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WBS BUSINESS LAW DIGEST

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New Flexibility in Raising Capital

Now that the SEC has progressed in implementing rules authorized in the 2012 Federal JOBS Act, companies have been provided with greater flexibility in their private fundraising strategies.

GENERAL ADVERTISING

Prior to these revisions to Regulation D, non-publicly traded companies were prohibited from generally advertising their private placements. Pursuant to new revisions to Rule 506 of Regulation D which became effective on September 23rd, private funds may now advertise in any media, provide greater accessibility to their fundraising websites, speak at seminars, and use social media. The most significant catch is that investments may only be accepted from "accredited investors" who satisfy specified income or asset levels.

Additionally, unlike past practices where private funds often relied on an investor's completion of a suitability

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Not all LLC's are Created the Same

Before beginning the adventure of a new business venture, owners should make sure that they step off on the right foot and make certain that the vehicle they use for the business is working the way they expect. More and more often, owners are choosing to use a limited liability company (LLC) structure for their business. There are plenty of good reasons for doing so but there may be unexpected consequences in determining what state's laws will apply to your LLC. Here in Illinois, our clients often choose between using Delaware or Illinois LLCs. This decision may impact decision making authority, operational costs, liability, and creditor protection.

As a general point, Delaware LLCs tend to allow owners greater freedom in their organizational agreements, while Illinois LLCs often provide greater protection to owners who control less than fifty percent of the company, known as minority owners. A carefully prepared operating or limited liability company agreement can modify many of the default laws provided in Illinois and Delaware to combine some of the more attractive features from each state; although, as we will note below, some of the provisions cannot be modified.

CONTROL

In both Delaware and Illinois, the owners can organize the LLC so that it is managed either by the members or by one or more managers. In Illinois the organizational document must specify whether the LLC will be managed by its members or managers, while in Delaware, the default position is that the LLC will be member-managed.

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questionnaire, a fund may no longer rely solely on an investor's representation as to their income or assets. Instead, the fund must take reasonable steps to verify that the investors are in fact accredited. While the new rule states that the reasonableness of income and asset verification steps will depend on the facts and circumstances of the particular investor and the transaction, the rules do provide the following non-exhaustive list of methods that can be used to verify investor suitability:

1. Review of IRS filings to verify income;
2. Review of bank statements and an investor's written representation to verify net worth;
3. Review of written accreditation verification from a registered broker-dealer, an SEC-registered investment adviser, a licensed attorney or a certified public accountant; and
4. A method for verifying the accredited investor status of persons who had invested in the issuer's Rule 506(b) offering as an accredited investor before September 23, 2013 and remain investors of the issuer.

The SEC has also proposed additional modifications to the rule which would require companies to include certain disclosures in their general solicitation materials, indicating that the SEC is not yet done with its revisions to Regulation D.

CROWDFUNDING

Crowdfunding, or the use of online portals to raise up to one million dollars per year, will soon provide another fundraising option for privately held companies as a result of the SEC's October 23rd issuance of proposed crowdfunding rules. Unlike the general advertising changes discussed above, the crowdfunding rules would allow private funds to accept investments from all investors, regardless of whether or not they are accredited.

In an attempt to protect investors, the SEC's rules limit the amount crowdfunding investors may invest based upon their income and assets. For instance, over the course of a year, an investor earning less than \$100,000 in annual income may only invest the greater of \$2,000 or 5% of their annual income or net worth;

while an investor with income greater than \$100,000 is limited to investments totaling 10% of their net worth or income. Investors are also prohibited from reselling their crowdfunding investments for one year.

Limitations will also be placed on the funds. The companies must disclose to the SEC, potential investors, and the crowdfunding portals information regarding:

1. Officers, directors and owners of 20% or more of the company;
2. The company's business and how the company is going to use the raised funds;
3. The price of securities offered;
4. The target offering amount and deadline to reach that amount, and whether the company will accept investments in excess of that amount;
5. The company's financial condition; and
6. The company's financial statements, including audited statements of companies seeking to raise more than \$500,000.

These disclosures would have to be updated with any material changes and also updated upon reaching the target offering amount. Annual reports will also need to be filed with the SEC and made available to investors.

Finally, crowdfunding will only be allowed to be offered online through an SEC registered broker-dealer or crowdfunding portal. These investor access points will be required to provide investors with informational materials about the companies, implement measures to reduce the risk of fraud, and provide investor forums to discuss offerings. The intermediaries will be prohibited from offering investment advice or recommendations, soliciting purchases or offers, and holding or handling investor funds or securities.

The new opportunities for private placements are intended to ease some of the burdens of the difficult process of raising capital. Please contact us if you would like to discuss how your company could take advantage of these changes. ❖

An Illinois member-managed LLC provides the members with equal management rights and majority rule over most day to day decisions. On the other hand, a Delaware member managed LLC provides the members with control based upon their percentage interest in the LLC's profits. Therefore, by default, a 25% owner of an Illinois LLC will have equal management rights with a 75% owner, while in Delaware the 75% owner will be able to control the daily operational decisions.

