



CROWDFUNDING FOR THE ENTREPRENEUR

**A Guide for Small Businesses
in Michigan**

**AUTHORED BY
MICHIGAN COMMUNITY RESOURCES
CROWDFUNDING LEGAL TEAM**

**MADE POSSIBLE BY THE GENEROUS SUPPORT OF
THE MICHIGAN STATE BAR FOUNDATION**
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DISCLAIMER

THIS GUIDE PROVIDES BASIC INFORMATION FOR SMALL BUSINESSES AND ENTREPRENEURS ABOUT FEDERAL AND MICHIGAN LAWS AND TOPICS RELATED TO CROWDFUNDING. THIS GUIDE IS A BRIEF PRIMER ON THE TOPIC AND SHOULD BE USED FOR INFORMATIONAL PURPOSES ONLY. NOTHING IN THIS GUIDE CONSTITUTES LEGAL OR FINANCIAL ADVICE.

“CAPITAL” REFERS TO THE FUNDS AND FINANCIAL RESOURCES THAT ARE CRITICAL TO STARTING AND RUNNING ANY BUSINESS. BEFORE YOU START ANY CAPITAL RAISING EFFORT, YOU SHOULD CONSULT WITH A KNOWLEDGEABLE ATTORNEY.

RAISING CAPITAL, IN MOST CIRCUMSTANCES, REQUIRES COMPLYING WITH STATE AND FEDERAL SECURITIES LAWS. SECURITIES LAWS CAN BE COMPLICATED AND FAILURE TO COMPLY WITH SECURITIES LAWS CAN EXPOSE BOTH YOU AND YOUR BUSINESS TO SIGNIFICANT LIABILITY. AN EXPERIENCED ATTORNEY CAN HELP YOU AND YOUR BUSINESS AVOID THE COMMON PITFALLS THAT CREATE RISK AND LIABILITY WHEN RAISING CAPITAL.

WE ENCOURAGE YOU TO DO YOUR OWN RESEARCH AND MEET WITH THE FINANCIAL AND LEGAL PROFESSIONAL OF YOUR CHOOSING PRIOR TO ENGAGING IN CROWDFUNDING.


IF YOUR NONPROFIT ORGANIZATION HAS A SPECIFIC QUESTION OR LEGAL NEED, PLEASE CONTACT MICHIGAN COMMUNITY RESOURCES OR CONSULT WITH YOUR ATTORNEY.

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TO FIND MORE RESOURCES THAT CAN HELP BUILD STRONG ORGANIZATIONS, VISIT





CROWDFUNDING FOR THE ENTREPRENEUR

A GUIDE FOR SMALL BUSINESSES IN MICHIGAN

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About The Michigan State Bar Foundation



The Michigan State Bar Foundation provides leadership and grants to improve access for all to the justice system, including support for civil legal aid to the poor, law-related education, and conflict resolution. The Michigan State Bar Foundation was established in 1947 by lawyers and judges to help the legal profession meet its responsibilities to the public. Since then, the Foundation has made more than 1,817 grants totaling over \$180 million to educate the public about the importance of the rule of law, train young people in peaceful conflict resolution and assist those in need with critical civil legal services.

Michigan State Bar Foundation

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About Michigan Community Resources



The mission of Michigan Community Resources is to support and empower nonprofit community-based organizations working in low-income communities, with an emphasis on community and economic development, by providing pro bono legal services and technical assistance. Originally known as Community Legal Resources, we grew from a legal service provider for nonprofits to a comprehensive support organization for low-income communities in Michigan. We provide the legal, community organizing, and urban planning skills and resources that community-based organizations and low-income communities need to revitalize and thrive.

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PREFACE

THANK YOU
FOR READING
“CROWDFUNDING FOR
THE ENTREPRENEUR:
A GUIDE FOR
SMALL BUSINESSES
IN MICHIGAN.”

We are glad for your interest and hope this guide assists you in deciding whether crowdfunding is right for you. Before you read, please be aware of the following comments and limits on the scope of this resource.

This guide is intended to provide entrepreneurs and small business owners with information on some of the legal issues surrounding investment crowdfunding. This is an educational resource and should not be considered business or investment advice.

Crowdfunding may be a potential tool to reduce economic barriers to development in distressed communities that are often overlooked by traditional lenders. It can help small businesses raise seed money and nonprofits fund campaigns to power programs and community projects. But there are risks that prospective crowdfunders must consider, in particular with regard to investment crowdfunding.

Crowdfunding is an area that is rapidly changing. There are frequently new resources, tools, laws, and regulations that impact how crowdfunding works. No matter how recently you are reading this guide after it is published, we encourage you to do your own research. Thoroughly review the glossary to better understand the concepts introduced here and fully investigate the resources provided on our Crowdfunding Resource Page to learn more. Meet with the crowdfunding financial, investment, and legal professionals of your choosing to determine the best path and the appropriate tools for you.

