



# **The Illinois Crowdfunding Exemption And How To Use It To Raise Capital**

# Introduction

- **About Me**

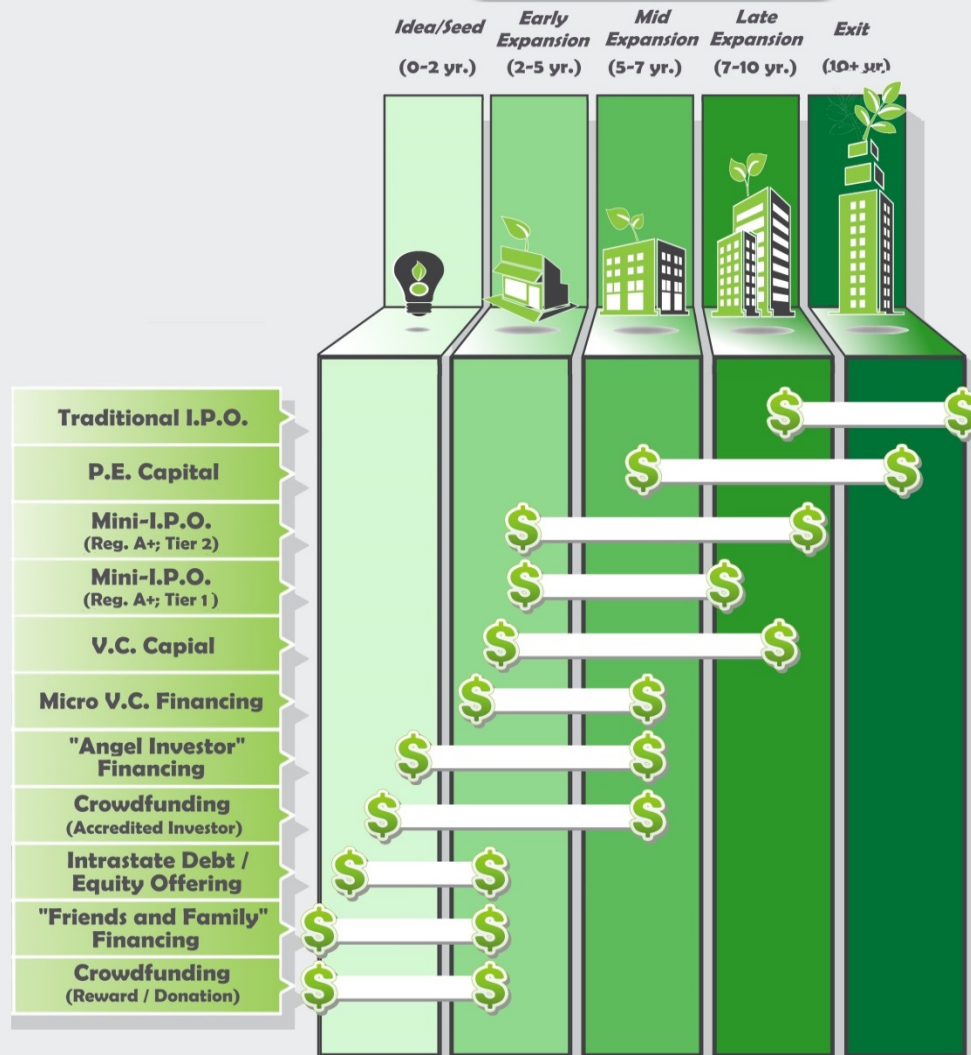
- Partner with the law firm of Freeborn & Peters LLP in Chicago
- Specialize in securities, commercial finance, real estate and general corporate law
- Industry recognized expert in crowdfunding
- Drafted the Illinois Crowdfunding Exemption Bill (*Illinois House Bill 3420*)

# Capital Options

- Traditionally capital options available to entrepreneurs and small business included mainly:
  - Bank financing
  - “Friends and Family” financing
  - “Angel Investor” financing
  - V.C. (“*Series A Round*”) capital
  - Private Equity (*P.E.*) Capital
  - Traditional I.P.O.
- Today there are more options than ever for business to raise capital



## GROWTH STAGE



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# What Is Crowdfunding?

