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Law Report

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Crowdfunding

In the last 12 months, the business and legal worlds have tried to predict whether crowdfunding under the Jumpstart Our Business Startups Act (the JOBS Act) will provide a good fundraising solution for small businesses ranging from high-tech start-ups to theatrical and film productions. In the spring of 2012, the JOBS Act was signed into law, requiring the Securities and Exchange Commission (the SEC) to adopt new rules reflecting the law. Title 3 of the JOBS Act provides for crowdfunding, which will allow entrepreneurs to raise small amounts of money from a large number of unaccredited investors. Generally speaking, if an investor is an individual, he or she is considered an unaccredited investor if his or her net worth is less than $1 million excluding the value of his or her primary residence, or if his or her annual income is less than $200,000 or his or her joint income with a spouse is less than $300,000. The crowdfunding exemption to the U.S. securities laws, according to securities lawyer Gary Emmanuel, is meant to strike a balance between giving access to small investors that want to contribute small amounts of money to start-ups and new businesses while at the same time providing investor protections. After all, unaccredited investors traditionally are less sophisticated investors and less able to bear the risk of loss. The general consensus is that it is still unclear whether or not crowdfunding under the JOBS Act will be a viable or advisable option, given the limitations in the JOBS Act and the fact that the SEC has yet to adopt final rules.

J.J. Sherman

Here are some of the limitations that already appear in the JOBS Act:

1. Crowdfunding for any project is limited to $1 million. It is also limited to $1 million in a 12-month period.
2. There are limits to the total amount that can be invested by an individual investor in any 12-month period in a company. If your annual income or net worth is less than $100,000, then you may invest up to 5% of your annual income or net worth. If your annual income or net worth is more than $100,000, then the maximum that you can invest is 10% of your annual income or net worth. The maximum amount that an investor with a high net worth can invest in a crowdfunding vehicle is $100,000.
3. Crowdfunding may only occur through a funding portal. You cannot crowdfund directly on your website or on your social media page, but you may add a link to your website or social media pages and direct the investor to the funding portal.
4. A company that elects to crowdfund must provide disclosure materials to prospective investors. The company will have to file the disclosure materials with the SEC and with the funding portal.
5. There are financial disclosure requirements. If you are raising $100,000 or less in a 12-month period, then you must provide income tax returns and certified financial statements. If you're raising funds in the $100,000 to $500,000 range, you have to provide financial statements reviewed by a public accountant. If you're raising over $500,000, then you have to provide audited financial statements.
6. Crowdfunding under the JOBS Act imposes securities law liability for making a material misstatement. The liability extends not only to the company but also to its officers and directors. The risk of liability with crowdfunding potentially is significant, because crowdfunding assumes a large number of unsophisticated investors who may have an expectation of return on investment based on disclosure documents that promise generous returns in the future without adequate risk factors and warnings.

An entrepreneur raising money for a start-up must weigh whether crowdfunding under the JOBS Act is attractive, given the many disclosure requirements, potential securities law liability and the low fundraising limit.

Author's Footnote: Today, people use the terms "crowdfunding" and "Kickstarter" interchangeably, but crowdfunding under the JOBS Act and crowdfunding using a vehicle like Kickstarter are very different. Unlike crowdfunding under the JOBS Act, where an investor purchases an equity interest in a company and has all the rights of a security holder, donation-based portals like Kickstarter and Indiegogo permit individuals to donate money to a campaign with no expectation of any return on investment, except perhaps some "perks" to say "thank you" such as a T-shirt or a copy of a CD. ◆

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24 The number of CREW Network members, including presidents, past presidents and other leaders of the Los Angeles, Washington, D.C., Northern Virginia and Miami chapters, who nominated J.J. Sherman to receive the 2013 CREW Network Impact Award for Entrepreneurial Spirit. Thank you!

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California's Energy Use Disclosure Law

California's Nonresidential Building Energy Use Disclosure Program (known as "AB 1103") begins this 2013.

What is the purpose of AB 1103? The stated purpose is to promote energy efficiency in the use and operation of commercial buildings throughout California.

When is disclosure required? An owner of a commercial building must disclose a Disclosure Summary Sheet, Statement of Energy Performance, Data Checklist, and the Facility Summary for the building to (1) a prospective buyer of the building, no later than 24 hours prior to execution of the sales contract; (2) a prospective lessee of the entire building, no later than 24 hours prior to execution of the lease; and (3) a prospective lender financing the entire building no later than submittal of the loan application.