CROWDFUNDING BASICS

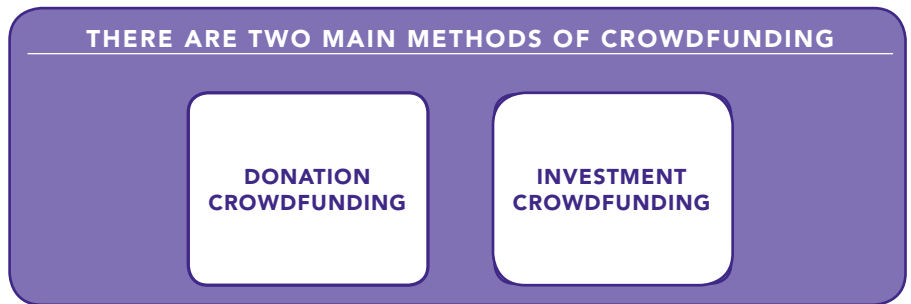
WHAT IS CROWDFUNDING?

Crowdfunding is a capital-raising and fundraising tool that allows a group of people (the “crowd”) to gather small, individual contributions to build a larger pool of funds to support a cause, project, or business.

The main advantage of crowdfunding is that it lets you reach an unlimited number of potential investors or donors through the internet, social media, or other forms of marketing.

Crowdfunding is often conducted through an **online portal**. The portal helps by:

- Making it easier for potential investors or donors to find businesses or organizations looking to raise capital;
- Giving businesses and organizations a platform to provide information to many investors or donors at once; and
- Processing the investments or donations that a business or organization receives.



TYPE OF CROWDFUNDING	HOW DOES IT WORK?	WHO CAN CONTRIBUTE OR INVEST MONEY?	WHAT DO CONTRIBUTORS OR INVESTORS RECEIVE IN RETURN?
DONATION CROWDFUNDING	Sponsoring organization solicits outright donations from the public for a particular cause, project, or business.	Any interested individual, business or organization.	The donor may receive a token product or reward, or receive nothing other than the benefit of donating to a project the donor supports.
INVESTMENT CROWDFUNDING	Business offers to sell an ownership stake in the company or borrow money from investors that will be repaid with interest.	Anyone can participate in Michigan and federal crowdfunding, but only accredited investors can participate in accredited investor crowdfunding as explained below.	Investors receive either an ownership stake in the business or the right to receive repayment of the money loaned to the business plus interest.

DONATION CROWDFUNDING

Donation crowdfunding involves soliciting outright donations from the public for a cause, project, or business. The sponsoring organization may provide nothing in return but the fulfillment of donating to a worthy cause. Reward-based crowdfunding is a type of donation crowdfunding where people contribute online to an organization or business in exchange for a token reward or “prize,” often a sample product. Donation crowdfunding does not require compliance with state and federal securities laws. Donation crowdfunding has been available as a fundraising technique for many years.

When might I use donation crowdfunding?

Donation crowdfunding can fund almost any project. But it tends to work best for projects with modest capital raising needs from one-time donors and which appeal to individual local communities or groups of people with similar interests.

INVESTMENT CROWDFUNDING

Investment crowdfunding, on the other hand, allows businesses to raise capital from the public by either:

1. Selling an **ownership stake (“equity”)** in the business to investors; or
2. Borrowing money (**“debt”**) from investors that must be repaid either with a fixed rate of interest or as a percentage of revenue received by the business.

Investment crowdfunding requires compliance with state and federal securities laws. Investment crowdfunding has not been available to raise capital until recently.

/GLOSSARY TERMS/

Debt Interest: The right to repayment after a sum has been loaned, usually with a fixed or variable rate of interest.

Equity/Ownership Stake: The portion of a business owned by an investor which is accompanied by certain economic and legal rights.

TYPES OF INVESTMENT CROWDFUNDING IN MICHIGAN

MICHIGAN
CROWDFUNDING

FEDERAL
CROWDFUNDING
(NOT CURRENTLY
AVAILABLE)

ACCREDITED
INVESTOR
CROWDFUNDING

When might I use investment crowdfunding?

Investment crowdfunding tends to work best for businesses seeking long-term investors to start a new business or expand an established business where the capital needs are greater and where other forms of capital raising through banks, friends, and family are no longer sufficient to provide the needed funds. For example, small businesses located in communities that do not traditionally attract private development may be able to fund projects by soliciting investment from local businesses, residents, and organizations directly using an online investment crowdfunding portal.

/GLOSSARY TERMS/

Accredited Investors include each of the following:

- Individuals with a net worth of \$1 million, excluding his or her residence
- Officers and directors of the company or organization seeking investment and certain entities with more than \$5 million in assets
- Individuals with an income of \$200,000 a year (or \$300,000 for married couples)

Non-Accredited Investor: An investor who does not meet the financial or asset criteria to make investments as an Accredited Investor.

Intermediary: An electronic medium or person which provides information on projects seeking funding and which collects and transfers investor funds to these projects.

WHAT IS NEW ABOUT INVESTMENT CROWDFUNDING?

Before 2013, a business that wanted to raise capital through the sale of its equity or debt could not use the internet or social media to find investors. Most “capital raises” funding businesses were limited to accredited investors. Non-accredited investors had limited opportunity to participate in such capital raises. And most alternative ways to raise capital involved expensive and complicated registration with state and federal government agencies.

Starting in 2013, the **Jumpstart our Business Startup Act (“JOBS Act”)** permitted the use of general solicitation of investors through crowdfunding internet portals and social media. The JOBS Act allows non-accredited investors to participate in many crowdfunding offerings. This change was intended to open up greater opportunities for nontraditional (e.g., non-accredited) investors to invest in small businesses.

WHAT ARE THE OPTIONS FOR INVESTMENT CROWDFUNDING IN MICHIGAN?

There are three ways to raise capital in Michigan through investment crowdfunding.