- [illegible]

# Types of Crowdfunding?

- **4 main types of crowdfunding campaigns**
  - Donation Based: People “donate” money with nothing expected in return
  - Rewards Based: People contribute money with the expectation of receiving a promised reward (*e.g. a product or service*)
  - Debt Based: People contribute money with the expectation of being paid back, plus interest
  - Equity Based: People contribute money with the expectation of receiving a piece of the ownership of the company

# Types of Crowdfunding?

- Most commonly known type of crowdfunding campaigns are rewards-based campaigns
  - These are the projects you see in the news and other media raising money through sites such as Kickstarter, Indiegogo, etc.
- The Illinois Exemption Relates To “Investment Based” crowdfunding (*i.e. debt/equity based*)



# Investment Based Crowdfunding

- Like Kickstarter (*and other rewards-based campaign sites*), with debt and equity based campaigns, an entrepreneur starts a campaign in order to raise money to fund their new business, create a new product, get working capital, etc.
- Unlike Kickstarter however, a contributing person in a debt/equity campaign will be making an investment in the entrepreneur's business
- Put simply, in debt and equity based campaigns, a person will give money to an entrepreneur in return for a piece of the action





# How Does It Work?

- **All Starts with the “Crowdfunding Portal”**

- “Crowdfunding Portal” just means the website through which the offering is being made
- Portal is the go between the investors and the company
- Portal is typically responsible for documenting the deal as well as being the pass through of all informational materials to investors

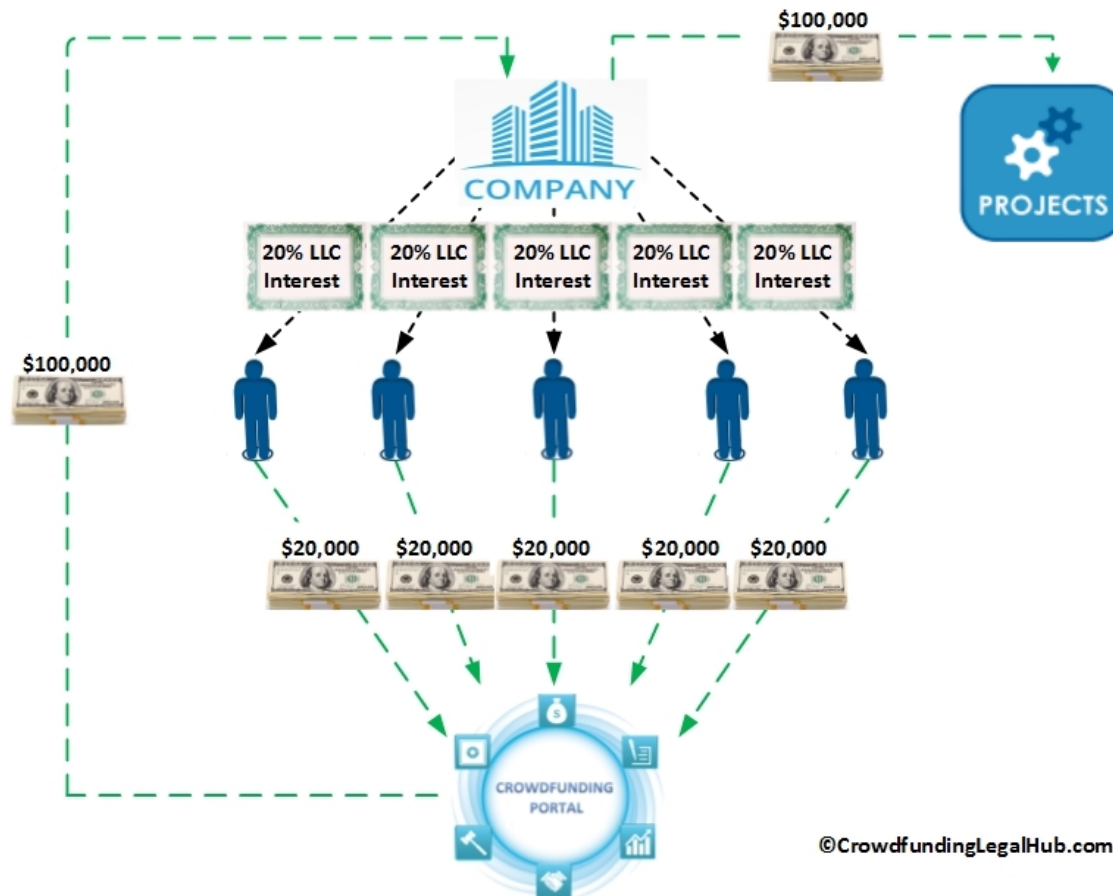


- **Differentiation**

- Portals typically differentiate themselves by type of crowdfunding (*e.g. debt, equity, reward, etc.*) as well as niche focus

