Financing Options for Closely Held Businesses (MNVest, Kickstarter and Crowdfunding Generally; Angel Investors, Reg A+ and More)

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1. Current Regulatory Landscape and Key Definitions.

1.1. Generally. Nearly every means by which a company raises capital involves securities laws. These laws regulate the manner in which securities are sold, the amount of money that may be raised, the persons to whom the securities may be offered, and the method by which investors may be solicited.

1.2. Federal Registrations and Exemptions. As a general rule, in order to comply with Federal securities laws, a person selling a security must either (a) "register" such sale with the SEC or (b) identify a specific exemption that allows such sale to be conducted without registration.

1.2.1. SEC registration is time consuming and expensive.

1.2.2. For most small businesses, SEC registration is not a feasible option.

1.3. State Blue Sky Laws. In addition, an issuer selling securities must adhere to **blue sky laws** in each state where the securities are being sold, all of which vary from each other. In Minnesota, the securities laws are set out in Chapter 80A.

1.4. Private Placements.

1.4.1. Section 4(2). The most common federal exemption entrepreneurs rely on is Section 4(2) of the Securities Act, which exempts "transactions . . . not involving any public offering" – i.e., a **private placement**. A company seeking to determine whether an offering will be exempt from registration under Section 4(2) will need to evaluate a number of factors which, although routinely addressed by courts, seldom lead to a definitive answer as to whether an offering is a "public offering" under Section 4(2). Different courts emphasize different factors critical to the Section 4(2) exemption, no single one of which necessarily controls. The factors are simply guidelines, and include:

(a) Offeree qualification (i.e., whether the investors are sophisticated);

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(b) Manner of the offering (i.e., whether the company will engage in advertising or other promotional activities);

(c) Availability and accuracy of information given to offerees and purchasers (i.e., whether the people to whom the company proposes to sell securities have access to basic financial information about the company);

(d) The number of offerings and number of purchasers (i.e., whether the company solicited investment from a large group of people); and;

(e) Absence of intent to redistribute (i.e., whether the people to whom the company proposes to sell securities have an intention to hold the securities for investment purposes – generally for a minimum holding period of 24 months).

1.4.2. Regulation D. In Regulation D, the SEC provides a clear set of "safe harbor" rules that issuers can follow to ensure that they are conducting a valid private placement under Section 4(2). The most common safe harbors that small companies have customarily relied upon in conducting private placements are Rule 504 and Rule 506 (now called Rule 506(b) – *see below*).

1.5. Key Definitions.

1.5.1. General Solicitation Rule 502(c) of Regulation D provides that "neither the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising, including, but not limited to, the following: (1) any advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or radio; and (2) any seminar or meeting whose attendees have been invited by any general solicitation or advertising." In general, this means that issuers will need to have a substantial pre-existing relationship with a potential investor before making an offer of securities under Rule 504 or Rule 506(b).

1.5.2. Accredited investor. Under Rule 501(a) of Regulation D, an accredited investor is a person who meets certain qualifications and, therefore, is deemed able to protect himself or herself in making investment decisions without additional protections under the securities laws, such as those obtained through the SEC registration process and the public disclosure of information about the company that is made through the process of becoming an SEC reporting company. There are several ways to qualify as an accredited investor with the most common being (1) an individual

with at least $200,000 (or $300,000 jointly with a spouse) in annual income over the past 2 years or at least $1 million in net worth (excluding the value of a principal residence) or (2) an entity in which all of the equity owners are accredited investors or the entity has at least $5 million in net assets.

2. The "Old Rules" For Raising Capital.

2.1. Rule 504. Generally speaking, Rule 504 allows companies to raise up to $1 million from an unlimited number of accredited and non-accredited investors (subject to counterpart state Blue Sky registrations and exemptions). Companies are not permitted to engage is general solicitation except for in states where the securities have been registered or states that provide an exemption from registration that allows the company to generally solicit to accredited investors only.

