting of the Vermont Society of CPAs	Montpelier	January 13, 2015	Address approximately 100 accounting professionals regarding VSBOE

Act No. 199
Summary of DFR's Small Business Issuer Education and Outreach

Media Outreach	Date	Topic/Audience Reach
Interview with Vermont Digger	July 3, 2014	Discuss VSBOE and its impact on Vermont's capital markets; statewide distribution through Vermont Digger website and republished by the Brattleboro Reformer and Bennington Banner
Guest on WDEV "Vermont Conversation" Radio Show	July 9, 2014	Discuss VSBOE and its impact on Vermont's capital markets; radio show reaches Washington and Caledonia Counties
Interview with Vermont Public Radio	July 24, 2014	Discuss VSBOE and its impact on Vermont's capital markets
Interview with Champlain Valley and Rutland Business Journals	January 1, 2015	Discuss VSBOE and its impact on Vermont's capital markets; distribution reaches Chittenden and Rutland Counties

Individual Outreach	Date	Topic/Audience
Meeting with Vermont Businesses for Social Responsibility	June 17, 2014	Meeting with Executive Director Andrea Cohen and Public Policy Manager Danial Barlow discussing VSBOE and its benefits to VBSR's membership
Meeting with Lamoille Economic Development Corporation	July 10, 2014	Meeting with Executive Director John Mandeville discussing VSBOE
Meeting with the VSJF Flexible Capital Fund, L3C	July 16, 2014	Meeting with President Janice St. Onge discussing VSBOE
Meeting with Slow Money Vermont and Attendance at Kick-Off Event	September 17, 2014	Meeting with founding members discussing VSBOE
Meeting with Community Capital of Vermont	October 30, 2014	Meeting with Martin Hahn and Josh Jerome discussing VSBOE
Meeting with Fresh Tracks Capital	December 9, 2014	Meeting with Cairne Cross, General Partner, to discuss VSBOE
Meetings with individual business owners and entrepreneurs	Various	Individual meetings with approximately 15 Vermont businesses interested in exploring a VSBOE offering

LEGISLATIVE REPORT: ACT 199 – JANUARY 15, 2015

LICENSED LENDER REPORT

SUSAN L. DONEGAN, COMMISSIONER
VERMONT DEPARTMENT OF FINANCIAL REGULATION

JANUARY 15, 2015

INTRODUCTION

Section 20 of Act 199 of 2014, *An act relating to furthering economic development*, charged the Department of Financial Regulation ("DFR") with submitting a report on licensing requirements for commercial lenders in Vermont. Specifically, DFR was directed to solicit public comment, evaluate, and report on any statutory and regulatory changes to the State's licensed lender requirements that are necessary to open private capital markets and remove unnecessary barriers to business investment in Vermont. In response to this directive, the following report is hereby submitted to the House Committee on Commerce and Economic Development and to the Senate Committees on Finance and on Economic Development, Housing and General Affairs.

In Vermont, a person or entity who would like to make a loan generally needs to obtain a license from DFR. State lender licensing programs are a common feature throughout the United States, although requirements differ by state. Vermont has licensing requirements for a variety of loan activities, including certain commercial lending practices.[1] Exemptions from the licensing requirements exist for a number of entities (like chartered banks) and lending activities. Vermont is not alone in requiring licensing for commercial lending. For example, New York requires licenses for commercial loans up to $50,000 that have an interest rate greater than 16%,[2] and anyone engaged in the business of making commercial loans in California must obtain a license unless otherwise exempted.[3]

In recent years, increased attention has been given to the issue of access to capital and credit for Vermont's business community and entrepreneurial industry. Access to capital can be an issue where a business is unable to access adequate conventional credit such as bank lending, and where a financing gap exists for a business startup or expansion. In some cases, commercial borrowers turn to merchant cash advance companies, a nonbank provider that advances fast cash in exchange for an agreed-on percentage of future sales (and often charges high interest rates). However, traditional commercial lending is undergoing a transformative change with the rise of "alternative lenders."[4] Alternative lenders are typically technology-based and often use a peer lending platform.[5] These new lending models offer a middle ground between banks, which usually only approve the most creditworthy businesses and may have long approval processes,