# Equity Crowdfunding

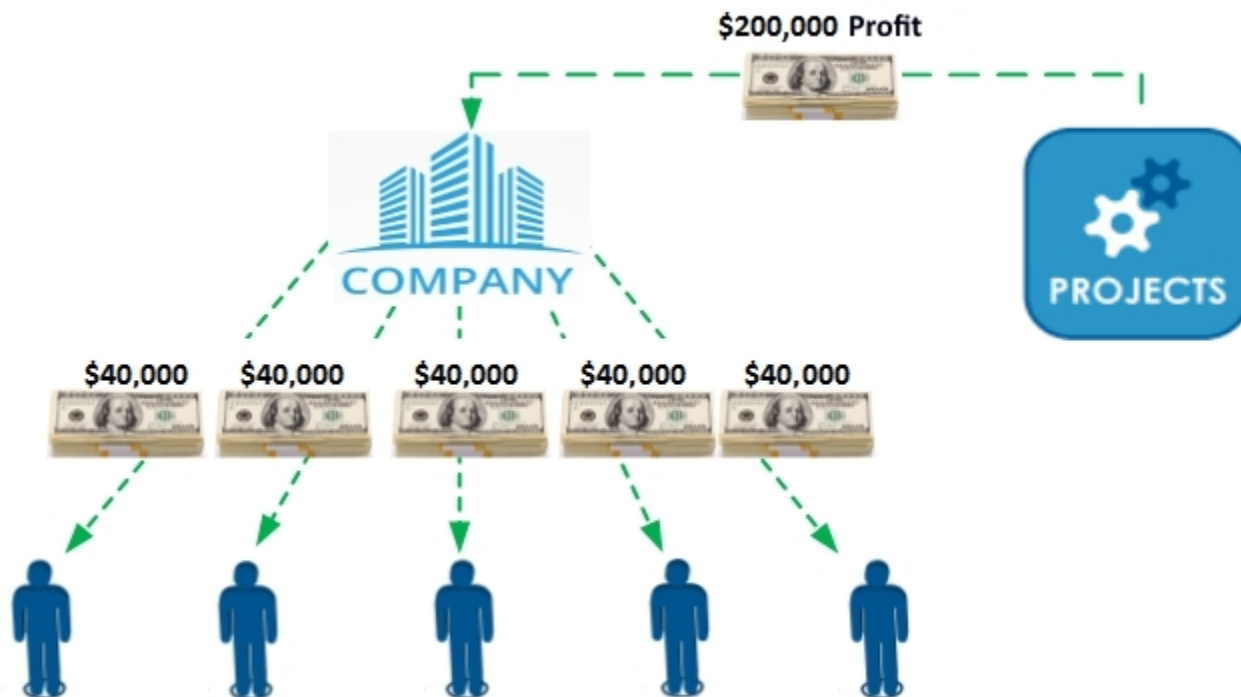
- What is happening in an Equity-Based crowdfunding campaign?



