



**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*)

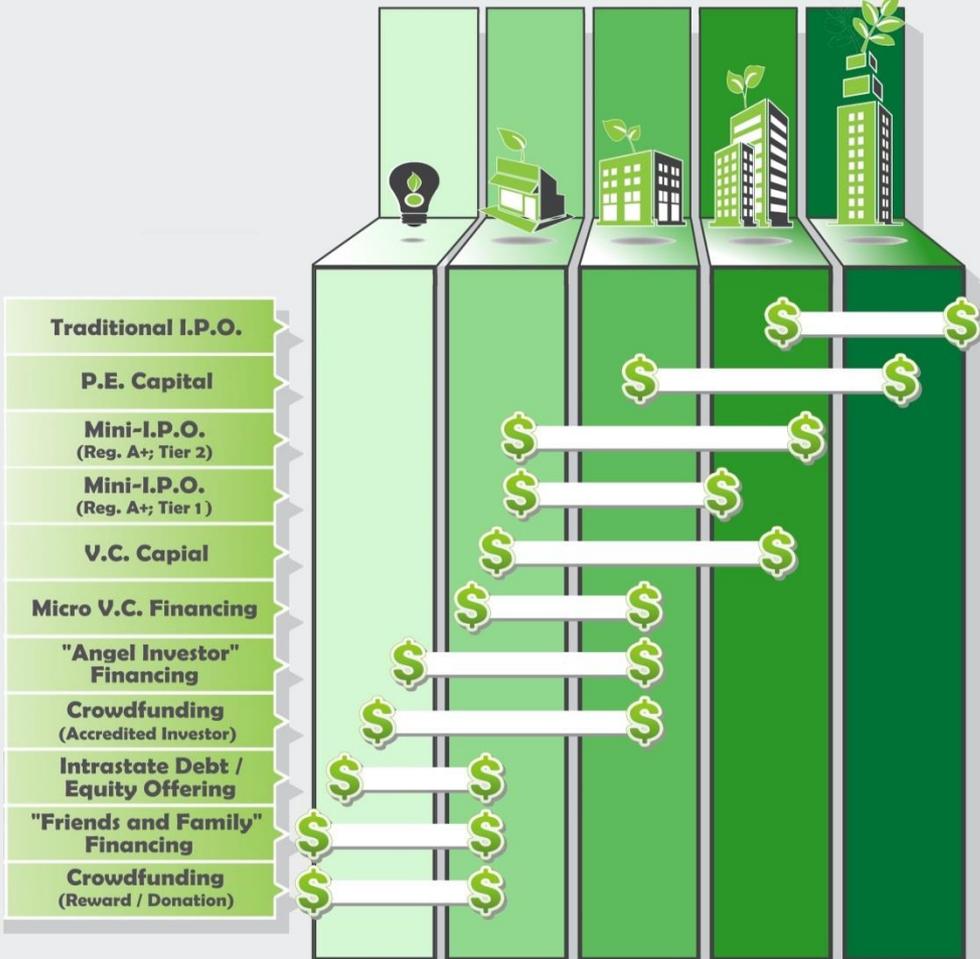
Capital Options

- 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

Idea/Seed *Early Expansion* *Mid Expansion* *Late Expansion* *Exit*
 (0-2 yr.) (2-5 yr.) (5-7 yr.) (7-10 yr.) (10+ yr.)



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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.