[1] For purposes of this report, the term "commercial lenders" refers to those engaged in the business of making loans as defined in 8 V.S.A. § 2201(a)(1). This report does not discuss requirements applicable to those investing money in a debt security as defined in 9. V.S.A. § 5102(28).
[2] N.Y. Banking Law § 340.
[3] Cal. Fin. Code § 22500.
[4] *See* William Cohan, *Bypassing the Bankers*, The Atlantic (Aug. 13, 2014), http://www.theatlantic.com/magazine/archive/2014/09/bypassing-the-bankers/375068/; Amy Cortese, *Can't Get a Bank Loan? The Alternatives are Expanding*, N.Y. Times (Mar. 6, 2014), http://www.nytimes.com/2014/03/06/business/smallbusiness/cant-get-a-bank-loan-the-alternatives-are-expanding.html.
[5] Peer-to-peer lending that occurs over the internet is often referred to as "crowdfunding." DFR is currently studying opportunities for crowdfunding to increase access to capital for Vermont's small businesses. Act 199 of 2014, § 19.

and high-interest cash advance companies. Additionally, the growing millennial entrepreneurial sector is familiar with social platforms and embrace Internet-based alternative lending.[6]

Given these changes to the business financing landscape, access to capital and state regulatory requirements for commercial lending are current topics of discussion throughout the country. Vermont is looking at new ways to facilitate financing for business development and growth. For instance, DFR is currently studying opportunities for crowdfunding to increase access to capital for Vermont's small businesses.[7] Additionally, some have asked whether the application of Vermont licensing requirements to commercial lending practices needs to be changed in order to promote business investment in the state. This study addresses that question.

To organize and inform this discussion, the following report is broken into multiple sections. Section one provides an overview of the current licensing requirements in Vermont and recent changes to the requirements for commercial lenders. Section two introduces the public comments received by DFR relating to this study. Lastly, Section three analyzes whether any statutory or regulatory changes are needed to the licensing requirements for commercial lenders in Vermont.

I. HISTORY AND OVERVIEW OF LICENSED LENDER LAW

The Licensed Lenders Act, 8 V.S.A. §2200 *et seq.*, has a long history in Vermont. Its origins can be traced back as early as 1937.[8] Prior to April 30, 1980, the licensing requirements of the Licensed Lenders Act (§2201) applied only to loans of $1500 or less, and the entire chapter was entitled "small loans."[9] Effective April 30, 1980, the Legislature broadened the act to include licensed lenders generally, eliminated the $1,500 loan limit and added exemptions to the licensing requirement.[10] The purpose of the licensed lender law in Vermont (and similar laws in other states) is based on the strong public policy concern of protecting the public from unfair lending practices.[11]

The Licensed Lenders Act has undergone many changes since its inception. In recent years, particular focus has been given to requirements for commercial lenders and ways to reduce regulatory burdens associated with commercial loans. For instance, an "angel investor" exemption was added in 2008 to enhance opportunities for access to capital for startup companies.[12] Additionally, significant changes were made to the Act in response to a study released in January 2010 that focused on licensing requirements for commercial lenders. The study was the result of a directive in the Vermont Recovery and Reinvestment Act of 2009 that the Commissioner of DFR convene a work group to study the application of Vermont's licensed

[6] Sarah O'Brien, *Alternative lenders are hot – especially among millennials*, CNN Money (Dec. 18, 2014), http://money.cnn.com/2014/12/18/smallbusiness/alternative-lending-millennials/index.html.
[7] Act 199 of 2014, § 19. Crowdfunding is a way to raise capital by obtaining monetary contributions from a large number of individuals, typically via the Internet.
[8] Act 184 of 1937, § 1.
[9] Klein v. Wolf Run Resort, Inc., 163 Vt. 506, 514 n.2 (1995) (Dooley, J., dissenting).
[10] Vermont Dev. Credit Corp. v. Kitchel, 149 Vt. 421, 424 (1988).
[11] *See* Klein, 163 Vt. at 514 (Dooley, J., dissenting).
[12] Act 159 of 2008; 8 V.S.A. § 2201(d)(12).

lender requirements to certain commercial lending practices.[13] The identified purpose of the study was to recommend statutory amendments to "facilitat[e] limited instances of high-risk, secured commercial lending by specialized lenders such as venture capital firms, individuals, and partnerships . . . [and to] consider proposals such as a limited exemption or expedited registration process that permits capital investments in and secure commercial loans to technology firms, in a responsible manner."[14]

The work group met several times in 2009, and reached consensus on a simplified licensing process for commercial lenders, as well as other amendments to the Licensed Lender Act.[15] Recommendations from the study were adopted during the 2010 legislative session.[16] Major changes to the Act included an amendment to the definition of a "commercial loan,"[17] creation of a simplified licensing procedure for commercial lenders,[18] and a reduction in license application and renewal fees for commercial lenders.[19] The simplified commercial licensing procedure streamlined the process for application for and approval of commercial loans, and eliminated requirements applicable to other lenders to provide personal financial information and annual financial statements and to file a bond with the Commissioner.