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# Equity Crowdfunding

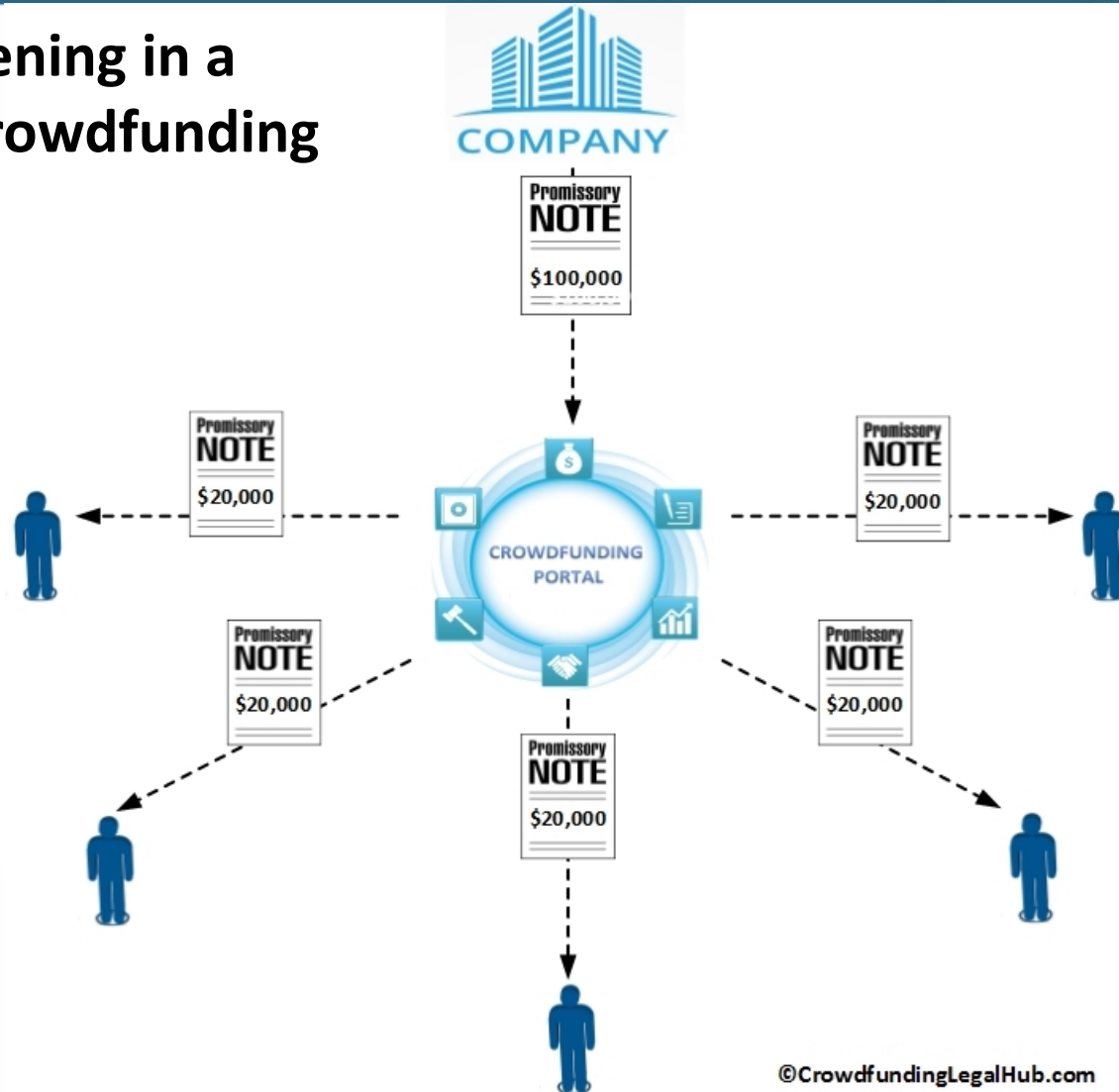
- How Do Investors Make Money?



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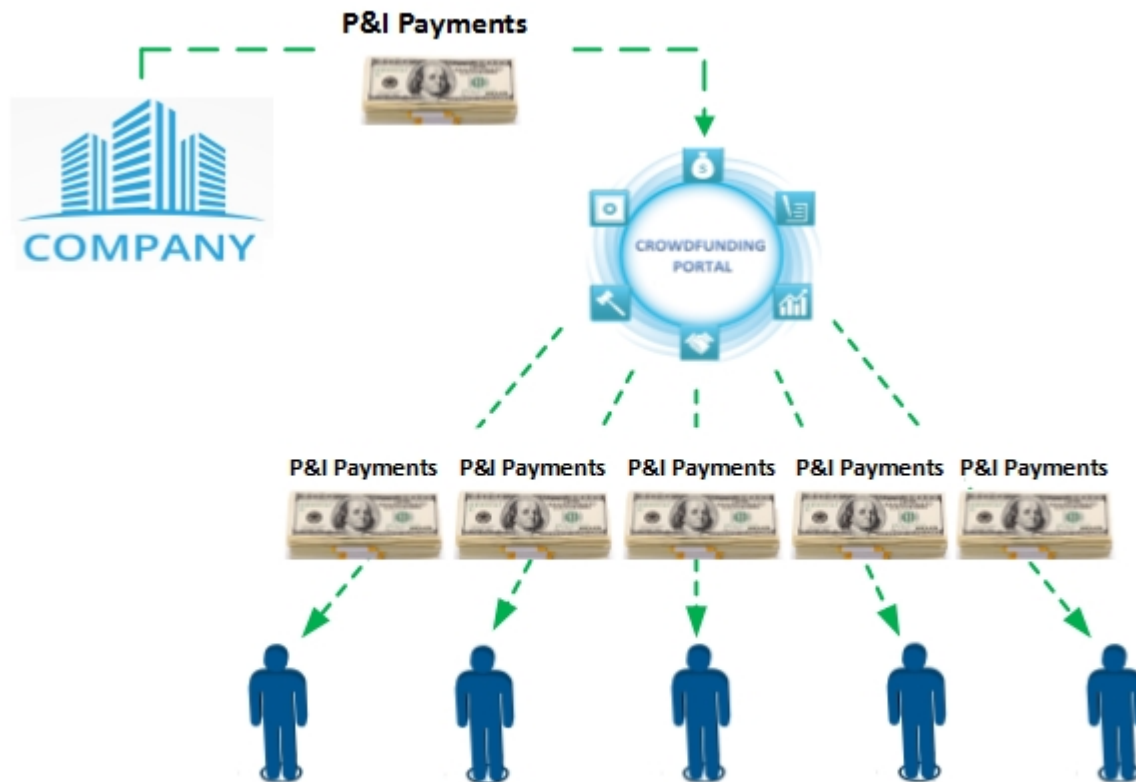
# Debt Crowdfunding

