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Crowdfunding: From Social Enterprise to SEC Regulations

Panel Discussion

CROWDFUNDING: FROM SOCIAL ENTERPRISE TO SEC REGULATIONS

WELCOME AND INTRODUCTION:

Katila Howard: Ok well we're going to get started. And I have the honor of introducing the Dean of the Law College, who is going to do our welcoming and give you several remarks. Thank you.

Dean Howarth: Well first I have to offer congratulations to Katila and the rest of you for being the first event in the eight years I've been at the Law College that actually started on time. So congratulations, as it's probably a good sign of your ambition and importance of the substantive issues that you all will be discussing today.

So my first opportunity of course is to welcome our distinguished guests who are here with us today and others who will be part of the program as the day unwinds. We are committed to being successful and gracious in welcoming hosts. So would all of our guests today please make sure you let us all help to make this a rewarding day? The other thing that I wanted to specifically say to all of you, including the members of our wonderful Journal of Business and Securities Law is that I am really intrigued by the subject matter. The idea of doing a symposium today on crowdfunding is truly very interesting and I'd like to thank, and this may or may not be true, but I'd like to think that part of the environment that created the impulse and the insight that this is worth the attention of the Journal and all of us is something related to the kind of, the ambiance if you will, related to trying to be very forward thinking at this law school. Taking pride in the school is, of course, as they have to do with law and technology, that have to do with law and predictive analytics, that have to do with the kinds of issues that you all will be talking about today. And I see the efforts, the Journal today and the contributions of all of our distinguished guests and participants as very much in line with that.

I think the goal here is not to be preparing the lawyers to practice the way that I practiced. When I was privileged to have clients, some of the ways that I practiced absolutely…the dedication, the professional responsibility, the focus on the needs of the client, the leadership opportunities, and the communities in which we work with, the keen analytical skills, and knowledge, and legal judgment absolutely. So the goal right now though is for us to educate all of you in those fundamentals. At the same time that in the sense that we are all educating each other as to where the profession is moving and I see this day today as very much in line with that. We're really about that mission. So thank you very much for being here and I think I'm about to put you all ahead of schedule because I don't really have fifteen minutes to talk about because I think it's better to get to it. You all seem poised and ready to get to the substance and I don't want to stand in the way

PANEL 1 – EQUITY CROWDFUNDING:

Matt Morrow: Thank you Dean for your remarks and for being with us here today. My name is Matt Morrow and I am the Editor in Chief of the Journal of Business and Securities Law and I will be moderating our first panel this AM, which should last until about eleven AM, when we'll have a small break and there will also be lunch served, so please stay around for that and mingle with the panels. Full attendance would be great.

I'd like to take a moment here to introduce our first panel, which will be speaking about equity funding. First we have Eric Alden from the NKU Salmon P. Chase College of Law. Professor Alden is the associate professor of law who came to Chase from Palo Alto California where he previously had been equity partner in a corporate securities law and the large high tech IPO law firm in Silicon Valley area and later equity partner in the Silicon Valley office of a Global Law firm. His broad securities regulatory and transactional experience including public companies disclosure counseling, corporate governance, public and private offerings of equity, debt and high risk structures, mergers and acquisitions, the formation of private investment funds, and representation of banks and hedge funds and their interactions with the public markets. With an overall emphasis on technological securities law and SEC focus on compliance matters. During 2005, 2006 Professor Alden served as the attorney fellow at the Securities and Exchange Commission in Washington, D.C in the division of corporate finance and the office of the general counsel.

Next is Mr. Thomas Coke. Mr. Coke is a former securities regulator for the State of Michigan, now delving into the private sector as serving as the go-to source for crowdfunding and the JOBS Act that he focuses on how small business will be able to harness the new rules to raise capital. Mr. Coke has experience running his own law firm and is a certified mediator. Additionally he is also the CEO of CampusStarter. Mr. Coke received his bachelor's degree from Kalamazoo College and received his Juris Doctorate from Michigan State University as an alum of the College of Law here. Mr. Coke works for the Youth Organizations such as local sport club organizations.

The third member of our panel this morning is Mr. Richard Hoeg who comes to us from Honigman Miller Schwartz and Cohn. Mr. Hoeg focuses his practice and area of general corporate governance with particular focus on venture capital representation and mergers and acquisitions. He received his Juris Doctorate just down the road at the University of Michigan Law School where he graduated Magna Cum Lade. He received his Bachelor of Arts in Economics from Hillsdale College where he graduated summa cum lade. Thank you all for being here today. We are going to get started with our presentation from Mr. Alden. Thank you very much.