The first two ways, **Michigan crowdfunding** and **federal crowdfunding**, are forms of investment crowdfunding in which any investor may participate. The third is **accredited investor crowdfunding**, which is the most flexible form but only accredited investors may participate.

WHEN CAN A BUSINESS USE EACH TYPE OF INVESTMENT CROWDFUNDING?

Michigan Crowdfunding

Through the Michigan Invests Locally Exemption Act (**MILE Act**), a business can raise capital through investment crowdfunding if it meets the following criteria.



Any Michigan resident can invest through Michigan crowdfunding, but there are limits on how much money an individual investor can invest. There also are limits on the amount of money a business or organization can raise in any 12-month period. In addition, the business must make filings with the State of Michigan and provide certain information (“**disclosures**”) to investors about the business. To ensure the investment opportunity is offered only to Michigan residents, most Michigan crowdfunding offerings are done through an internet portal that can confirm that interested investors are Michigan residents.

FEDERAL CROWDFUNDING (NOT CURRENTLY AVAILABLE)

Federal crowdfunding, unlike Michigan crowdfunding, will allow solicitation of **non-accredited investors** across state lines. That means that businesses can attract investors online outside of Michigan. The rules and limitations for federal crowdfunding have been proposed, but not yet approved, so federal crowdfunding is not yet available to raise capital. It is currently expected that federal crowdfunding will be approved by federal regulators in late 2015.

Anyone can invest through federal crowdfunding, but there are limits on the amount of money an individual investor can invest. There are also limits on the amount of money that a business may raise in any twelve-month period. Under the current proposed rules, federal crowdfunding must be conducted through an **intermediary**: either a **registered broker-dealer** or a **registered online funding portal**. The business must also make certain filings with federal regulators and provide certain disclosures to investors.

ACCREDITED INVESTOR CROWDFUNDING

Accredited investor crowdfunding requires all investors to qualify as **“accredited investors.”** The business raising the capital must take reasonable steps to verify that all investors are accredited. Accredited investor crowdfunding offers the same ability to reach investors through the internet or social media as Michigan or federal investment crowdfunding and has fewer overall limitations.

So long as all investors are accredited, the business can advertise the capital raise on the internet, social media or in any other manner. There are no limits on the amount of money an individual investor can invest and no limits on the amount of money a business may raise.

SHOULD I USE INVESTMENT CROWDFUNDING TO RAISE MONEY FOR MY BUSINESS?

There are pros and cons to any method of raising capital, including investment crowdfunding. Consider the different ways to raise capital and choose the one that best fits your current circumstances. Investment crowdfunding is not for everyone. However you choose to raise capital, **work with a knowledgeable attorney** who is experienced in raising capital.

It is very important that entrepreneurs undertaking a capital raising effort, whether pursuing traditional business fundraising or investment crowdfunding, consult a knowledgeable attorney to assist the business in meeting securities compliance rules and obligations.

COMPARISON OF INVESTMENT CROWDFUNDING METHODS

	MICHIGAN CROWDFUNDING	FEDERAL CROWDFUNDING (NOT CURRENTLY AVAILABLE)	ACCREDITED INVESTOR CROWDFUNDING
WHAT IS THE LIMIT ON AMOUNT OF CAPITAL RAISED?	<ul style="list-style-type: none"> • \$2 million every 12 months with audited or reviewed financial statements. • \$1 million every 12 months without audited or reviewed financial statements. 	<ul style="list-style-type: none"> • \$1 million per 12 months with audited financial statements. • \$500,000 with reviewed financial statements. • \$100,000 if neither audited nor reviewed financial statements are provided. 	No limit.
WHAT IS THE LIMIT ON THE NUMBER OF INVESTORS?	No limit.	No limit.	No limit.
WHAT IS THE LIMIT ON INVESTOR TYPE?	Michigan resident only.	Any investor.	Accredited investor only.
WHAT IS THE LIMIT ON THE TYPE OF ISSUER (SPONSORING COMPANY/ ORGANIZATION)?	Private Michigan entity.	Private US entity.	Any company.
IS THERE AN INVESTMENT LIMIT?	<ul style="list-style-type: none"> • Yes. Investment limit of \$10K for non-accredited investor. • No limit on investment by an accredited investor. 	<ul style="list-style-type: none"> • Yes. If investor's income/net worth is below \$100K, investment limit is the greater of \$2,000 or 5% of annual income/net worth. • If investor's income/net worth is above \$100K, 10% of income/net worth up to \$100K. 	No limit.