2.1.1. Minnesota counterpart – Limited Offering Exemption. Minnesota has a "limited offering" exemption that is often relied on by companies who are conducting Rule 504 offerings. Under Minn. Stat. § 80a.46, sales by a company to no more than 35 non-accredited investors (and an unlimited number of accredited investors) in Minnesota during any 12 consecutive months are exempt from registration in Minnesota if the following conditions are met:

(a) The company does not use general solicitation or general advertising;

(b) The company reasonably believes all non-accredited investors participating in the offering are purchasing for investment;

(c) The company does not pay any commission or other remuneration, directly or indirectly, for soliciting any prospective buyer in Minnesota, except for payments to a broker-dealer or agent registered in Minnesota; and

(d) If the company is selling securities to more than 10 non-accredited investors, then the company must file a "Statement of Issuer" with the Minnesota Securities Division.

2.2. Rule 506. Rule 506 is the most common "safe harbor" relied on by companies conducting private placements. Generally speaking, Rule 506 allows an issuer to raise an unlimited amount of capital from an unlimited number of accredited investors and up to 35 non-accredited investors. However, if even one non-accredited investor becomes a purchaser in the offering, then the company must provide all investors with a very detailed disclosure document that satisfies other

SEC requirements. For this reason, the practical reality is that Rule 506 offerings are usually restricted to accredited investors only.

2.2.1. Minnesota counterpart. Securities issued in reliance on Rule 506 are considered Federal "covered securities" and the offer and sale of such securities are exempt from registration in Minnesota (Minn. Stat. § 80a.50) as long as the issuer makes a notice filing with the Minnesota Securities Division containing the following:

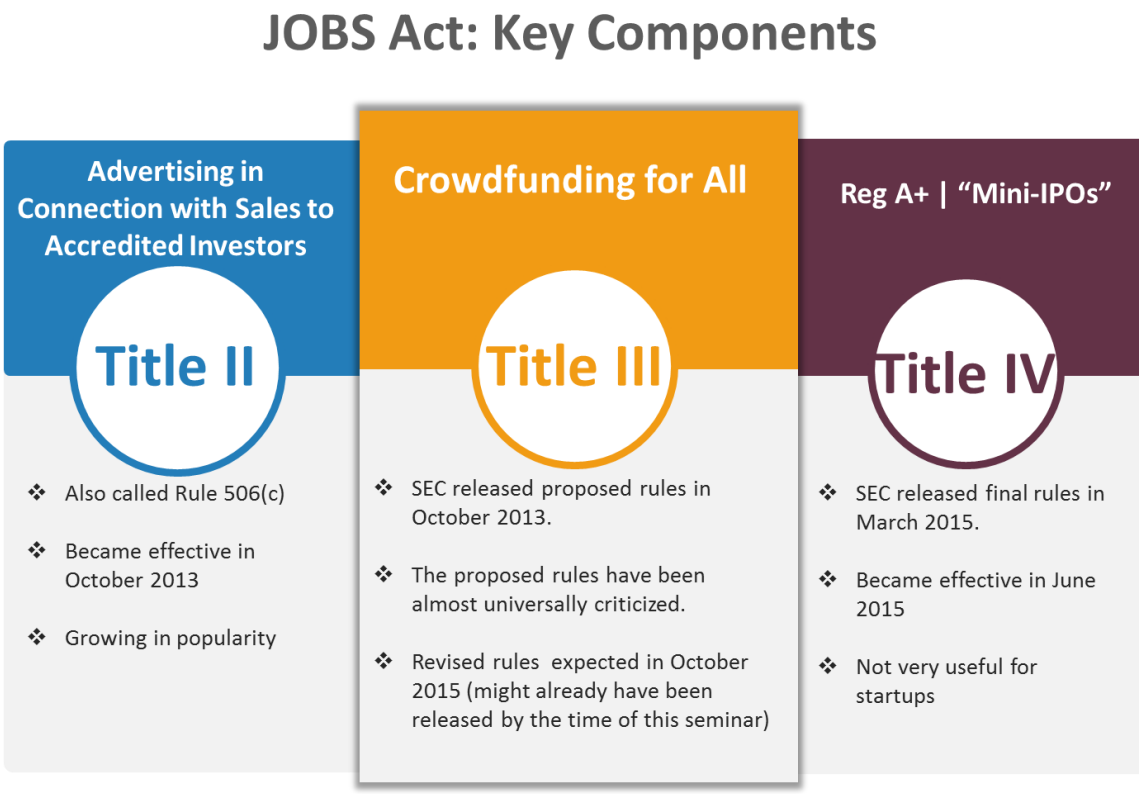
(a) A copy of the Form D that the issuer filed with the SEC;