The removal of the financial information and the bonding requirements means that DFR no longer has a mechanism to evaluate the financial responsibility of the lender. Additionally, DFR has no way to ensure that a readily available source of funds exists to reimburse harmed commercial borrowers or to pay for departmental penalty or examination costs. Instead, the simplified process focuses on identifying the lender and the lender's location, identifying the control persons of the lender, criminal history background checks, actions by other governmental and regulatory agencies, and the "experience, character, and general fitness" of the applicant.[20] The goal of these changes was to reduce barriers for commercial lenders to enter the Vermont commercial lending market while still maintaining a way for DFR to identify "bad actors" (such as lenders with criminal histories or regulatory infractions from other jurisdictions) and protect consumers.

As a result of modifications to the Licensed Lenders Act, several options exist for someone who wants to make a commercial loan. In many cases, the licensing requirements of the Licensed Lenders Act do not apply. The following options are available to someone who would like to make a commercial loan in Vermont:

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[13] Act 54 of 2009, § 30.
[14] Id.
[15] The work group consisted of representatives from BISHCA (now DFR), the Vermont Bankers Association, the Vermont Bar Association, the Department of Economic Development, the Vermont Economic Development Authority, and both the borrower and investor sides of the entrepreneurial industry sector in Vermont.
[16] Act 134 of 2010, §§ 24a-h.
[17] Prior to this amendment, the statutory definition of "commercial loan" provided that any loan less than $25,000 was not a commercial loan, even if made for commercial purposes. The 2010 amendment removed the $25,000 threshold from the definition of "commercial loan." Act 134 of 2010, §§ 24a; 8 V.S.A. § 2200(1).
[18] Act 134 of 2010, §§ 24c and f; 8 V.S.A. § 2202a; § 2204c.
[19] Act 134 of 2010, §§ 24c and g; 8 V.S.A. § 2202a(b); § 2209(a)(6).
[20] 8 V.S.A. § 2204c(a)(1).

Scenario	License Needed?	Reference
A commercial loan made by enumerated persons or entities (e.g., a state agency, federal agency, depository or financial institution, pawnbroker, insurance company, housing finance agency, etc.).	No – exempt.	8 V.S.A. § 2201(d)(1), (2), (3), (4), (5), (6), (7), (8), (9), (11), (13), (14), (15).
A person who lends, other than commercial mortgage loans, an aggregate of less than $75,000 in any one year at an interest rate of 12% or less.	No - exempt.	8 V.S.A. § 2201(d)(10).
Any commercial loan of $1,000,000 or more.	No – exempt.	8 V.S.A. § 2201(h).
A person who makes an unsecured commercial loan that is expressly subordinate to all senior indebtedness of the borrower.	No – exempt. There is no limit on the number or amount of this type of loan that a lender may make.	8 V.S.A. § 2201(d)(12).
A person who makes no more than 3 mortgage loans in a consecutive 3-year period.	No – exempt.	8 V.S.A. § 2201(d)(16) and (e)(6).
A person who makes rare or isolated loans and is not "engaged in the business" of making loans.	No.	8 V.S.A. § 2202a(1). Courts have held that a single, isolated loan entered into by an entity that is not in the business of making loans would not trigger licensing requirements.[21]
All others who make solely commercial loans and do not fall within an exemption.	Yes – these lenders can seek the simplified "commercial lender only" license through DFR. There is no bond or financial responsibility requirement, and license holders may make as many commercial loans in Vermont as they like.	8 V.S.A. § 2202a.

[21] *See* Nordic Windpower USA vs. Jacksonville Energy Park, 2012 WL 1388357 (D.Vt. 2012) (*citing* Hawk Resorts Int'l v. Colburn, No. 90-2-10 Wrcv (Mar. 23, 2011)).