COMPARISON OF INVESTMENT CROWDFUNDING METHODS

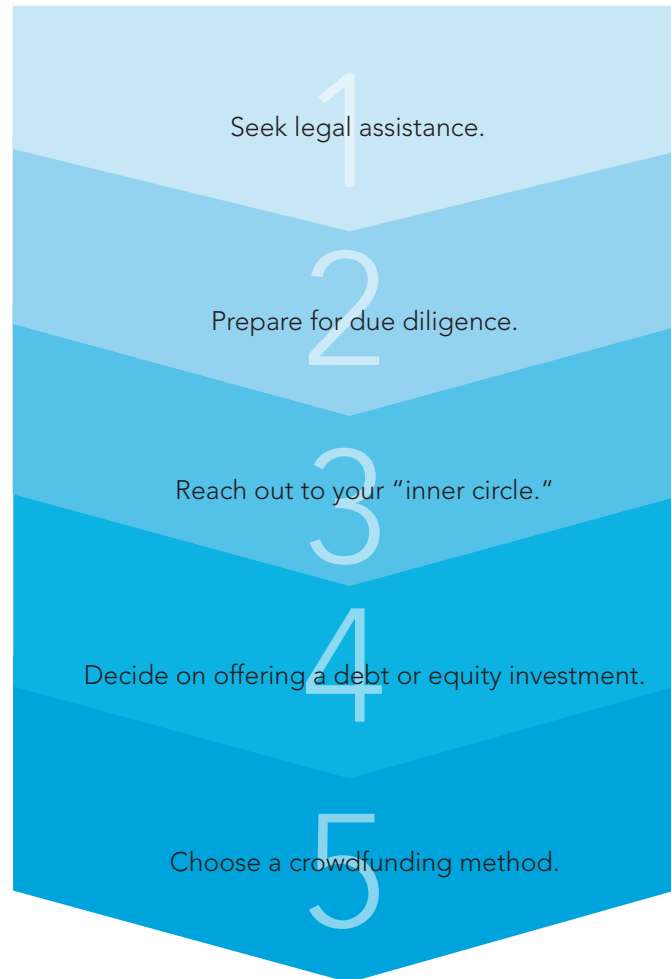
	MICHIGAN CROWDFUNDING	FEDERAL CROWDFUNDING (NOT CURRENTLY AVAILABLE)	ACCREDITED INVESTOR CROWDFUNDING
WHAT IS THE INFORMATION REQUIREMENT?	Disclosure Statement with specific requirements filed with Michigan's Department of Licensing and Regulatory Affairs ("LARA") 10 days before offering.	<ul style="list-style-type: none"> Offering Circular with specific requirements (including audited financials if greater than \$500K). Form C filed with SEC before commencement of offering and 21 days before first sale and provided to intermediary and investors; periodic updates required. 	Form D notice of offering filed with SEC after first sale. Some disclosure to investors may be necessary to address market or liability concerns.
IS STATE LAW COMPLIANCE REQUIRED?	Yes. Filing with LARA is required as described above.	No.	No.
IS ONGOING REPORTING REQUIRED?	Yes. A quarterly report to investors including disclosure of directors' and officers' compensation, discussion of business operations and financial condition of issuer. Michigan resident only.	Yes. File Form C-AR annual report with SEC, including financials meeting requirements in last offering circular.	No.
ARE THERE RESALE RESTRICTIONS?	Investor cannot resell an investment to non-Michigan resident within 9 months after initial investment.	Yes. Resale is limited during the first year.	Yes. There is a 1-year restriction for resale by non-affiliates but no restriction for affiliates.
ARE THERE RESTRICTIONS ON SOLICITATIONS?	General solicitation and advertising is permitted, but only to Michigan residents. Filings with LARA are required if offered via website, and ongoing conditions must be met.	Yes. The company cannot advertise the terms of the offering but may advertise the offering itself and direct investors to the intermediary .	General solicitation and advertising permitted if issuer reasonably verifies each investor is accredited or reasonably believes each investor is accredited.
IS AN INTERMEDIARY REQUIRED?	None required, but an internet platform often used.	Yes. The offering must be conducted through a single intermediary .	None required, but an internet platform is often used.

HOW DOES CROWDFUNDING WORK IN ACTION?

Case Study

Let's look at a hypothetical crowdfunding case study and see how an entrepreneur would get started.

/FIVE KEY STEPS FOR INVESTMENT CROWDFUNDING/



THE CASE OF BART'S DONUTS, LLC.

Homer Simpson of Springfield, Michigan loves donuts. He loves them so much, he started making them. Other people loved the donuts he made too, and he started selling them. Homer launched Bart's Donuts, LLC, named after his son, who is the pride and joy of the family. Homer used personal funds to perfect his recipes, build his brand, and sell the donuts out of a pop-up at Moe's Tavern. While the pop-up sales were going well, he really wanted to expand Bart's Donuts into a full brick and mortar donut shoppe.

Homer determined he would need \$100,000 to pay for building out the shoppe and keeping the business going. Given his connection to the community, Homer wants to let the folks who support his business have the chance to invest in it. He has not had much luck trying to get a loan at the local bank. With that in mind, Homer thinks crowdfunding is the way to go. Homer diligently gets started on his first step.

Step 1: Seek Legal Assistance from an Experienced Attorney

Homer goes to see Lionel Hutz, a business and securities lawyer, for help with his capital campaign. Homer retains Lionel to supervise how Bart's Donuts will meet its legal obligations, conduct **due diligence** and maintain compliance with state and federal regulations. Due diligence is the process by which potential investors are able to examine all the information necessary to make an informed investment decision.

Lionel will make sure:

- The business is properly organized or incorporated;
- His fundraising efforts are legal; and
- Homer's relationship with investors is fair and minimizes risk.