KICKSTARTER

 **indiegogo**

- 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

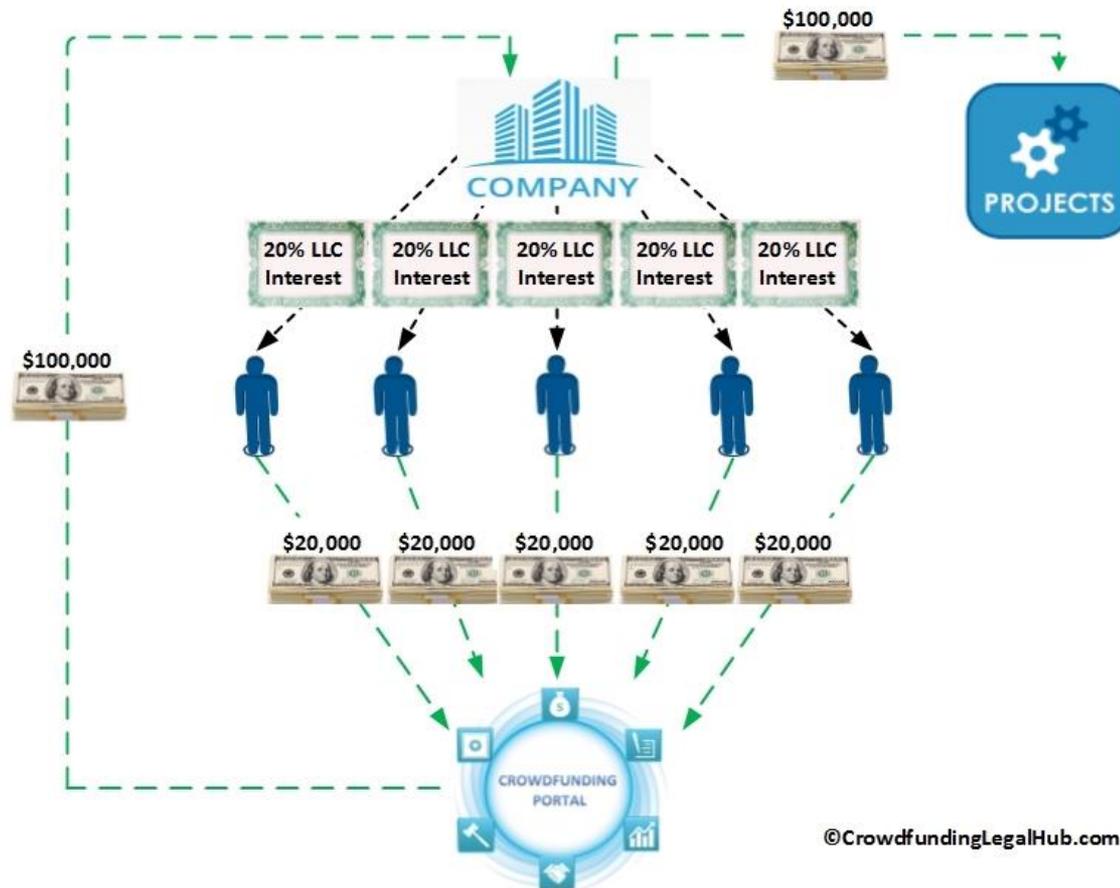


- **Differentiation**

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

Equity Crowdfunding

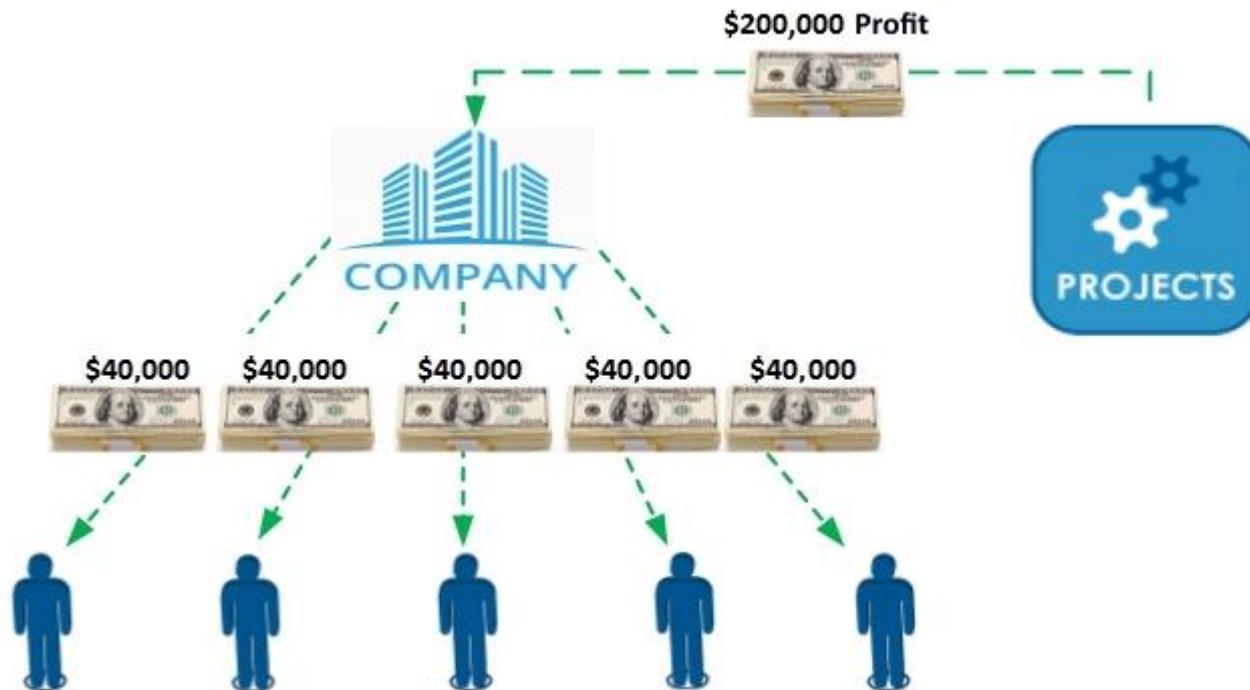
- What is happening in an Equity-Based crowdfunding campaign?