(b) A statement of the aggregate amount of securities already sold or offered to persons in Minnesota;

(c) A consent to service of process signed not later than 15 days after the first sale of securities to persons in Minnesota; and

(d) A filing fee, which is currently $100 plus 0.1% of the maximum aggregate offering price at which the securities are to be offered in Minnesota, with total fees not to exceed $300.

3. The "New" Rules: Jumpstart Our Business Startups (JOBS) Act. On April 5, 2012, Congress passed the JOBS Act in an effort to foster job growth by modernizing Federal securities laws. The JOBS Act consisted of three key parts that are relevant for securities crowdfunding:



3.1. Title II and Rule 506(c) – Advertising to Accredited Investors. In late 2013, the SEC (pursuant to the authority granted to it under Title II of the JOBS Act), finalized new Rule 506(c) which allows companies to generally solicit (or advertise) their securities offerings so long as all of the investors who actually purchase securities in the offer are accredited. This means that companies may now talk about their offerings in public seminars, send out email blasts, push offering information out on social media sites, as well as run ads on TV, radio, and the internet. Companies who comply with Rule 506(c) are now free to talk about their offering to whomever they want (including non-accredited investors). Companies who generally solicit under Rule 506(c) may only sell the securities to accredited investors.

3.1.1. Verification Steps. Using Rule 506(c), however, comes with certain additional compliance requirements. Companies must take additional steps to verify that all purchasers actually are accredited. In Rule 506(c), the SEC listed several non-exclusive methods that are deemed to satisfy the verification requirements (provided that the issuer does not have

knowledge that the purchaser is non-accredited). The "safe harbors" include:

(a) Income verification by checking federal tax forms, including W-2's and tax returns, and a statement by the investor that he or she expects enough income in the current year to remain accredited;

(b) Net worth verification by checking a recent credit report (with the past 3 months) and bank or investment account statements, together with a written representation from the purchaser that he or she has disclosed all liabilities necessary to make a determination of net worth; and

(c) Certification of accredited investor status by a registered broker-dealer, SEC-registered investment advisor, licensed attorney, or CPA who has verified the purchaser's accredited investor status.

3.1.2. MN Notice Filing. MN still requires a notice filing for 506(c) offerings (see Section 2.3.1 above). Other states may also require similar notice filings.

3.1.3. Comparison of Rules 504, 506(b), and 506(c).

	Rule 504	Rule 506(b)	Rule 506(c)
How much money can I raise?	Up to $1M	Unlimited	Unlimited
Can I advertise the sale of my securities?	**No, unless coupled with a state exemption or registration that allows advertising.**	**No, unless coupled with a state exemption or registration that allows advertising.**	**Yes.**
To whom can I sell securities?	Anyone However, counterpart state exemptions or registrations may impose additional restrictions on number of non-accredited investors.	Unlimited number of accredited investors Up to 35 non-accredited investors if you believe they are "sophisticated"	Unlimited number of accredited investors
Do I have to comply with the SEC's formal information delivery requirements?	No, but counterpart state exemption or registration may impose additional requirements.	No, if only accredited investors are included Yes, if any non-accredited investors are included	No.
Do I have to verify that any accredited investors are truly accredited?	No, accredited investors can "self-certify."	No, accredited investors can "self-certify."	Yes, you must take "reasonable steps" to verify that the investors are, in fact, accredited.