DISTRIBUTIONS

Just as was the case with control, unless an agreement provides otherwise, Illinois interim and final distributions must be made equally between the members regardless of their ownership percentages, while Delaware will allocate distributions based upon the owners' respective share of contributions to the LLC.

DEPARTURE OF A MEMBER

If a member wishes to leave an LLC prior to its dissolution, the state of organization will alter their rights to do so. In a Delaware LLC, a member may not resign from the company before dissolution. In Illinois, there is an unwaivable right for a member to resign from a member-managed LLC; although a member of a manager managed LLC may not resign prior to dissolution unless the operating agreement says otherwise.

When an owner leaves, the amount they may be paid for their ownership interest may also depend on the state's law that governs the entity. In Illinois, if the members disagree on a buyout price, the departing member can file a lawsuit and ask the court determine the fair value of their interest. Fair value is a valuation without a discount for a minority owner's ownership percentage. In Delaware, the determination is more cut and dry and measures the fair value based on the departing members' share of distributions. While Delaware seems less friendly to a departing member, a Delaware court typically does not reduce the fair value based on the illiquid nature of ownership in a privately held company unlike Illinois which can provide an illiquidity discount.

CORPORATE FORMALITIES

Unlike in Illinois where no corporate formalities,

such as meeting minutes, are required to be maintained in order to avoid a third party from holding an owner individually liable, Delaware has held in some situations that the failure to maintain these formalities does open the door to owners' individual liability for LLC actions.

REQUIRED PROVISIONS

Unlike in Delaware, there are a number of requirements that owners of Illinois LLCs cannot change by agreement. For instance, the operating agreements of Illinois LLCs can change all of the above noted provisions except:

Fiduciary Duties

In a key difference from Delaware, Illinois LLCs may not eliminate or reduce a member's fiduciary duties, although the owners may agree on specific types of activities that will not violate a fiduciary duty if they are not manifestly unreasonable. Delaware allows the elimination of all fiduciary liabilities, although in both Delaware and Illinois, an agreement may not limit or eliminate liability for behavior constituting a bad faith violation of the covenant of good faith and fair dealing.

Dissociation

Illinois operating agreements may not restrict the rights of a member in a member-managed company to resign from the company, except to the extent the agreement can provide for different buyout obligations if the member wrongfully resigns.

Dissolution

Illinois members may always apply for a court order to dissolve the LLC based on the unreasonable frustration of the LLC's economic purpose, a member's conduct making it impractical to continue doing business with that member, the impracticality of doing business in conformity with the LLC's operating agreement and articles of organization, the failure to purchase a member's interest when they resign, or oppressive conduct by the controlling members or managers.

Judicial expulsion of a member

Illinois members may also always apply to a court to remove a member from an Illinois LLC for engaging in wrongful conduct having a materially adverse effect on the LLC's business, willfully or persistently committing

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a material breach of the operating agreement or the member's fiduciary duties, or engaging in conduct relating to the LLC's business that prevents it from reasonably carrying on business with the member.

Books and records

Illinois LLCs must maintain specified books and records, and an operating agreement may not unreasonably restrict a member's access to the records.

ASSET PROTECTION

Finally, Delaware and Illinois provide different rights to creditors of LLC owners. If an owner of a Delaware LLC has a judgment entered against them individually, the creditor can have a court attach any funds that the owner is paid from the LLC. Illinois goes further though and allows creditors to have a court transfer the actual ownership of the LLC to satisfy a debt, in addition to attaching any proceeds the owner would be paid from the LLC.

There are therefore a number of important considerations business owners should carefully consider before beginning business that may vary depending on how much of an LLC they control and how they wish to be treated compared to their co-owners. The attorneys of Williams, Bax & Saltzman, P.C. have significant experience in evaluating these sometimes competing concerns and assisting owners with choosing the type of entity which best serves their needs. ❖

WBS Newsflash

CONGRATULATIONS TO THE WBS TEAM ON THE FOLLOWING RECENT ACCOMPLISHMENTS:

- ✚ WBS acted as tax counsel for a merger of international and domestic technology companies.
- ✚ WBS represented majority owners of privately held companies in negotiating favorable settlements of several litigated shareholder disputes.
- ✚ WBS represented a tenant in the negotiation of a Gold Coast commercial lease.
- ✚ Michael Weis has been recognized as a Leading Lawyer by LeadingLawyers Network in 2013.

This newsletter does not constitute legal advice of any kind. For information about the articles contained herein, or if you are seeking legal advice on any issue, please contact Williams, Bax & Saltzman, P.C. at 312-372-3311, and allow us to see how our services can meet your needs. All rights reserved.