ROLE OF THE CROWDFUNDING ATTORNEY

- Organize and incorporate the business
- Guide entrepreneur through the process of meeting business and securities compliance rules and obligations
- Advise entrepreneur in business dealings to ensure relationship with investors is fair
- Advise entrepreneur in business dealings to minimize risk and liability

/QUESTIONS TO ASK WHEN HIRING A CROWDFUNDING ATTORNEY/

- What financial limits are placed on the type of deal I'm doing?
 - Limits on the amount I can raise
 - Limits on the amount an investor can invest
 - Limits or requirements related to the financial status of an investor
- Is there anything about the deal that will affect or limit what I might be able to do with my business in the future? These issues can be the result of something in the laws and regulations governing the deal, or they can result from the relationship the business has with its investors.
 - Issues relating to how I spend the money I've raised
 - Issues relating to how/when/where I might expand my business
 - Issues relating to raising more capital in the future
- Are there other legal issues in this deal that will require another, possibly specialized attorney?
 - Tax
 - Estate planning (even if I'm not rich, I still have an "estate")
- And of course always have a frank discussion about the attorney's fee structure—and there's no such thing as a stupid question. Attorneys are just as interested in having total clarity about fees as you are!

Step 2: Prepare for Investor Due Diligence

- Assemble all information about the company's ownership and management.
- Assemble all information about the company's existing operations, if any.
- Create a detailed description of the company's plan for raising money and spending the money it's going to raise.
- Generate a description of all the risk factors affecting the investment, both as a result of the company's business risks as well as risks associated with the type of investment being offered.
- Discuss whether there is any litigation pending or threatened against the company.

Homer's not the most patient guy. In the middle of wolfing down a Glazed Gut Bomb Special (sure to be his best seller), Homer tells Lionel to start drafting up the documents so he can get started asking for money. Lionel admonishes Homer to chew a bit more carefully and put on the brakes—there's **due diligence** ahead. Due diligence is the process by which potential investors are able to examine all the information necessary to make an informed investment decision.

Technically, Lionel advises, the investors are the ones "conducting" due diligence. But the fact is, it's the company's responsibility to make all the important information readily available to prospective investors. Moreover, Lionel reminds Homer that potential investors "don't know what they don't know", so it's the company's responsibility to identify all issues and risks that could be relevant to the investment, including things the investors wouldn't know to ask about. Lionel tells Homer that he's going to have to share a lot of information through the process of "disclosure" and that disclosure cannot "make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."

Homer's last bite immediately lodges in his esophagus, working its way down only after hearty chest-punch and a swig of warm beer. He manages to squeal "English, Lionel, English." Lionel comforts Homer, "okay, let's just focus on gathering all the information we possibly can about you, the company and the proposed deal and we'll go from there. You have a solid business plan, so that's a great place to start."

/GLOSSARY TERMS/

Due Diligence: Research performed on a business entity to evaluate its potential as an investment; "due diligence" includes reviewing financial statements, pending litigation, and discussions with management to assess the long - term viability of the business and risk.

Step 3: Reach out to the “inner circle” of potential investors

- Reach out to family and friends to invest in your company.
- Draft clear and accurate investment documents to outline the terms of your agreements, even with family and friends.

Homer plans to ask his closest friends and family to invest first, before approaching the broader community. Most new business owners approach friends and family for casual “handshake” investments.

Homer seeks Lionel’s advice on how to approach raising funds for the business. Lionel tells Homer to be cautious in his financial dealings with family and friends. It is important to have good documents that spell out the nature and terms of the investment, even with friends and family. In fact, Lionel says, good investment documents may be *more important* among friends and family. These documents clearly explain everyone’s responsibilities and how disputes will be resolved. Laying out clear terms at the outset can save relationships down the road.

Homer takes note of Lionel’s advice and turns his attention to the question of what type of investment he should use to raise business capital.

Step 4: Decide if your business should offer a debt or equity investment

RAISING BUSINESS CAPITAL WITH DEBT

If Homer chooses debt, Bart’s Donuts will be taking out a loan. This means the company will owe its lender (or in the case of crowdfunding, lenders) the amount it borrows (plus likely some interest). Loans can be set up in a variety of ways.

Fixed interest rate loan

The loan might have an **even amortization**, meaning that there is a **fixed interest rate** and the same payment amount each pay period (for example, monthly). As the loan is paid down, a bigger portion of each payment will go towards the principal, and a smaller portion will go to interest.

Variable interest rate loan

The loan could have a **variable interest rate** instead. This is where the interest paid on the loan varies according to a formula to which the parties agree. Homer might get to delay when payments on the principal are due, or have some flexibility in payments. He might even be able to structure payments based on the donut shoppe’s revenues.

Collateral loan

There may be **collateral** for the loan, meaning that if the company fails to make its payments, the lenders can take some of the company’s assets.

Whichever option he chooses, **Homer sees that if he uses debt crowdfunding, Bart’s Donuts will need to repay a loan, likely with interest.**

Bart’s will have to repay the loan even if the business is not profitable. But, Homer likes the fact that he will not have to share ownership of his business. Homer also likes the fact that his relationship with the lenders is temporary. Once the loan is repaid, the lending relationship is over.

RAISING CAPITAL WITH DEBT

PROS & CONS



- Business owner will not share company ownership with investors.
- Business relationships with investors will be short-term.
- Business will have to repay loan even if the business is not profitable. Depending on the terms the business may have to start repaying loan quickly, if cash flow is an issue.

RAISING CAPITAL WITH EQUITY

PROS & CONS



- Investors will share business risk with the business owner.
- Since equity investors are usually paid out of profits, equity usually puts less stress on a business's cash flow.
- Investors will receive an ownership stake in the business.
- Investors will be part of the company and possibly decision making for a long term period.
- If investors don't want a permanent relationship, the deal terms may need to provide for some type of "exit," which can be a challenge to think about at the beginning.