Numerous other opportunities exist for Vermont businesses who want to access capital and credit aside from obtaining a traditional commercial loan subject to licensing requirements. For instance, Vermont has 12 regional economic development corporations, which assist small businesses in a myriad of ways, including financing through revolving loan funds.[22] Similarly, the Vermont Economic Development Authority ("VEDA") and the Vermont Sustainable Jobs Fund are legislatively-created organizations that provide loans and other finance support to Vermont enterprises.[23] In addition to prompting this study, Act 199 of 2014 created the Vermont Entrepreneurial Lending Program to provide investment funds to Vermont businesses whose capital needs are unmet by conventional lending.[24] Additionally, several non-profit organizations, such as the Vermont Community Loan Fund, Northern Community Investment Corporation and Community Capital of Vermont, provide alternative avenues for commercial lending for small businesses.[25] Lastly, commercial loans may not be the appropriate form of capital for every business. In such cases, businesses can explore raising capital through securities offerings such as the Vermont Small Business Offering Exemption.[26]

II. SUMMARY OF PUBLIC COMMENTS

Public opinion regarding licensing for commercial lenders is mixed. As part of this evaluation, DFR solicited public comment on whether any statutory and regulatory changes to the State's licensed lender requirements are needed. In order to gather public input, a notice was posted to the DFR homepage stating that DFR was seeking public comment, along with instructions on how to submit comments. Additionally, DFR reached out directly to a number of representatives from both the entrepreneurial and lender sectors of Vermont. DFR received four written comments, which are summarized below:

- Comment 1 suggests that the licensed lender statute be revised to create an exemption for commercial loans made solely to business entities in which no individual is personally liable for the debt and no personal assets are pledged as collateral. The commenter states that an exemption applicable to purely commercial loans made to legal entities mitigates concerns associated with loan sharking and would increase flexibility for structuring non-subordinated or secured loan transactions from non-institutional investors.

- Comment 2 suggests that a modification to the licensed lender statute that would exempt accredited investors making commercial loans that are convertible into equity securities of the borrower. The Commenter also states that many investors

[22] *Regional Development Corporations*, Agency of Commerce and Community Development, http://accd.vermont.gov/business/partners/rdc (listing Vermont regional development corporations).
[23] Vermont Economic Development Authority, http://www.veda.org/about-veda/; Vermont Sustainable Jobs Fund, http://www.vsjf.org/
[24] Act 199 of 2014, § 4 (amending 10 V.S.A. chap. 12). The Fund is administered through VEDA. Id.
[25] Vermont Community Loan Fund, http://www.investinvermont.org/about; Northern Community Investment Corporation, http://www.ncic.org/who-we-are/; Community Capital of Vermont, http://www.communitycapitalvt.org/about-us/.
[26] Vermont Dept. Fin. Reg., Rule No. S-2014-1, *Rule providing for the Vermont Small Business Offering Exemption* (June 16, 2014).

have the capacity to make loans above $75,000 (an exemption in 8 V.S.A. § 2201(d)(10) currently exempts a lender that lends up to $75,000 in one year), and should not be required to lend on an unsecured basis or agree to subordination (in order to fall within the "angel investor" exemption contained in 8 V.S.A. § 2201(d)(12)).

- Comment 3 states that few specialized technology enabled non-bank lenders do business in Vermont because of the small addressable market and due to the licensed lender law. The commenter suggests that Vermont licensed lender law be modified so that it no longer applies to any commercial loan transactions.

- Comment 4 provides background comments. The comment discusses the 2009 changes to the Vermont licensed lender law to create a streamlined licensing process for commercial lenders and the 2014 change that allows a person to make up to 3 mortgage loans in a consecutive 3-year period. The commenter states that a license should be required if a lender is providing multiple loans throughout a year or providing investment funds that are structured as debt.

III. CONCLUSION AND RECOMMENDATION

Vermont's licensed lender requirements exist to protect the public from unfair and unconscionable lending practices.[27] The fact that a loan is associated with financing a business expense, or that a borrower is a business entity, does not negate the need for oversight. To the contrary, business entities are part of the "public" that DFR is charged with protecting.[28] While some suggest that commercial lender licensing requirements be repealed or modified to exempt additional categories of loans, such changes would weaken DFR's ability to protect borrowers.

