



# 2017

Ashton Consulting Group | Raising Capital



The ACG Team:

Ashton Consulting Group, LLC

Raising Capital in the United States

“Proceed with Caution”

6/19/2017

# Raising Capital in the United States

## “Proceed with Caution”

Anyone raising capital (finders or company officers), absent an exemption (see Regulation D and employee, officer or director), for any company (private or public) through investors (including friends and/or family) is engaging in the sale of securities and must be registered with the Securities and Exchange Commission (SEC) under the Securities Act. Please be sure you consult a legal adviser before engaging in the sale of any securities. Selling securities unregistered is considered illegal.

## The Cost of Raising Private Capital Today

It is not only expensive to raise capital in the United States; it is dangerous if not done legally!

We hear about individuals who are looking to raise capital (Debt or Equity) but the cost and fees are too high. We will also hear from some individuals who believe any fees should be on success only. Unfortunately, raising money for a success fee (unregistered) is an illegal act.

The current regulatory framework prevents unlicensed advisors from participating and collecting a success fee of any kind and in some cases no fees at all. The registered brokers have added cost and compliance issues that drive up cost and they will not take a risk on smaller transaction. This frame work makes it difficult for many to get in the game of raising capital.

Ashton Consulting Group believes there is a larger issue at hand that many (those looking for capital) do not want to talk about or admit... “If you cannot afford the process you most likely will not be successful in the process”. It is not a simple task to raise capital and there are no silver bullets. It takes time and resources to put together the right package and to locate the right investor. In today’s environment it is too expensive for Small and Medium Enterprise (SME) to raise capital.

30 years ago there where angel investors, 20 years ago they tried to organize to be more efficient and today they are more fee generation then angel investing. Venture Capital has always been in short supply but over the decades they have been institutionalized, becoming higher priced quasi banks or Private Equity Groups and I am sure people you have heard the term Vulture Capitalist. The Broker Dealer (syndicators) community has all but withdrawn from the SME market place for fear of liability.

Years ago an Angel investor would be a great source of private funding. They would take you under their wing, help you structure and raise capital, and become a partner in the process while risking their own capital. The entrepreneur would invest hard work and sweat. The market needs this type of model. It was unlikely to return until we developed “The New Angel”.

In today’s market a new model needed to be created. Ashton Consulting Group allows the SME to access capital (that is cost effective) and that is workable in the current regulatory frame work. The process of raising capital always takes a little time, but our approach will strengthen your company and make access to capital smarter and easier. Whether we like it or not, or can afford it or not, the cost of raising capital is outside the reach of many in need of capital and we fear the cost in many ways will be going up for many.

## What are typical funding sources for entrepreneurs?

- **Friends and Family**
  - Friends and family are often the best place to start, because you'll often benefit from friendly terms and the least amount of administrative requirements.
- **Banks**
  - Banks have long been a staple of small business lending. If you decide to go this route, prepare an airtight business plan and always have a back up funding source in mind. According to FDIC data, small business loans have declined 39 percent since 2007.
- **Angel Groups**
  - Angel investors are a great source of capital, if you can find them. These angels are often wealthy individuals or small groups in search of ways to grow their personal assets.
- **Venture Capital Groups**
  - More formalized in structure and investment strategy than angels, venture capital firms will have specific and targeted investment goals. Do your research before approaching any of them to understand their investment strategy and market focus. When working with VCs, be prepared for a hands-on addition to your board and a potentially significant dilution of equity.
- **Alternative Sources**
  - The first, known colloquially as “crowdfunding,” would allow small businesses for the first time to solicit funds over the Internet from individual investors. However, the more investors you have, the more you may have to “herd cats” to get any decision approved.
  - Also emerging is the possibility for small businesses to use advertisements to attract wealthy investors. The problem with this approach is the inherent passivity of advertising. You don't know who, if anyone is going to answer that ad

## Who can legally raise money by selling securities?

Only a Registered Broker or Dealer is licensed legally to Solicit Securities.

A broker is defined as “any person engaged in the business of effecting transactions in securities for the accounts of others. In contrast, the federal securities laws do not specifically define the term “finder.”

Although, the federal securities laws have no formal definition of a finder, the SEC has indicated it considers various factors when deciding whether a finder has violated the securities laws by failing to register as a broker or dealer. According to case law and SEC no-action letters, the following facts are typical of finders who would not need to register as brokers or dealers:

- Introduces investors to issuers or their promoters without further involvement in discussions between the issuer and the investor(s) and without giving advice on the investment's structure or suitability;

- Receives compensation for making introductions and the compensation is not tied to the success of the capital raising (i.e. not a commission);
- Assists in transactions that convey all of a business's equity securities or assets to a single purchaser or group of purchasers; and
- Does not assist purchasers with obtaining financing, other than providing uncompensated introductions to third-party lenders or help with completing the paperwork associated with loan applications.

The following factors are typical of broker activity where the person involved would need to be a registered broker-dealer:

- Participates in discussions and negotiations between the issuer and the potential investors;
- Assists in structuring transactions;
- Receives transaction-based compensation, i.e., a commission or some form of compensation that varies with the size or type of the resulting investment;
- Engages in "pre-screening" potential investors to determine their eligibility to purchase securities;
- Engages in "pre-selling" the issuer seeking financing to gauge the level of interest;
- Conducts or assists with the sale of securities;
- Provides advice regarding the value of securities;
- Locates issuers on behalf of investors;
- Solicits new clients; Disseminates quotes for securities or other pricing information;
- Actively (rather than passively) finds investors;
- Is in the business of selling securities;
- Sends private placement memoranda, subscription documents, and due diligence materials to potential investors;
- Advises on portfolio allocations to accommodate an investment;
- Provides analyses of potential investments;
- and Provides potential investors with confidential information identifying other investors and their capital commitments.