RAISING BUSINESS CAPITAL WITH EQUITY

If Homer chooses equity, he will give his crowd investors some ownership in his business. Equity investors will share the business risk with Homer.

Investors will only get paid when the business is profitable. Each investor in the business will get paid as a partner, which generally means the investor will get a **distribution** of the profits based on how much of the company he or she owns. Homer likes that equity investors will share the business risk with him, but he also recognizes the drawbacks.

First, as Lionel explains, equity can be complicated. Homer will need a formula to determine how much of the business the investors' \$100,000 "buys," meaning he'll have to come up with a dollar value stating how much the business is worth. That can get sticky, particularly with crowdfunding, as there will be minimal negotiation and discussion between Homer and his investors. Equity relationships also are more likely to be permanent, or at least long-term, than lending relationships.

There are different ways Homer can set up the equity capital raise. Each equity investor will own a part of Bart's Donuts. But this does not necessarily mean they will have input or control over Homer's business decisions. Lionel advises Homer that, as with debt, equity fundraising can be accomplished many different ways:

A deal may be structured to create different classes of owners; some who get paid first out of profits and others who get paid last. Lionel notes that it is common for the **general partner** (in this case, Homer), to retain company control and get the biggest share of profits, but for the **limited partners** (in this case, the crowd investors) to get paid first.

Homer recognizes that **the defining characteristic of equity is that the crowd investors will receive a piece of ownership in his company**, sharing in the company's upside and downside, and they will likely be around for a while.

RAISING CAPITAL WITH REVENUE SHARING

While equity and debt are basically the two forms of investment available, Lionel mentions to Homer that he could do a "Revenue Share", which is a kind of combination of the two. Basically, under a revenue share model, Bart's Donuts would take on its \$100,000 investment and agree to pay investors some fixed percentage of its revenues until the investors are repaid some pre-determined multiple of their original investment.

For example, Bart's Donuts might pay investors 5% of its gross revenues every quarter until the investors receive 1.5 times their investment, or \$150,000. If Bart's outperforms expectations, the investors get their \$150,000 more quickly (meaning a higher rate of return); if Bart's revenues lag, investors will get their \$150,000 over a longer period of time (a lower rate of return). Revenue sharing arrangements have to be put together carefully, but Lionel points out to Homer that they contain some of the best features of both debt and equity. "Like those Cro-Nuts we're looking to sell," adds an intrigued Homer, "the best of a croissant and a donut, rolled into one. You gotta try one, Lionel."



Step 5: Choose a crowdfunding method

Homer wants to raise \$100,000 from a relatively large number of small investors. When a company solicits investments through **general advertisement**, it must typically register with the Securities and Exchange Commission (SEC). **General advertisement** means that the company makes information about the investment widely available to potential investors, instead of to a small group of personal contacts.

But Homer does not have the resources to register with the SEC. Registering with the SEC involves extensive and costly filings, fees and information sharing. To raise the money without SEC registration and fulfill his legal obligations, Homer needs to be very careful and strategic about how he proceeds.

Homer has several crowdfunding options that will allow him to avoid SEC registration. Homer will have to decide whether to raise funds through Michigan crowdfunding; from non-Michigan residents through federal crowdfunding, when available; or accredited investor crowdfunding.

OFFERING LIMITED TO MICHIGAN RESIDENTS - MICHIGAN CROWDFUNDING

Bart's Donuts is organized as a Michigan LLC, so it is an in-state entity. This means Bart's Donuts has earned all its money in Michigan and plans to spend all the money it raises in Springfield. So it could qualify for an "intrastate" offering, which is exempt from SEC registration.

Homer plans to pitch the Bart's Donuts investment to Michigan residents, so he may be able to raise the money using Michigan's MILE Act. The MILE Act requires crowdfunding campaigns to meet specific criteria.

IS BART'S DONUTS ELIGIBLE FOR MICHIGAN INVESTMENT CROWDFUNDING?

- Homer is seeking \$100,000, which falls within the dollar amount limits under MILE.
- Homer will use a registered online funding-platform approved by the State of Michigan for MILE deals.
- Investors will be limited to \$10,000; however, an investor may provide a special certification that he or she is an "accredited investor" in which case that investor will be allowed to invest more.
- Bart's Donuts will work with Lionel to draft and file a "disclosure statement" containing information about the company's history and operations, ownership and executive team, along with the planned use of the funds and terms of the deal, among other things.
- Homer already put together a pretty solid business plan for Bart's Donuts. He's happy to discover that a detailed business plan provides a nice foundation for the material required by the disclosure statement.
- Homer is prepared to answer questions about the investment's "liquidity." Liquidity describes how easy or practical it will be for an investor to sell the investment for cash. MILE investments are going to be relatively "illiquid" or difficult to sell. Any investor is barred from selling his or her interest in Bart's Donuts to a non-Michigan resident for nine months after the investment. Aside from the legal requirements under MILE, investments like this may be relatively illiquid anyway

OFFERING AVAILABLE TO NON - MICHIGAN RESIDENTS

Just as Homer's ready to begin the Michigan investment crowdfunding process, he gets a call from his old boss, Mr. Burns. Mr. Burns is an accredited investor who retired to Florida a few years ago. Mr. Burns tells Homer that he has several wealthy Michigan expat friends who are now Florida residents, but also love donuts, and would be interested in investing. Homer wants to include Mr. Burns and friends in the pool of potential investors, but can't under MILE.