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Equity Crowdfunding

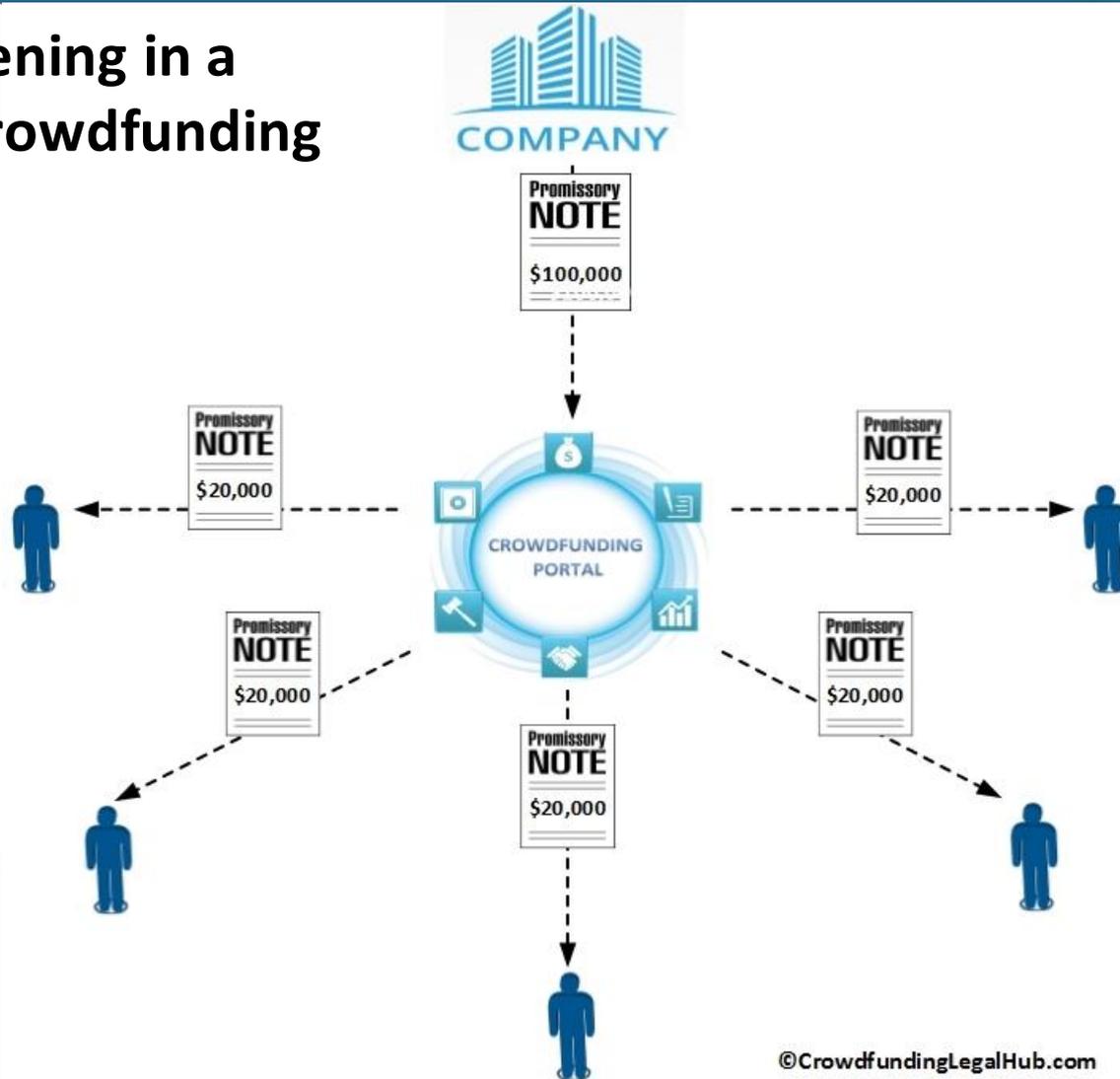
- How Do Investors Make Money?