- What is happening in a Debt-Based crowdfunding campaign?



# Debt Crowdfunding

- How Do Investors Make Money?



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# Illinois Crowdfunding

## (The Basics)

- An Illinois company can raise up to \$4 Million dollars, per year, from Illinois residents
- Can be debt or equity based
- Investors can be “accredited” or “non-accredited” (*i.e. anyone so long as they are an Illinois resident*)
- A non-accredited investor can invest up to \$5,000 per year; No limit as to the amount an accredited investor can invest
- All crowdfunding must be done online through a “Registered Internet portal”



# Illinois Crowdfunding

## (The Rules)

- Company must be an Illinois company
  - Formed and doing business in Illinois
  - Must meet 80-80-80 test
  - Must not be subject to disqualification
- Company must have current financial statements
  - Balance sheet, Income Statement, Equity Statement
  - If raising  $\leq$  \$1 MM, internally prepared; If raising  $>$  \$1 MM, audited
  - Certified by senior officer



# Illinois Crowdfunding

## (The Rules)

- Company must establish a maximum and minimum offering amount and a funding deadline
  - Minimum amount must be at least 50% of maximum amount
- Company must enter into an escrow agreement with a qualified escrowee
  - Cannot accept money directly; all investor funds will be held in escrow
  - Funds will not go to the Company until the minimum offering amount is reached



# Illinois Crowdfunding

## (The Rules)

- At least 5 days prior to the first offering or any “general announcement” (*which ever comes first*) Company must:
  - File a notice with the Illinois Secretary of State
  - Deliver a copy of the Escrow Agreement to the Illinois Secretary of State
  - Pay the \$100 filing fee to the Illinois Secretary of State
- As long as offering remains open, must update all filings
- Secretary of State will review filings and respond



# Illinois Crowdfunding

## (The Rules)

- Company must deliver the following to prospective investors:
  - The minimum/maximum offering amount and deadline
  - A copy of the Escrow Agreement
  - A description of the Company (*name, address, etc.*)
  - A detailed description of intended use of the offering proceeds (*including compensation to be paid to employees*)
  - Identity of all persons/entities owning > 10% of voting equity
  - Identity of all directors/managing officers
  - Name of all crowdfunding portals (*and other agents*) being used in the offering and a description of the consideration
  - A description of applicable risk factors



# Illinois Crowdfunding

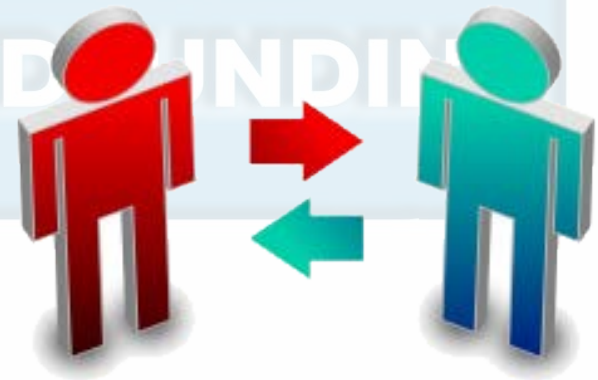
## (The Rules)