Commercial borrowers are not necessarily more sophisticated than an individual borrower. The commercial loan amounts that generally fall within licensing requirements (between $75,000 and $1,000,000) are squarely within the range of loans that are often sought by small and midsize businesses. These businesses could be just as susceptible to unscrupulous lending practices as an individual, and a loan on unfair terms could quickly shutter a new or small business. Even if no individual is personally liable for a commercial debt, the closure of a business due to debt can have significant financial impacts for business owners and employees.

However, commercial borrowers are not given the same protections as other borrowers. As discussed above, changes to the Licensed Lender Act were adopted in 2010 to create a streamlined process for commercial lenders after a collaborative working group reached a consensus to recommend the changes. The 2010 amendments removed requirements applicable to other loans, and resulted in a process that is similar to a simple registration. These changes

[27] In re Gorman, 274 B.R. 351, 357 (D.Vt. 2002); 8 V.S.A. § 10.
[28] Indeed, commercial loans to business entities fall expressly within the Licensed Lender Act's requirements. 8 V.S.A. § 2200(1). *See also, e.g.,* State v. Int'l Collection Serv., 156 Vt. 540 (finding that Attorney General may bring suit on behalf of businesses under Vermont Consumer Fraud Act).

were adopted as a middle ground approach designed to help facilitate business investment in Vermont while still retaining limited means for DFR to monitor commercial lenders and protect borrowers.

DFR recommends that the current licensing requirements for commercial lenders remain in place. The simplified commercial lender licensing procedure created in 2010 removed the more significant deterrents to obtaining a commercial lender license, reduced application fees, and made the process less time-consuming. As a result, barriers for commercial lenders to enter the Vermont commercial lending market were significantly reduced. Additionally, as described in Section I, many exemptions exist that enable lenders to make commercial loans without being subject to licensing. However, DFR believes that the existing requirements applicable to commercial lenders are important to maintain in order to help prevent bad actors from entering the marketplace and so that DFR can continue in its role of protecting commercial borrowers.

LEGISLATIVE REPORT: ACT 199 – JANUARY 15, 2015

REGULATION 2014-1
ELECTRONIC INSURANCE NOTICES

SUSAN L. DONEGAN, COMMISSIONER
VERMONT DEPARTMENT OF FINANCIAL REGULATION

JANUARY 15, 2015

An Update on the Proposed Electronic Insurance Notices Rule

The proposed Electronic Insurance Notices rule (Regulation 2014-1) passed out of the Interagency Committee on Administrative Rules (ICAR) on January 12, 2015. A public hearing on the rule will be held approximately 30 days from that date. The public comment period will end shortly after that, at which point the Legislative Committee on Administrative Rules (LCAR) will review the rule.

The proposed rule sets forth the procedural requirements permitting certain insurers to send certain notices to policyholders by electronic means instead of by certified mail. Insurers may only elect to send notices by electronic means if they obtain the consent of the policyholder in a manner consistent with the procedures outlined by the proposed rule. The proposed rule came about as a result of legislation passed in 2014 providing that "the Commissioner of Financial Regulation shall adopt rules specifying the methods by which a notice to a party required under section 3880, 3881, 4224, 4225, 4712, or 4713 of this title shall be given." 8 V.S.A. 3666.

VERMONT DEPARTMENT OF FINANCIAL REGULATION

REGULATION 2014-1

ELECTRONIC INSURANCE NOTICES

Table of Contents

Section 1. Authority

This regulation is promulgated pursuant to the authority granted by 8 V.S.A. §§ 15, 3666 and chapters 105, 113, and 128.

Section 2. Purpose

The purpose of this regulation is to set forth rules and procedural requirements which the Commissioner deems necessary to permit certain insurers to send certain notices to policyholders by electronic means.

Section 3. Severability Clause

If any provision of these regulations or the application thereof to any person or circumstance, is held invalid, such invalidity shall not affect other provisions or applications of these regulations which can be given effect without the invalid provision or application, and to that end the provisions of these regulations are severable.

Section 4. Definitions

A. "Delivered by electronic means" includes:

(1) Delivery to an electronic mail address at which a party has consented to receive notice; and

(2) Posting on an electronic network, or site accessible via the internet, mobile application, computer, mobile device, tablet, or any other electronic device, together with separate notice to a party sent to the electronic mail address at which the party has consented to receive notice of the posting.