3.2. Title III "retail" crowdfunding and Regulation CF (no final rules yet). Title III of the JOBS Act was meant to democratize the business funding process by allowing non-accredited individuals the opportunity to participate online and invest into private companies. Like Titles II and IV, implementation of this law is dependent on the SEC promulgating rules, but unlike Titles II and IV these rules have not yet been adopted. On October 23, 2013, the SEC issued proposed rules, which have been criticized by most commentators as onerous and impractical. The nearly 600-page rules set out a very difficult and expensive process for any business that wished to raise funds through crowdfunding. The SEC is expected to release new rules any day now.

3.3. Title IV and Regulation A+. Reg A+, which went into effect in June 2015, has been described as a mini-IPO or "IPO-Lite," in that it allows nearly any company with principal offices in the U.S. or Canada to use internet crowdfunding to raise up to $50 million per year from any number of both accredited and non-accredited investors under a regulatory scheme that is far less burdensome than that of a traditional IPO. There is no prohibition on general solicitation, and offering companies are not required to independently verify the sophistication (income or net worth) of their investors. Corporations, limited liability companies, and limited partnerships can take advantage of Reg A+'s two-tiered offering scheme and can sell nearly all types of securities, including equity, debt, and debt securities convertible into equity securities. Furthermore, the securities issued in Reg A+ will be unrestricted and freely transferable. One of the most exciting changes for companies seeking to raise capital under Reg A+ is that Tier 2 offerings are not subject to state Blue Sky registration and merit review (further explained below).

3.3.1. Tier 1. Tier 1 offerings are largely similar to old Regulation A offerings, but the old limit of $5 million raised in a 12-month period per issuer has now been increased to $20 million. Unlike Tier 2, there is no limit on the amount a non-accredited investor may invest in any Tier 1 offering.

(a) State Registration. Tier 1 still requires that offerors register under the Blue Sky laws of every state in which money is raised. However, the NASAA (North American Securities Administrators Association) recently launched a multi-state coordinated review program for Regulation A offerings that, if successful, would allow an issuer to register with multiple states by filing just one package with a relatively quick turnaround time. This could make Tier 1 much more attractive for many issuers, given its lower cost.

(b) Reporting. Tier 1 is less burdensome than Tier 2 in terms of SEC requirements for initial filing and ongoing reporting. Tier 1 does not require audited financial statements nor ongoing reporting.

The only requirement is that offering companies file a Form 1-Z to report the completion of their offering.

3.3.2. Tier 2. Under Tier 2, companies are allowed to raise up to $50 million in a 12-month period and, most importantly, there is no requirement that the offering company register under any state Blue Sky laws because the federal Reg A+ preempts state law. Tier 2 offerings must only be registered with and approved by the SEC. On the other hand, Tier 2 limits investment by non-accredited investors to the greater of 10% of their annual income or net worth, excluding their primary residence, per offering. Tier 2 also includes substantially more onerous reporting requirements than Tier 1.

(a) Audited Financial Statements. Tier 2 issuers must provide the SEC with two years of audited financial statements before approval, while Tier 1 issuers only need to provide "reviewed" statements.

(b) Ongoing Reporting. After a successful Tier 2 raise, Tier 2 issuers who have 300 or more record holders of the security offered must also file the following ongoing reports:

(i) Detailed annual reports, using Form 1-K;

(ii) Semiannual reports, using Form 1-SA, including unaudited interim financial statements and a management discussion; and

(iii) Current event reports, using Form 1-U, reporting all fundamental changes.

4. How can companies engage in securities crowdfunding today?

4.1. Title II / Rule 506(c) + State exemption. The vast majority of companies that sell securities on "crowdfunding" sites like CirculeUp.com and SeedInvest.com rely on Rule 506(c) to advertise their offerings, but they are only permitted to sell their securities to accredited investors. In the view of these authors any many other industry experts, this is not true crowdfunding.

4.2. Rule 504 + State registration. Theoretically, a company may legally conduct a small (less than $1 million) crowdfunding campaign in Minnesota by combing a Federal Rule 504 exemption with a Minnesota SCOR offering under Minn. Stat. § 80A.50(b).