- Company must conduct the offering solely through a “Registered Internet portal”
  - Portals have their own registration requirements
- All communications between the Company and potential investors about the offering must be done through the portal

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# Illinois Crowdfunding

## (The Rules)

- Only Illinois residents can view offering materials and invest
  - Refers to a person's "principal residence"
  - Company must take reasonable measures to limit access to offering information only to Illinois residents
    - Cannot just hand out information about the offering to anyone
  - Vetting of investors generally done by the portal
    - If Company has reason to believe a person is not a resident they must tell the portal



# Illinois Crowdfunding

## (The Rules)

- Company may make a “general announcement” to anyone
- General announcement limited to:
  - Statement that offering is being made
  - Name and contact information of Company
  - A brief description of business
  - Name & web address of crowdfunding portal
  - Max/min offering amount
- Announcement can be made by any means, including social media



# Illinois Crowdfunding

## (The Rules)

- For so long as the securities remain outstanding, Company must provide quarterly financials to investors
  - Within 45 days after the end of each fiscal quarter
  - Must be certified by a senior officer
- Can fulfill requirement by posting financial statements on Company's website or through the portal
  - Must alert investors



# Illinois Crowdfunding

## (The Cost)

- **Pre-Offering Expenses:**

– Financial statements ( <i>audited</i> )	\$3,000 - \$10,000
– IL S.O.S filing fee	\$100
– Business plan/pitch deck	\$2,000 - \$5,000
– Offering documents ( <i>generally paid through portal</i> )	<u>\$3,000 - \$10,000</u>
	<b>\$15,000 Avg.</b>

- **Offering Expenses:**

– Portal fees ( <i>generally 3-8% of offering amount</i> )	\$30,000 - \$80,000
– Marketing materials/fees ( <i>generally 1-3% of offering amount</i> )	<u>\$10,000 - \$30,000</u>
	<b>\$75,000 Avg.</b>



# Illinois Crowdfunding

## (The Cost)

- **Ongoing Expenses:**
  - Quarterly Financial Statements
  - Preferred distributions (*if any*)
  - Debt Expenses (*P&I*)
- **All amounts/documents owed to investors are typically sent through to the Portal:**
  - Portal handles transfer of distributions and payments
  - Portal disseminates financial statements and tax documents



# Illinois Crowdfunding

## (Keys To A Successful Offering)

- You **NEED** to have a clear business plan



- Show investors how you are going to use the money to make them money



Step 1



Step 2

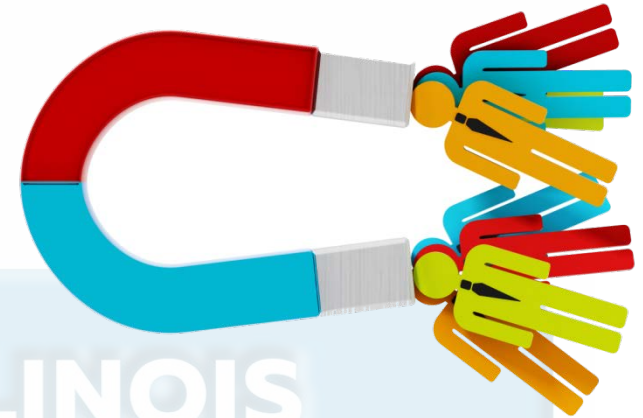


Step 3

# Illinois Crowdfunding

## (Keys To A Successful Offering)

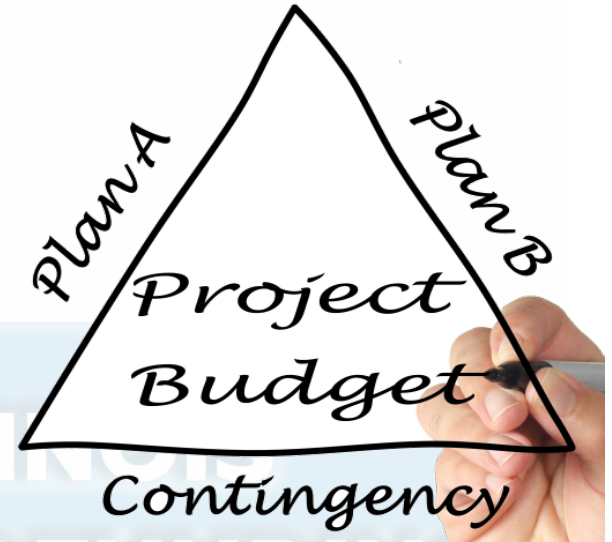
- You **NEED** to market your offering
  - Offerings do not sell themselves
  - Leverage all modes of advertising
  - BUT stick only to the “general announcement” information
- You **NEED** to be responsive to investors
  - Answer questions as often and as fully as possible
  - Keep investors in the loop as to status changes (*positive or negative*)
  - Manage expectations