B. "Party" means any recipient of any notice required as part of an insurance transaction, including but not limited to an applicant, an insured, or a policyholder.

Section 5. Delivery of Notices by Electronic Means

A. Subject to subsection (C) of this section, any notice to a party required under section 3880, 3881, 4224, 4225, 4712, or 4713 of this title may be but is not required to be delivered by electronic means, provided the process used to obtain consent of the party to have notice delivered by electronic means meets the requirements of 9 V.S.A. chapter 20 (the Uniform Electronic Transactions Act).

B. Delivery of a notice pursuant to subsection (A) of this section shall be considered equivalent to any delivery method required under section 3883, 4226, or 4714 of this title, including delivery by first-class mail, certified mail, or certificate of mailing.

C. A notice may be delivered by electronic means by an insurer to a party under this section if:

(1) The party has affirmatively consented to such method of delivery and not subsequently withdrawn consent;

(2) The party, before giving consent, is provided with a clear and conspicuous statement informing the party of:

(i) The right of the party to have the notice provided or made available in paper or another nonelectronic form at no additional cost;

(ii) The right of the party to withdraw consent to have notice delivered by electronic means, at any time, and any conditions or consequences imposed in the event consent is withdrawn;

(iii) Whether the party's consent applies:

(a) Only to the particular transaction as to which the notice must be given; or

(b) To identified categories of notices that may be delivered by electronic means during the course of the party's relationship with the insurer;

(iv) How, after consent is given, the party may obtain a paper copy of a notice delivered by electronic means at no additional cost; and

(v) The procedures the party must follow to withdraw consent to have notice delivered by electronic means and to update information needed to contact the party electronically;

(3) The party, before giving consent:

(i) Is provided with a statement of the hardware and software requirements for access to and retention of a notice delivered by electronic means as to which the party has given consent; and

(ii) Consents electronically and confirms consent electronically, in a manner that reasonably demonstrates that the party can access information in the electronic form that will be used for notices delivered by electronic means as to which the party has given consent; and

(4) After consent of the party is given, the insurer, in the event a change in the hardware or software requirements needed to access or retain a notice delivered by electronic means creates a material risk that the party will not be able to access or retain a subsequent notice to which the consent applies:

(i) Provides the party with a statement of:

(a) The revised hardware and software requirements for access to and retention of a notice delivered by electronic means; and

(b) A revised statement required by subdivision (2) of this subsection; and

(ii) The party affirmatively consents to continued delivery of notices by electronic means.

D. Every notice delivered pursuant to subsection (A) of this section shall include the statement required by subdivision (C)(2) of this section. This section does not otherwise affect the content or timing of any notice required under chapter 105, 113, or 128 of this title.

E. If a provision of chapter 105, 113, or 128 of this title requiring notice to be provided to a party expressly requires verification or acknowledgement of receipt of the notice, the notice may be delivered by electronic means only if the method used provides for verification or acknowledgement of receipt. Upon notification to the insurer that the electronic notice was not deliverable, the insurer shall send a paper copy of the notice as otherwise required by law.

F. The legal effectiveness, validity, or enforceability of any contract or policy of insurance may not be made contingent upon obtaining electronic consent or confirmation of consent of a party in accordance with subdivision (C)(3)(ii) of this section.

G. Withdrawal of consent:

(1) A withdrawal of consent by a party does not affect the legal effectiveness, validity, or enforceability of a notice delivered by electronic means to the party before the withdrawal of consent is effective.

(2) A withdrawal of consent by a party is effective within 30 days after receipt of the withdrawal by the insurer.

(3) Failure to comply with subdivision (C)(4) of this section shall be treated as a withdrawal of consent for purposes of this section.

H. A party who does not consent to delivery of notices by electronic means under subsection (A) of this section or who withdraws his or her consent shall not be subjected to any additional fees or costs for having notices provided or made available in paper or another nonelectronic form.

I. This section shall not be construed to modify, limit, or supersede the provisions of the federal Electronic Signatures in Global and National Commerce Act, 15 U.S.C. chapter 96, as amended.

Section 6. Interpretation

The delivery of notice in accordance with Section 5 of this regulation is intended and shall be construed to meet the requirements of Department Insurance Regulation 78-01, Section 1, as revised.

Section 7. Effective Date

This regulation shall become effective [date of adoption].