4.2.1. General Solicitation under Rule 504. Rule 504 allows an issuer to engage in general solicitation to accredited and non-accredited investors if the issuer either:

(a) registers the offering exclusively in one or more states that require a publicly filed registration statement and delivery of a substantive disclosure document to investors; or

(b) registers and sells the offering in a state that requires registration and disclosure delivery and also sells in a state without those requirements, so long as the company delivers the disclosure documents required by the state where the company registered the offering to all purchasers (including those in the state that has no such requirements).

4.2.2. MN SCOR Offering. Minn. Stat. § 80A.50(b) provides a simplified process for "small corporate offering registrations (SCOR)" that otherwise are exempt from Federal registration under Rule 504.

(a) **Form U-7**. SCOR was developed by the North American Securities Administrators Association (NASAA) to facilitate compliance by smaller companies with state regulations. SCOR allows companies to complete a Form U-7 Disclosure Document in lieu of the expensive and substantial disclosure documents required for a registration statement. The Form U-7 consists of 50 detailed questions designed to provide the state and the investor with important information regarding the company's operations. The questions in the U-7 form consist of items such as the company's history; its business and properties; risk factors facing the company; use of the offering proceeds; description of the securities being offered; dividend history; key personnel; principal stockholders; and pending or threatened litigation. **Instead of filing Form U-7, an issuer may use a different format that complies with all items and instructions of Form U-7 and as provided under Minnesota Rule 2876.3021. If the issuer wishes to use a format other than Form U-7, then it must include a reasonably detailed table of contents and an index indicating where the information required by each item of Form U-7 is located.**

(b) **Required Filings**. A company seeking to conduct a SCOR offering in Minnesota must submit the following items to the Minnesota Securities Division:

(i) Completed Form U-7 (note that Form U-7 requires the company to attached audited or reviewed financial statements);

(ii) Consent to service of process in MN;

(iii) A specimen of the security being offered (e.g., copy of the stock certificate, if applicable)

(iv) Opinion of counsel concerning the legality of the securities being registered, which states whether the securities, when sold, will be validly issued, fully paid, and nonassessable and, if debt securities, binding obligations of the issuer;

(v) List of other states in which the securities are registered or are being registered;

(vi) A copy of the offering document (i.e., PPM) provided to prospective purchasers; and

(vii) a copy of any other pamphlet, circular, form letter, advertisement, or other sales literature intended as of the effective date to be used in connection with the offering.

4.2.3. Issuer-Operated Portal. Technically, no provision in Chapter 80A prohibits a company who registers its securities as part of a SCOR offering from using the internet to advertise its offering. Therefore, it seems that a company who validly registers its securities through a SCOR offering may own and operate its own "crowdfunding" website.

4.2.4. Third Party Portal. Under current Minnesota statute, for third-parties to act as portals for SCOR offerings, except under limited exceptions, they must be registered with the state as broker-dealers (Minn. Stat. § 80A.41 and § 80A.56).

4.3. Federal intrastate exemption + State exemption (i.e., *MNvest*).

4.3.1. Section 3(a)(11) and Rule 147. Another lesser known Federal securities exemption is the "intrastate" exemption embodied by Section 3(a)(11) of the Securities Act and Rule 147 promulgated by the SEC. Generally speaking, Section 3(a)(11) exempts from SEC registration any offering that is confined to the borders of a single state. To qualify for this exemption, the company must meet requirements of Rule 147, which include:

(a) The company must be incorporated in the state in which it is offering the securities;

(b) The company must only sell the securities to individuals residing in that state;

(c) 80% of the company's consolidated gross revenues must be derived from the state in which the offering is conducted;

(d) 80% of the company's consolidated assets must be located within the state in which the offering is conducted; and

(e) 80% of the offering's net proceeds must be intended to be used, and actually used, in connection with the operation of a business or real property, the purchase of real property located in, or the rendering of services, within the state in which the offering is conducted.