# Illinois Crowdfunding

(Keys To A Successful Offering)

- You **NEED** to budget appropriately
  - Budgets should be precise but include a contingency amount
  - Things come up, plan accordingly
- You **NEED** to set realistic goals and timelines
  - Don't ask for \$4 MM if you know you won't get it or don't need it
  - Don't wait until the last minute (*estimate between 45-90 days to close*)





# Illinois Crowdfunding

(Keys To A Successful Offering)

- You **NEED** to have your material company agreements properly documented including
  - Operating Agreement (*or other governing document*)
  - Material contracts (*if any*)
  - Employment Agreements
  - Credit Documents
  - IP Assignments
  - Etc.





# Illinois Crowdfunding

(Keys To A Successful Offering)

- You **NEED** to properly identify the inherent project and Company risks to investors
  - Project / Company specific risks
  - Industry risks
  - Market risks
  - Etc.
- Rule of thumb
  - When in doubt, disclose it



# Illinois Crowdfunding

(F.A.Q.)

- Will doing an Illinois crowdfunding campaign make it harder for me to find funding later?
  - Equity Investor interests are non-voting (*though typically have preferred distribution rights*)
  - Agreements can be set up with option to buy-out equity interests in the event of a “Series A” round or other significant funding
  - Shows proof of concept and interest; Increases leverage
  - Crowdfunded debt treated the same as ordinary debt



# Illinois Crowdfunding

(F.A.Q.)

- **What types of returns are investors expecting?**

- Depends on multiple variables, particularly Company or project specific risks
- On equity investments, generally expecting between 8-17% ROI (*preferred and cumulative*)
- On debt investments, generally expecting between 7-15% interest (*paid quarterly or annually*)



# Illinois Crowdfunding

(F.A.Q.)

- So I can just start an Illinois crowdfunding campaign and I will get money right?
  - Many companies will not make it onto a portal at all (*not prepared, project too risky, etc.*)
  - No guaranty that an offering will be successful



# Illinois Crowdfunding

(F.A.Q.)

- **Which types of companies will Illinois crowdfunding work best for?**
  - Consumer goods
  - Mobile tech
  - Healthcare tech
  - Real estate projects
  - Established companies
- **Which types of companies will Illinois crowdfunding NOT work for?**
  - Idea-stage companies
  - Companies without a specific business or profit plan





# Illinois Crowdfunding

(F.A.Q.)

- Is Illinois crowdfunding only for entrepreneurs and small businesses?
  - Illinois crowdfunding can be a great outlet for larger established companies
  - Turn customers into advocates and salespeople
  - Growing a bigger Illinois presence
  - Positive press/marketing



# Illinois Crowdfunding

(F.A.Q.)

- **Why should I do an Illinois crowdfunding campaign rather than a national crowdfunding campaign?**
  - Lower fees
  - Less competition
  - Investor, customer base or project is local
  - Allows for investment by accredited and non-accredited investors



# Illinois Crowdfunding

(F.A.Q.)

- **Are there other benefits to Illinois crowdfunding besides raising capital?**

- Increased Company control
- Equity preservation
- Product / market testing
- Marketing
- Positive publicity and community support
- Local job creation



# Illinois Crowdfunding

(F.A.Q.)

- If equity investors are “non-voting” I can run the company any way I want right?

- Fiduciary duties still apply
- Must act in the best interest of equity holders
- Cannot self-deal; arm’s length transactions
- Business judgement rule



# Illinois Crowdfunding

(F.A.Q.)

- **This is great, so I can start a campaign immediately right?**
  - Law will not be effective until January 1, 2016
  - Use interim period to prepare Company and campaign materials

**Start now** ▶



# Illinois Crowdfunding

(F.A.Q.)

- **This sounds simple, I can do it on my own right?**
  - Consult with Attorney and other professionals early and often
  - Before and after offering
  - Securities laws and transactions are very tricky; Harsh penalties
  - Know what you what you don't know



# Thank You

## QUESTIONS??



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