How will AB 1103 be implemented? The law will be implemented in phases. On or after July 1, 2013, it applies to buildings with a total gross floor area measuring more than 50,000 square feet. On or after January 1, 2014, it begins to apply to buildings with a total gross floor area measuring more than 10,000 square feet and up to 50,000 square feet. On or after July 1, 2014, it begins to apply to buildings with a total gross floor area measuring at least 5,000 square feet and up to 10,000 square feet.

How will disclosure be prepared? At least 30 days before a disclosure is required to a prospective buyer, prospective lessee, or prospective lender, a building owner must open an account or update an existing account for the building on the federal Environmental Protection Agency's Energy Star measurement and verification tool, "Portfolio Manager," and input, or authorize its energy providers to input, energy information relating to the building. Portfolio Manager then generates a Disclosure Summary Sheet and three disclosure documents designed to provide insight into the energy use of a building during the last 12 months: a Statement of Energy Performance, a Data Checklist, and a Facility Summary.

What is the Statement of Energy Performance? The Statement of Energy Performance is a standard report generated by Portfolio Manager that describes a building's energy performance. The Statement includes the name and location of the building; the age, size, and rating, if any, of the building; and summaries of energy use and greenhouse gas emissions. There is space for a licensed architect or engineer to certify the accuracy of the data, although this certification is not required.

What is the Data Checklist? The Data Checklist is a standard report generated by Portfolio Manager that summarizes a property's physical and operating characteristics. The Checklist describes the way the space is being used as well as the hours of occupancy. The Checklist also summarizes the conventional and renewable energy being used within the building by fuel type. There is space for a licensed professional to certify the accuracy of the data, although this certification is not required.

What is the Facility Summary? The Facility Summary summarizes the space and energy use of a building and compares a building's energy use to national medians. It compares the energy use of the building as it is currently operated against previous performance along with the average national energy use for a building with similar characteristics. There is also a brief section devoted to cost and greenhouse gas emissions associated with these energy uses.

Is California's energy reporting law part of a trend in large, populated areas? Yes. New York City's Local Law 84 requires annual benchmarking data to be submitted by owners of buildings with more than 50,000 square feet for public disclosure by May 1 of each year. According to NYC's PlaNYC Green Buildings and Energy Efficiency, this is meant to bring transparency for energy and water usage and inform building owners and tenants on how to make their buildings more efficient. Based on the public disclosure, *The New York Times* reported on December 24, 2012 that 7 World Trade Center was "far from a top performer" with a score of 74 (just below the minimum of 75 set for high-efficiency buildings by the EPA's Energy Star program), while the Chrysler Building and the Empire State Building achieved a score of 84 and 80, respectively, as a result of extensive upgrades of their insulation and mechanical systems. The MetLife Building scored a 39 and the Seagram Building scored a 3. ◆

Supplier Diversity Announcement

As a 100 percent woman-owned business certified by the Women's Business Enterprise National Council (WBENC), we are proud to serve as a diversity supplier and help our clients achieve their commitment to diversity. We recognize that businesses gather strength from difference.

Law Offices of J.J. Sherman, P.C. is on the Minority and Women-Owned Law Firm Outside Counsel List of the FDIC.

Spotlight on the Retail Lease

Design Approval

Retail leases traditionally provide landlords the unfettered right to approve or disapprove a tenant's design of a retail space. Landlords generally want a tenant's design to conform to the design elements in the shopping center. Tenants, on the other hand, desire certainty that their store can have a unique "look" and design for branding purposes. These competing interests can be resolved in any number of ways. The parties can attach approved "conceptual designs" to the lease with a statement that so long as the actual store design is substantially similar to the conceptual designs, the actual store design will be approved by the landlord. Alternatively, the parties can state that the store will have a design similar to the tenant's most current store prototype. Other times, the landlord will pre-approve the tenant's entire design including plans and drawings in advance of the tenant signing the lease. During retail lease negotiations, be sure to address how and when design will be approved by the landlord, and inquire whether any third parties (municipal authorities, ground lessors, etc.) have approval rights over tenant design. ◆

New California Limited Liability Company Act Takes Effect January 2014

On January 1, 2014, the California Revised Uniform Limited Liability Company Act (known as RULLCA) will take effect and will apply to all existing California limited liability companies (LLCs) as well as all foreign limited liability companies registered with the Secretary of State of California as of that date. It will replace the current California law governing LLCs, the Beverly-Killea Limited Liability Company Act.