4.3.2. General Solicitation in Intrastate Crowdfunding Offerings. There is no prohibition in Section 3(a)(11) or Rule 147 regarding general solicitation as long as such solicitation (1) complies with applicable state law and (2) does not result in an offer or sale to nonresidents of such state.

(a) **SEC Guidance on Online Advertising**. In recent months, the SEC has provided guidance on how intrastate issuers can use the internet to publicize their offerings without having those online advertisements result in an offer or sale to nonresidents of that state.

(i) **Limiting Access to Out of State Residents**. In April 2014, the SEC clarified in Questions 141.03–141.05 that issuers hoping to utilize the Rule 147 exemption could use the Internet for general advertising and solicitation if they implemented measures to limit the offers to people within the issuer's state. In the context of an offering conducted within state crowdfunding requirements, those measures have to include:

(1) limiting access to information about a specific investment opportunity to persons who confirm they are residents of the relevant state "(for example, by providing a representation . . . such as a zip code or residence address)" and

(2) providing a disclaimer and restrictive legend clarifying "that the offer is limited to residents of the relevant state under applicable law." (Question 141.04).

(ii) **IP Address Blocking**. In recent months, the SEC suggested what might be a simpler method of limiting the offer to

those within the relevant state. The issuer can "implement technological measures" that limit any offers to persons with an IP address originating within the issuer's state and prevent offers to any individuals outside of the issuer's state (Question 141.05). However, the offer should still contain a disclaimer and restrictive legend. Presumably, this clarification allows issuers to skip the opt-in step where the viewer must verify they are residents of the relevant state before viewing the solicitation or advertisement. The simplification could greatly increase the number of views and potentially improve the effectiveness of the communication.

4.4. MNvest. New intrastate crowdfunding system for accredited and non-accredited investors. The MNvest system is codified in Minn. Stat. § 80A.461. However, MNvest offerings cannot yet be conducted until the Minnesota Department of Commerce releases final rules and regulations (expected shortly).

4.4.1. Generally: MNvest offerings are exempted from registration under the Minnesota blue sky laws, included in statute sections 80A.49 to 80A.54. Minn. Stat. § 80A.461, Subd. 2. MNvest provides for a system of state-registered portals offering private securities for sale.

4.4.2. Intrastate Exemption Track. Securities offered under Section 3a(11) of the Securities Act of 1933 and Rule 147.

(a) Issuer must comply with the various Rule 147 restrictions (*see above*). Minn. Stat. § 80A.461, Subd. 3(2). This creates issues/ambiguity regarding use of the internet for advertising.

(b) Company may raise up to $2 million with audited or reviewed financial statements (or up to $1 million with by providing internally prepared financial statements). Minn. Stat. § 80A.461, Subd. 3(5).

(c) Notice filing required. Minn. Stat. § 80A.461, Subd. 3(11)(i).

4.4.3. SCOR (Small Corporate Offering Registration) Track. Issuers who register their securities with the Department of Commerce via a SCOR offering may sell those securities through a MNvest Portal. Minn. Stat. § 80A, Subd. 1(d). The requirements of the SCOR registration (described above) are set forth in Minn. Stat. 80A.50.

(a) No restrictions on company use of proceeds, assets, or revenues.

(b) Company may only raise up to $1 million.

(c) Longer and more detailed offering memorandum in conjunction with Form U-7.

(d) Company may seek coordinated review to sell in multiple Midwest states.

4.4.4. Portals. *See generally* Min. Stat. § 80A.461, Subd. 7.

(a) Broker dealers and non-broker dealers may seek to register as MNvest portals.

(b) Broker dealers may accept transaction based compensation and offer investment advice.

(c) Non broker dealers may not offer investment advice and may only charge flat or fixed monthly fees.

(d) Issuers may apply to become portals, however with more scrutiny from the state.

4.4.5. Escrow. Funds raised in connection with a MNvest offering must be deposited in escrow with a qualified escrow agent until the aggregate capital deposited into escrow from all purchasers is equal to or greater than the stated minimum offering amount. Minn. Stat. § 80A.461, Subd. 3(8).