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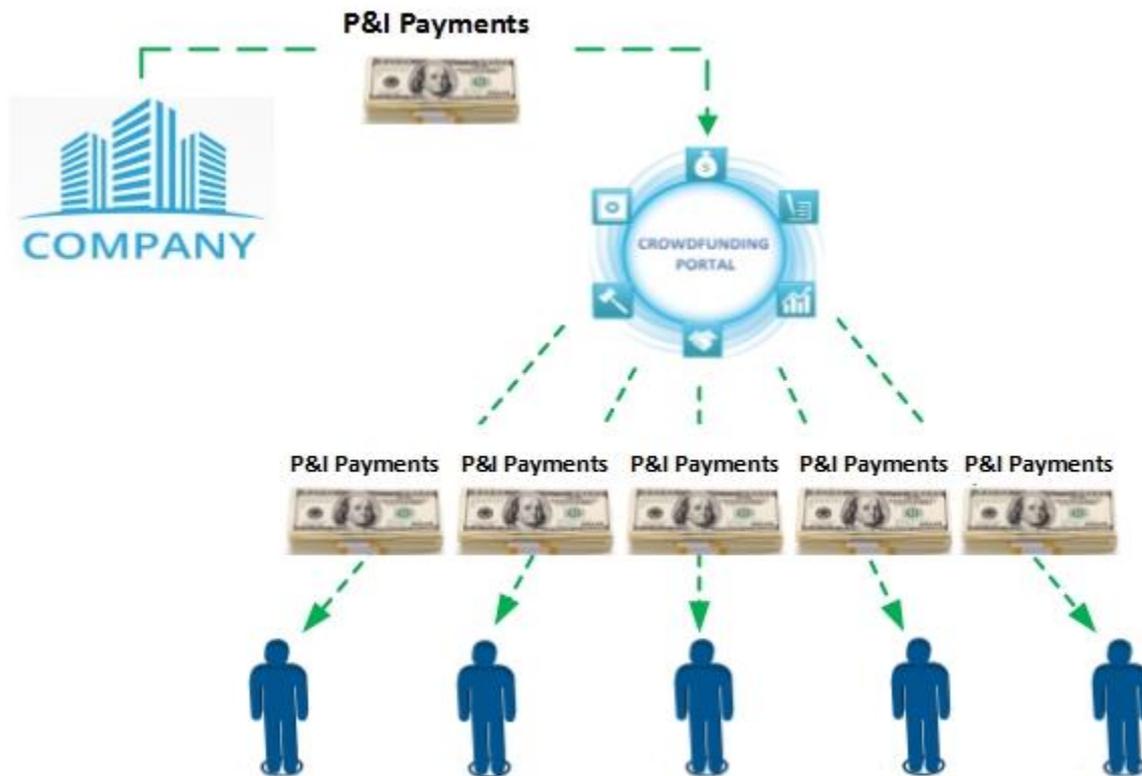
Debt Crowdfunding

- 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

IN **VEST** LOCAL

ILLINOIS

CROWDFUNDING



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 (*audited*) \$3,000 - \$10,000
- IL S.O.S filing fee \$100
- Business plan/pitch deck \$2,000 - \$5,000
- Offering documents (*generally paid through portal*) \$3,000 - \$10,000

\$15,000 Avg.

- **Offering Expenses:**

- Portal fees (*generally 3-8% of offering amount*) \$30,000 - \$80,000
- Marketing materials/fees (*generally 1-3% of offering amount*) \$10,000 - \$30,000

\$75,000 Avg.