Do existing LLCs have to file any new documents with the California Secretary of State on or around January 2014? No. The new law applies automatically to existing LLCs and there are no "opt in" or "opt out" procedures.

Why was the law revised? RULLCA is intended to bring California law more in line with the LLC laws of other states, so that companies doing business in multiple states can operate with more ease and efficiency both inside and outside California.

Is an LLC still formed by filing articles of organization? Yes. Similar to current law, an LLC is formed upon filing articles of organization with the Secretary of State of California, and the LLC's operating agreement serves as the contract among LLC members. RULLCA adds provisions concerning which RULLCA sections can be, and which cannot be, overridden by the operating agreement. RULLCA also gives more detail regarding withdrawal and the consequences of withdrawal of an LLC member from the LLC.

Is an LLC still manager-managed or member-managed? Yes. Similar to current law, under RULLCA, an LLC either is manager-managed or member-managed, and the articles of organization state the choice of management structure. Unless the articles provide otherwise, an LLC is member-managed.

How are fiduciary duties addressed under RULLCA? RULLCA imposes fiduciary duties only on persons in control of an LLC. Under RULLCA, a member of a member-managed LLC owes the duties of loyalty and care to the LLC and to its members. A member of a manager-managed LLC must exercise its rights consistent with the obligation of good faith and fair dealing, but does not otherwise have any fiduciary duty to the LLC or to its members solely by reason of being a member. Similarly, under RULLCA, a manager of a manager-managed LLC owes the duties of loyalty and care to the LLC and to its members, and must exercise its rights consistent with the obligation of good faith and fair dealing. The fiduciary duties of a manager to the LLC and to the members can only be modified in a written operating agreement with the informed consent of the members.

Consult with a California attorney if you plan to do business using a California limited liability company. ◆

FIRM NEWS

J.J. SHERMAN IN THE NEWS!
J.J. Sherman is featured in the May 2013 American Bar Association Journal article by Deborah L. Cohen on solo practitioners who rely on mentors.

WHO OWNS A SOCIAL MEDIA ACCOUNT?
J.J. Sherman's article, "Who Owns a Social Media Account?" was reprinted by WBEC-West on February 21, 2013.

FIRM EXPANSION!
We are working actively with clients doing business in California and are expanding our practice into the Washington, D.C. market in order to cater to clients doing business on the East Coast.

COMMERCIAL REAL ESTATE WOMEN!
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Copyright Update

On March 30, 2013, the United States District Court, Southern District of New York ruled in *Capitol Records, LLC v. ReDigi Inc.*, that a digital music file, lawfully made and purchased, may not be resold by its owner under the first sale doctrine.

Capitol Records is the recording label known for classics such as Frank Sinatra's "Come Fly With Me" and The Beatles' "Yellow Submarine." It sued ReDigi, Inc., a technology company that markets itself as "the world's first and only online marketplace for digital used music," alleging that ReDigi's web-based re-sale service amounted to copyright infringement of its copyrighted recordings.

Launched in October 2011, ReDigi's website allows users to "sell their legally acquired digital music files, and buy used digital music from others at a fraction of the price currently available on iTunes." A ReDigi user uploads an eligible file for sale to a remote server run by ReDigi called the "Cloud Locker." At the end of the upload process, the digital music file is located in the Cloud Locker and not on the user's computer.

In *Capitol Records v. ReDigi*, the court held that the unauthorized transfer of a digital music file over the Internet – where only one file exists before and after the transfer – constitutes a reproduction within the meaning of the Copyright Act, and that ReDigis's service infringes Capitol Record's exclusive reproduction rights under the Copyright Act. The court wrote "ReDigi stresses that it 'migrates' a file from a user's computer to its Cloud Locker so that the same file is transferred to the ReDigi server and no copying occurs. However, even if that were the case, the fact that a file has moved from one material object – the user's computer – to another – the ReDigi server – means that a reproduction has occurred."

The court also rejected ReDigi's defense based on the first sale doctrine. The first sale doctrine provides that the owner of a lawfully-made copy or phonorecord is entitled, without the permission of the copyright owner, to sell or otherwise dispose of possession of that copy or phonorecord. The court wrote, "The first sale doctrine is limited to material items, like records, that the copyright owner put into the stream of commerce." It concluded that the first sale defense does not permit sales of digital music files on ReDigi's website. ◆

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