Homer may also choose to seek investors beyond Michigan borders to increase the number of total investors available to make contributions. Homer sits down with Lionel back at Moe's Tavern to discuss other options, which include: **accredited investor crowdfunding** and **federal crowdfunding**.

RAISING BUSINESS CAPITAL WITH ACCREDITED INVESTOR CROWDFUNDING

If Homer uses accredited investor crowdfunding, he can reach potential investors outside of Michigan. But he can only get investments from accredited investors, no matter where they live. Investors will have to certify that they are accredited, but they won't be limited on the amount they can invest. Homer will not have to use a **crowdfunding platform**. If Homer chooses to use an online portal, the platform must restrict access to information about the deal to accredited investors.

BUSINESS REQUIREMENTS FOR ACCREDITED INVESTOR CROWDFUNDING:

Homer will need to fill out a **Form D Notice of Offering** and file it within 15 days of selling the investment. The Form D notice must contain:

- The basic terms of the investment
- A description of Bart's Donuts, LLC
- Information on how the money being raised will be used

Lionel explains that accredited investor crowdfunding does not have the same disclosure requirements as Michigan crowdfunding, but potential investors will probably want to see a **private placement memorandum** (PPM). A PPM has a lot of the same information as a disclosure, and circulating it can help protect Homer from a variety of investor claims if the investment does not perform.

Like Michigan crowdfunding investments, accredited investor crowdfunding is relatively illiquid. For one year, investors cannot sell their investment, except to certain related parties called **affiliates**.

RAISING BUSINESS CAPITAL WITH FEDERAL CROWDFUNDING

Lionel tells Homer that federal legislation will let him do most of what he wants: target small or large investors, no limitation to Michigan residents, etc.

Just as Homer cues Moe to serve up a celebratory round to the entire bar, Lionel advises him that he can't *actually use this legislation right now* because it will only become available after the SEC makes rules about its implementation, which hasn't happened yet. Though it seems likely these changes will come near the end of 2015. Homer sheepishly changes his beer orders to a single pint...make that two.

Homer has a lot to consider as he plans his fundraising strategy for Bart's Donuts. Armed with good counsel, a solid business plan, and an understanding of the benefits and limitations of his options, we can be confident that Homer will choose wisely.

/GLOSSARY TERMS/

Form D Notice of Offering:

An SEC filing form to be used to file a notice of an offering of securities under Regulation D of the SEC.

Form D requires information about the issuer and the offering made.

Private Placement Memorandum:

A legal document provided to prospective investors when selling stock or another security in a business. The PPM describes the company selling the securities, the offering terms and the investment risks.

ONLINE CROWDFUNDING RESOURCES AND INFORMATION

**Listing of these sites does not constitute an endorsement of any of the content included within.*

National Crowdfunding Platforms

Patronicity	https://www.patronicity.com/
RocketHub	https://www.rockethub.com/
CauseVox	http://www.causevox.com/
Razoo	https://www.razoo.com/
Kickstarter	https://www.kickstarter.com/
Indiegogo	https://www.indiegogo.com/
IOBY	https://www.ioby.org/

Michigan-based Crowdfunding Platforms

LocalStake	https://localstake.com/
Michigan Funder	http://michiganfunders.com/
Fundrise	https://fundrise.com/

Michigan Resources for Local Investing

Local Investing.com	https://www.local-investing.com
Locavesting.com	https://www.locavesting.com
Revalue Investing	https://www.revalueinvesting.com
Crowdfunding Michigan	https://www.crowdfundingMI.com
Sidewalk Ventures	http://www.sidewalk-ventures.com
Public Spaces, Community Places	https://www.patronicity.com/puremichigan

Due Diligence Checklist & Request Template

Go 4 Funding Due Diligence Checklist

<http://www.go4funding.com/Articles/Angel-Investors/Due-Diligence-Checklist.aspx>

The Venture Alley Due Diligence Request Template

<http://www.theventurealley.com/files/2013/08/Form-of-Due-Diligence-Request-short-form.pdf>

National Investor Networks

Slow Money

<https://www.slowmoney.org/>

Angel Investor Networks for Accredited Investors Only

Grand Angels (West Michigan)

<http://www.grandangels.org>

Ann Arbor Angels

<https://www.annarborangels.org>

Bluewater Angels (Midland)

<https://www.bluewaterangels.org>

Michigan Women's Foundation

<https://www.miwf.org>

Resource Links to Find Investor Groups

Michigan Venture Capital Association

<http://www.michiganvca.org/>

Angel Capital Association

<http://www.angelcapitalassociation.org/>

State of Michigan Resources (LARA)

Issuing and Investing In Securities through Crowdfunding: Frequently Asked Questions

http://www.michigan.gov/lara/0,4601,7-154-61343_32915_59944-289603--,00.html

LARA Tips on Intrastate Equity Crowdfunding

<http://www.michigan.gov/lara/0,4601,7-154--352390--,00.html>

LARA Crowdfunding - Things to Keep In Mind

<http://www.michigan.gov/lara/0,4601,7-154--352390--,00.html>

Michigan Invest Locally Exemption (MILE) Resources

Registered Crowdfunding Portals

http://www.michigan.gov/lara/0,4601,7-154-61343_32915_59944-319233--,00.html

Checking on a Company/Business Entity Search

http://www.dleg.state.mi.us/bcs_corp/sr_corp.asp

ONLINE CROWDFUNDING RESOURCES AND INFORMATION

**Listing of these sites does not constitute an endorsement of any of the content included within.*

CROWDFUNDING GLOSSARY

Accredited Investor: A director, executive officer, or general partner of the company selling the securities (and seeking investment); or a natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds \$1 million at the time of the purchase, excluding the value of the primary residence of such person; or a natural person with income exceeding \$200,000 in each of the two most recent years or joint income with a spouse exceeding \$300,000 for those years and a reasonable expectation of the same income level in the current year.