4.4.6. Investor Caps. Non-accredited investors may only invest up to $10k per offering, while accredited investors may invest an unlimited amount. Minn. Stat. § 80A.461, Subd. 3(7).

5. Capital Raising Pitfalls.

5.1. Rights of Ownership. When considering whether to engage in a private offering to raise investment capital, a company must consider that investors will be owners of the company following the offering (albeit likely constituting a minority stake in the entity) and as, such, those investors will have certain rights afforded to them by law.

5.1.1. Corporations.

(a) Voting Rights. Unless otherwise provided within the corporation's articles of incorporation, a shareholder in a corporation has one vote per share. In addition, even if the articles provide that the holders of a particular class of shares are

not entitled to voting rights, in some instances, these shareholders are entitled to voting rights as a matter of law. Minn. Stat. §302A.137.

(b) **Rights to Information.** Shareholders are entitled to inspect books and certain records of the corporation. Minn. Stat. §302A.461.

(c) **Dissenters Rights.** Most significantly, a shareholder of a corporation may dissent from, and obtain payment for the fair value of the shareholder's shares in the event of certain actions enumerated in Minn. Stat. §302A.471.

5.1.2. Limited Liability Companies.

(a) **Governance Rights.** A member's governance rights (i.e., the right to vote and control) in a limited liability company (LLC) under the Minnesota Revised Uniform Limited Liability Company Act, Minn. Stat. Ch. 322C, depends upon whether the LLC is member-managed, board-managed or manager-managed. If the LLC is member-managed, each member has equal rights in the management and conduct of the company's activities. Minn. Stat. §322C.0407, Subd. 2. Even if the LLC is manager-managed, certain proposed actions require consent of the members. Minn. Stat. §322C.0407, Subd. 3. In a board-managed LLC, while the board of governors manages the LLC's affairs, the board is selected by a majority vote of the members.

(b) **Right to Profits.** Unless otherwise provided in the LLC operating agreement, each member is entitled to participate in any distribution(s) of the company's profits (although as noted herein, some additional incentives may be necessary).

(c) **Right to Information.** Members have the right to access information from the LLC that is material to the member's interest as a member. Minn. Stat. §322C.0410.

(d) **Minority Rights Regarding Oppressive Conduct.** In contrast to a corporation and Minnesota's prior LLC statute, Minn. Stat. Ch. 322B, under the Minnesota Revised Uniform Limited Liability Company Act, a member does not have the right to dissent from a proposed course of action and require the LLC to purchase his/her membership interest. However, Minn. Stat. §322C.0701 provides for certain rights and remedies upon a court finding of "oppressive conduct" towards a minority member or members. Note, however, that the LLC operating agreement can limit the

remedies that a court may impose, including but not limited to a court-ordered buyout.

5.2. Maintaining Control. Frequently in private offerings for startup ventures, the capital contributed by investors through the offering often exceeds the amount of capital contributed by the company's founders. This can prove problematic for the founders seeking to maintain control of the entity by offering a minority ownership stake in the company through the offering. As discussed in more detail in Section 6, however, various incentives can be employed to make ownership of a minority interest in the business more palatable for investors.

5.3. Changes to Terms of Offering; Rescission Offers. Frequently a prospective investor will propose a counteroffer which differs from the terms outlined in the offering document. If accepted, be aware that changed terms for even a single investor will trigger an obligation to make a rescission offer to prior investors under Minnesota law. Minn. Stat. §80A.77.

5.4. Other Sources of Funds.

5.4.1. Debt Financing. Before embarking upon a private offering, it is best to consult with one or more lending institutions regarding a small business loan. Banks offer several small business loan programs, ranging from their own private loan programs to those loan programs established by the U.S. Small Business Administration (SBA). These types of programs are particularly useful when seeking financing to acquire equipment and/or real estate, given the ability to pledge these assets as collateral. Personal guaranties of those owners holding 20% or more is also generally required.

