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Giving Entrepreneurs A Kickstart

THE NEW FEDERAL JOBS ACT IS MEANT TO MAKE IT EASIER FOR START-UPS TO ATTRACT INVESTORS

by John Seay

By this time next year, you could own a share in the success of your favorite artists. On April 5, 2012, President Barack Obama signed into law the Jumpstart Our Business Startups Act, or JOBS Act. At least partially inspired by the popularity of “crowd-funding” websites like Kickstarter and Indiegogo, the JOBS Act encourages creative funding of privately-owned small businesses by significantly easing existing securities regulations and enabling entrepreneurs of all stripes to raise venture capital by offering shares to the general public.

In case you missed it, crowd-funding — which occurs when individuals pool their financial resources in order to fund projects they care about — is a popular method for funding creative ventures. Recently, Amanda Palmer, former bandleader of The Dresden Dolls, raised over \$360,000 in a mere 48 hours via Kickstarter, shattering the previous Kickstarter record for music fundraising and fully funding Palmer’s next album and tour.

Kickstarter will always serve a purpose in the entertainment industry, but for artists lacking the worldwide appeal of an Amanda Palmer, it can be difficult to raise significant capital using its existing platform. Kickstarter operates on a donation model. Artists offer fans a series of “rewards” that correspond to various donation levels. While many of those rewards are nice (\$500 for a performance by the band in your living room, for example), they are nevertheless basically tokens of appreciation — the equivalent of National Public Radio’s free tote bag. Once the JOBS Act takes effect, artists will have the opportunity to move beyond the donation model and instead sell shares in the success of a given creative project, thereby giving fans an opportunity to either prosper or perish along with the artist.

Compared to existing securities regulations, the JOBS Act is a verifiable game changer. With only a handful of narrow exceptions, existing securities regulations prevent entrepreneurs from offering returns on investments unless the investment opportunity, or “security,” has been filed with the Securities and Exchange Commission (SEC) and the investor is properly “accredited” (i.e., wealthy enough to bear the risk of investing). Not surprisingly, the cost of proper registration with the SEC is fairly high, especially where an entrepreneur seeks to offer shares to investors located in multiple states. And as an added bonus, if you don’t file your securities, you may be subject to civil and criminal penalties.

By contrast, the JOBS Act will exempt certain types of small public offerings from the filing requirement. Under the JOBS Act, websites like Kickstarter can morph into government-sanctioned and registered “funding portals” that small businesses — including, of course, artists — will be able to use to sell up to a million dollars worth of shares in a project to any potential investor — accredited or not — during a 12-month period,



Musician Amanda Palmer — shown here performing with her old band, The Dresden Dolls, in 2006 — used the crowd-funding website Kickstarter to raise money for a new record and new tour. Photo by Mykal Burns.

without having to file the security. The only major restriction on sales of shares is that no single investor may contribute more than \$2,000 or 5 percent of their annual income or net worth up to a maximum of \$10,000 in any 12-month period. However, the SEC is in the process of reviewing the JOBS Act and will issue additional rules and regulations at some point in the next year (they have until January 1, 2013, to do so), at which point the JOBS Act will go into effect.

While the JOBS Act has sparked excitement in the industry, not everyone is comfortable with the changes in securities regulations. Detractors view the exceptions created by the JOBS Act as an opportunity for scam artists to prey on unwitting individuals, and especially the elderly. Although, as noted above, the JOBS Act does place some restrictions on how much an individual can invest in a given year, it is unclear what sort of oversight there will be on the process. The JOBS Act suggests that investors will merely have to read disclaimers and check boxes online to verify that investment amounts do not violate the restrictions on investments. However, unless the SEC posits additional rules governing this process, there is no way for the SEC to verify that potential investors actually understand the disclaimers and that they have honestly answered any required questions.

Another concern over the JOBS Act is how exactly artists soliciting investments in a project will account to their investors. If individuals are investing in the work of an artist with an expectation of a return on that investment, then a fiduciary relationship has been created, and the artist is subject to certain duties imposed by law, the breach of which could result in messy lawsuits that could effectively end a promising career in the arts before it even begins. After all, if Kickstarter entrepreneurs already have a reputation for not mailing out the rewards they promise their donors, then imagine how difficult it will be for them to issue accurate accountings and dividends to what could be thousands of investors.

If your band or other project only needs to raise a modest sum of money, then the Kickstarter donation model is still available to you, and has proven lucrative given the right project and marketing. However, artists who have legitimate business plans that require venture capital to fully fund may soon have a friend in the JOBS Act. Let’s hope they also have a friend in a good accountant. As for fans of particular artists seeking to raise significant funds, select your investment opportunities carefully, or risk losing your investment.



President Obama signed the federal Jumpstart Our Business Startups Act, or JOBS Act, in April. The law makes it easier for artists and other entrepreneurs to attract funding by significantly easing existing securities regulations.

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