Amortization: The paying off of debt with a fixed repayment schedule in regular installments over a period of time.

Capital: Funds contributed by an individual, particularly an investor, for the purpose of maintaining or expanding a business enterprise.

Collateral: Something pledged as security for repayment of a loan, to be forfeited in the event of a default.

Crowdfunding Platform: Online system which provides information about projects seeking funding and possesses the ability to aggregate funds for investment into these projects.

Debt Interest: The right to repayment after a sum has been loaned, usually with a fixed or variable rate of interest.

Disclosure: Providing pertinent information, used for investment decision making, by a company to investors.

Distribution: An allocation of profits based on ownership percentage.

Due Diligence: Research performed on a business entity to evaluate its potential as an investment; "due diligence" includes reviewing financial statements, pending litigation, and discussions with management to assess the long-term viability of the business.

Equity Interest: A stock or any other security representing an ownership interest.

Federal Crowdfunding: Raising capital, typically small amounts from a large group of contributors, through either a registered broker-dealer or a registered funding portal, with corresponding limits on both the amount any individual investor can contribute and the amount a company can raise.

Fixed Interest Rate: An interest rate that is determined at the beginning of a transaction and does not change as opposed to a variable interest rate which changes based upon pre-determined economic triggers.

Form D Notice Offering: An SEC filing form to be used to file a notice of an exempt offering of securities under Regulation D of the U.S. Securities and Exchange Commission; Form D requires information about the issuer and offering.

General Partner: A person active in the day-to-day operations of a business who is allocated profits after the limited partners, investors in a fund who do not share in its operation, have been paid.

Intermediary: An electronic medium or individual which provides information on projects seeking funding and has the capability to collect and transfer investor funds to these projects; these intermediaries are registered broker-dealers or registered funding portals.

Investment: Funds allocated for a particular business purpose, particularly growth or expansion, with the expectation or hope that the funds will increase in value.

Limited Partner: Investors in a fund who received their distribution before the general partner, the one who manages the operations of the fund; limited partners do not participate in fund allocation decisions.

CROWDFUNDING GLOSSARY

Michigan Crowdfunding: Raising capital via the MILE Act from Michigan based investors for investment in a Michigan based company; the business must make filings and disclosures with the State of Michigan and there are limits on the amount of money a business or organization can raise in any 12-month period.

MILE Act: The Michigan Invests Locally Act or MILE is legislation that allows companies to raise capital if they meet certain criteria including: the business is incorporated in Michigan to sell securities in its business to Michigan investors, individuals who have a principal residence or business organizations with a principal office in Michigan, without having to register its securities. A business may accept up to \$10,000 from a single investor, unless the investor is an accredited investor and if so, the business may accept more than \$10,000 from the accredited investor and is able to raise up to \$1 million in 12 months without providing audited financial statements or reviewed financial statements to a prospective investor for the business's most recently completed fiscal year, prepared by a certified public accountant. A business may raise up to \$2 million in 12 months if it provides a prospective investor audited financial statements or reviewed financial statements for the business's most recently completed fiscal year prepared by a certified public accountant.

Non Accredited Investor: An investor who does not meet the requirements of an Accredited Investor.

Ownership Stake: The proportion of a business owned by an investor which is usually accompanied by economic and other legal rights.

Private Placement Memorandum (PPM): A private placement memorandum (PPM) is a legal document provided to prospective investors when selling stock or another security in a business. The PPM describes the company selling the securities, the terms of the offering, and the risks of the investment, amongst other things. The disclosures included in the PPM vary depending on which exemption from registration is being used, the target investors, and the complexity of the terms of the offering.

Registered Broker Dealer: A person or firm in the business of buying and selling securities, operating as both a broker and a dealer, depending on the transaction. A brokerage acts as a broker (or agent) when it executes orders on behalf of clients, whereas it acts as a dealer (or principal) when it trades for its own account.

Registered Online Portal: An online medium for the purpose of crowdfunding registered with the appropriate state or federal authorities.

Risk: The possibility of economic loss attached to owning a security; "risk" also generally encompasses the pitfalls and challenges associated with running a business operation.

Security: A financial instrument that represents some type of financial value. Securities are typically divided into debt securities and equities. A debt security is a type of security that represents money that is borrowed that must be repaid. Equities represent ownership interest held by shareholders in a corporation.

Shares: Ownership interest by an investor in a business entity.

USA JOBS Act: Legislation passed in 2012 by the US Congress that permits the general solicitation of investment opportunities through crowdfunding internet portals and subsequently provides greater opportunities for non-accredited investors to participate in investment opportunities.

U.S. Securities and Exchange Commission (SEC): An agency of the United States federal government that holds primary responsibility for enforcing the federal securities laws, proposing securities rules, and regulating the securities industry.