5.4.2. "Gap" Financing. "Gap" financing refers to state and local financing incentives that can bridge the gap between a bank loan and an equity capital investment.

(a) Minnesota DEED. The Minnesota Department of Employment and Economic Development (DEED) has several financing programs available for small businesses. For example, the Minnesota Investment Fund (MIF) provides financing to help add new workers and retain high-quality jobs on a statewide basis. The focus is on industrial, manufacturing, and technology-related industries to increase the local and state tax base and improve economic vitality statewide. An exhaustive list of state financing incentives can be found on DEED's website, http://mn.gov/deed/.

(b) Local Financing Incentives. Some cities have financing programs and incentives available for small businesses that locate within

those cities. For example, the City of Minneapolis Department of Community Planning and Economic Planning has a "Two-Percent Loan" program. Two-Percent Loans provide financing to small Minneapolis businesses (retail, service or light manufacturing) to purchase equipment and/or to make building improvements. A private lender provides half the loan at market rate and the City provides the rest, up to $50,000 at 2 percent interest (up to $75,000 in designated neighborhood commercial districts). The loan term is set by the private lender and can be for up to 10 years. Bank fees vary, but the City charges a 1 percent origination fee with a minimum of $150 due at closing.

(c) Tax Increment Financing. Tax increment financing, or TIF, is a public financing method that is used as a subsidy for redevelopment, infrastructure, and other community-improvement projects. Through the use of TIF, municipalities can dedicate future tax revenues of a "particular business or group of businesses toward an economic development project in the community.

5.4.3. Kickstarter/Rewards Based Crowdfunding. In recent years, websites such as Kickstarter.com have popularized "rewards-based" crowdfunding. Kickstarter.com is a web portal that allows individuals to make a contribution to a particular project in exchange for some reward, typically some type of tangible product. Other variations of rewards-based crowdfunding include "founders clubs" (often used by local breweries and distilleries) which offer a variety of member benefits (but not any voting rights or share of profits in the enterprise so as to steer clear of the definition of a "security") in exchange for payment of a one-time membership fee. These types of rewards-based incentives should be structured in a way that minimizes liability for the company; i.e., the terms and conditions of membership should be in writing and should specify what happens to the memberships if the company is sold or ceases to do business, that the memberships are non-transferrable and that the membership does not carry with it the rights of ownership.

6. Practical Considerations in Structuring a Private Offering

6.1. Put Rights. A put or put option is a device which gives the owner of the put the right, but not the obligation, to sell his/her shares, at a specified price (the put price), by a predetermined date to a given party (typically the company).

6.2. Call Rights. In contrast to put rights, call rights or a call option refers to the right, but not the obligation, to buy an agreed number of shares within a certain time

for a certain price (the "call price"). The seller is obligated to sell his/her shares to the buyer if the buyer so decides.

6.3. Preferred Distributions. In some instances, it may be necessary or advantageous to incentivize potential investors by including a preferred distribution for investors. Most closely held companies give their board the discretion to make (or not make) distributions of profits and the amount of such distributions. A preferred distribution constitutes the company's contractual obligation to pay a minimum amount to the holders of such preferred distribution rights ahead of making any discretionary distributions to all owners. Often times preferred distributions are "cumulative", meaning that a preferred distribution which is not made in one year cumulates and is to be paid when the company has funds available to pay it.

6.4. Preferential/Accelerated Distributions. In regards to general distributions of profits, in order to maintain governing control of the company following a private offering, and in addition or alternative to preferred distributions it may be necessary to offer investors a distribution preference. For example, suppose the investors as a group own 40% of the company. A distribution preference would be to make 60% of the company's operating distributions to the investor class for a period of years until the investors recoup their initial investment. Upon doing so, distributions would then be made pro rata based upon ownership percentages.

6.5. Written Agreement. All of these mechanisms should be included in a written agreement between the owners (an operating agreement for an LLC or a shareholder agreement for a corporation), and new investors should be required to execute a joinder to the agreement in order to bind themselves to the agreement.