Illinois Crowdfunding

(The Cost)

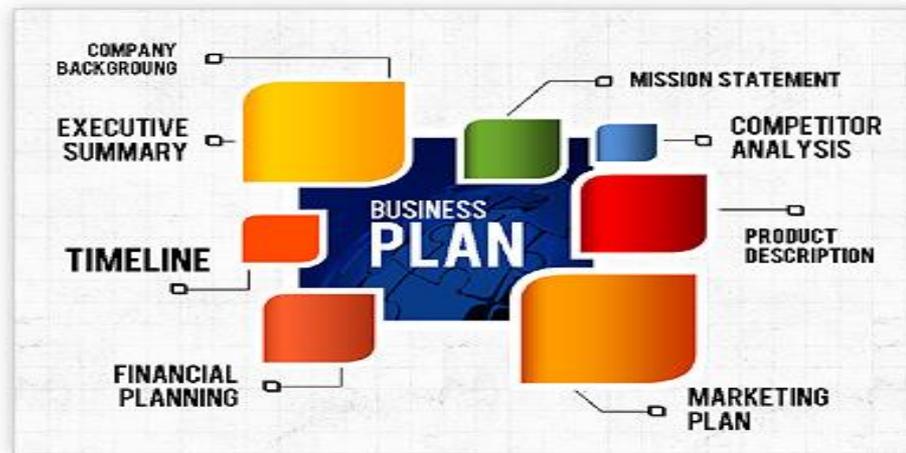
- **Ongoing Expenses:**
 - Quarterly Financial Statements
 - Preferred distributions (*if any*)
 - Debt Expenses (*P&I*)
- **All amounts/documents owed to investors are typically sent through to the Portal:**
 - Portal handles transfer of distributions and payments
 - Portal disseminates financial statements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

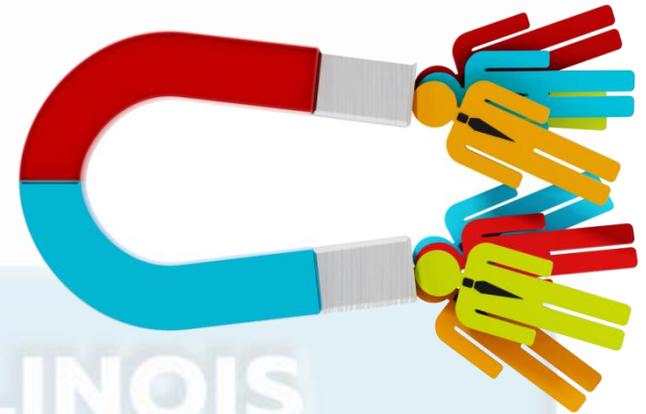


Step 3

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.)

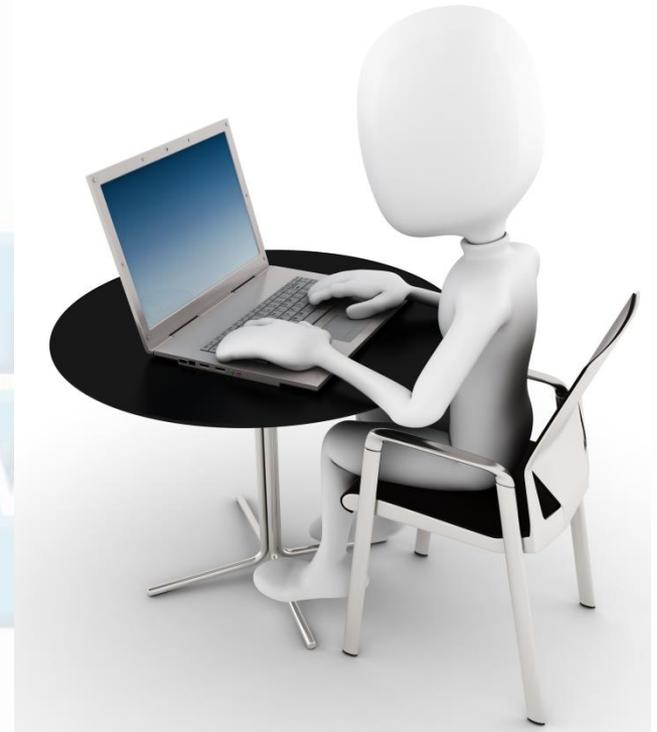
- **This is great, so I can start a campaign immediately right?**
 - Law will not be effective until January 1, 2016
 - Use interim period to prepare Company and campaign materials

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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