As these lists demonstrate, there is very little that a finder may do without becoming a broker-dealer required to register. No factor alone will determine whether a finder should register as a broker-dealer; all existing factors are considered together in making such a determination. Nevertheless, some factors may carry more weight than others. One of the factors that appear to draw attention from the SEC is the existence of transaction-based compensation, which often signals that the individual is more involved in the transaction than simply making introductions. In connection with its recent orders discussed above, the SEC stated that "the federal securities laws require that an individual who solicits investments in return for transaction-based compensation be registered as a broker."

The compensation of an un-registered Third-Party Marketer (Finder) cannot be tied to the success of a capital raise. Over the years, the SEC has made it clear that paying a finder a fee based on the amount of capital he or she is responsible for bringing to the fund or company is strictly prohibited. The safest course is to pay the finder a fixed fee regardless of the outcome of his or her efforts.

## **Who may the Third Party Marketer (TPM) or finder introduce?**

The finder should only contact individuals and entities to whom he has a bona fide pre-existing relationship and he reasonably believes are “accredited investors”.

## **What is the consequence to the company if done improperly?**

Using an unregistered finder to help fund a deal poses significant risks to both parties involved. The issuer will face regulatory action by the SEC and state authorities, and may face private actions by investors for damages or to rescind their investments. Using an unregistered finder will call into question reliance on the Regulation D private placement exemption and because Section 25501.5 allows investors to rescind investments procured through the use of unregistered finders, the funds raised will be at risk during the statute of limitations period. The contingency created through the rescission right also causes accounting troubles. Finally, if the investors demand a legal opinion to close the transaction, the issuer will also have a hard time convincing counsel to issue one.

Using an unregistered finder will also jeopardize future efforts to raise capital. A common sanction sought by the SEC against issuers utilizing unregistered finders is to bar the issuer from conducting Regulation D offerings in the future. This, of course, could have a lethal effect on a start-up company dependent on private capital. In addition, some regulators have at least informally advised issuers that the use of non-exempt finders will render the company liable as aiders and abettors of securities law violations under Section 20(e) of the Securities Exchange Act of 1934. For emerging growth companies planning to tap the public markets in the future, these issues will at best be spoilers during the road show presentations to large banks.

The consequences to the finder also are severe. If a finder's activities do not fall within the exemption from registration, his or her agreement with the issuer will be wholly unenforceable in court. As a result, the finder has no way to enforce payment by the issuing company and may not be compensated for his or her services. In addition, non-exempt finders are susceptible to civil and criminal penalties under both federal and state law.

## **How can an employee help a company raise capital lawfully?**

Under certain conditions, a company can permit its employees to help it raise investment capital without triggering the broker registration requirements. For example, the SEC's Rules allow an

employee, officer or director of a company to participate as a finder in a private offering provided that the employee:

- is not considered by the SEC to be a securities industry "bad boy";
- does not get paid commissions in connection with the offering;
- is not an associated person of a broker or dealer at the time of his participation;
- performs a job for the company other than in connection with the company's offering (i.e., marketing or customer relations);
- was not within the last year a registered broker; and
- does not participate in the company's securities offerings more than once every 12 months (with certain restrictions).

Keep in mind, that each state has its own set of regulations that may differ from federal regulations. For example, in some states only officers and directors of a company are permitted to engage in the sale of securities.

## What is Regulation D exemption?

First, a Regulation D offering accompanied by a Private Placement Memorandum should be prepared by a securities attorney that is experienced in matters of filing Regulation D offerings with the Securities Exchange Commission and the appropriate State Securities departments. Improperly filing your documents could be catastrophic to your fund raising future.

Rule 506 of Regulation D is a "safe harbor" for the private offering exemption, assuring issuers that they are within the Section 4(2) exemption if they satisfy the standards within the rule. The criteria for reliance upon the Rule 506 exemption from registration are that the offering be made without any means of "general solicitation"; that the offering be made to no more than thirty-five persons who are not "accredited investors"; that each non-accredited investor be financially sophisticated (that is, has such knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the investment); and that if the offering is made to any non-accredited investors, the same detailed disclosures required in comparable public offerings be made to them.

Blue-sky compliance (meaning the securities law compliance in each state where the securities are offered or sold) for Rule 506 offerings was simplified by the National Securities Markets Improvement Act of 1996 (NSMIA), Section 18(b)(4)(D) of the Securities Act of 1933, which preempts a state's registration requirements with respect to securities being offered and sold under Rule 506 of Regulation D. States are permitted only to (i) require a notice filing from the issuer, (ii) impose a filing fee, and (iii) require the issuer to consent to service of process in the state. In accordance with NSMIA, each state generally requires an issuer that offers and sells securities in its state pursuant to Rule 506 to submit the following materials within fifteen days after the first sale of securities in that state in order to qualify for an exemption from registration:

(a) an executed copy of Form D Notice of Sale of Securities, (b) an executed copy of Form U-2 Uniform Consent to Service of Process, and (c) a filing fee. A Form D must also be filed with the SEC.

## Summary

Please proceed with caution. If you are unsuccessful raising capital through the traditional means outlined in the document, do not resort to Third Party Marketers or Finders. Ashton Consulting Group, LLC is what the SME entrepreneur has been looking when raising capital. We're a different kind of angel.

We are fully compliant and capable of raising capital in a very unique and targeted way. Aligning your company with us will generate the capital you need and keep ownership of your company in your hands and it will all be done legally. [Contact Us](#) for more information today.