Eric Alden: Thank you everyone for inviting me here today. Is my voice calibrated about the right level? Ok, very good. Again, thank you for the kind introduction. Just picking up on it to sort of bring out the background a bit again, fifteen years I spent working in private practice in Silicon Valley doing high tech startups and venture capital financings, IPOs and all kinds of other work. So, this is bread and butter stuff to me. The formation of capital for little tiny startups is stuff that I have done for much of my professional life. However, in 2005 and 2006, I was at the Securities Exchange Commission, so I've also seen the issues from the other side of the line, if you will, from the regulatory side. And I'll try to speak from both perspectives as we go forward here.

I've learned that just a few minutes ago, I had prepared for about seven to ten minutes, but I found out we've actually got a little bit more and so extemporaneously I think that just a short history of how we got these new equity crowdfunding rules might in fact be very useful and of great interest to set the stage for what I'm going to say and hopefully for the other folks as well. So, very broadly speaking, the new equity crowdfunding rules come from the JOBS Act of 2012. So it's a recent innovation and the SEC has just very recently finally promulgated implementing rules to put in place the regulatory structure for equity crowdfunding pursuant to the JOBS Act. But there's history behind it. Before the JOBS Act the way that private financing has been conducted for the little tiny private companies that are getting started up has been almost exclusively by means of what is known as Rule 506. A Rule 506 offering is one where you, as a practical matter, only offer securities, sell securities, of the little tiny private companies to what are called "accredited investors." An accredited investor, broadly speaking, is a high income or high net worth person, or a business entity that has at least five million in assets. Broadly speaking, that's what accredited investors are. And that is how private financing activity is in point of actual fact conducted in practice.

There are a number of other possible exemptions and avenues that one might use under the SEC's regulatory structure to conduct offerings. All of them have been crippled or hobbled in one or another manner by expensive, highly prescriptive, highly detailed disclosure requirements or other limitations that render all of them unattractive. The one that the SEC managed to keep a very light touch on, and I'll go through in some detail exactly what was going on, is Rule 506, and that's why Rule 506 is the one that everybody is using. However, stepping back to this accredited investor definition that I gave you a moment ago -- Rule 506 has had the effect that the only people, as a practical matter, who have been able to invest in little tiny startups are relatively well-to-do people. Anybody who has a, what I'll call a normal income level, most of middle America, any of us academics now -- I used to be high enough income, but since I left private practice and went into academia I've, you know, I am no longer at least on the income definition of accredited, right -- everybody who has a normal income level has been protected by the government right out of the market. None of the little tiny start up issuers will offer securities to normal income or lower income people because the process of doing so would be so extraordinarily regulated. You'd have to do, effectively, what is a public offering. Pay huge amounts of money to lawyers. I can talk more about this later and answer questions on that. That it's not worth it.

So the intuition of the JOBS Act of 2012 was, I think, brilliant. The objective was to liberalize capital formation for tiny little businesses. It was to say, one, we shouldn't just go to accredited investors; we ought to open up the possibility of investing in a little tiny start up to people who are not accredited. Let's try to figure out some regulatory structure that will allow that to happen in a way that does not lead to many people getting hurt. Does not lead to too many problems, but opens things up. And second, to permit the extraordinary power, the revolutionary technical power, of the internet, which treats large groups of people and facilitates communications, let us unleash the power of the internet in terms of raising money. So both of those things are excellent initial instances of the JOBS Act.

Bear with me one second. So turning now specifically to crowdfunding and what is occurring in that domain. There are several different things that are referred to frequently as, quote, "crowdfunding," out in the market. The way crowdfunding actually started, with outfits like Kickstarter and Indiegogo, was using the internet to solicit funds, but in a way that did not involve the sale of a security. So what people would do is they would use the internet to say, "I would like to do the following activity or I need money for x, y or z. Please give me money. Make a donation. Just give me money." It's nice, you know, if you can pull that off, it's a wonderful thing. Of course, it's a donation, a donative transaction, and you're not selling a security. The whole securities regulatory structure is simply not implicated by that. Similarly, there are folks who have done crowdfunding via the internet to do what are in effect presales of products. Where they say, we are trying to develop, for instance, a board game. If you give us a little bit of money, we guarantee we will then give you one of the first copies coming out or an advance copy, that kind of thing. There are even arrangements that have been entered into where people sell percentages of royalty streams coming off of licenses. So all of those things are non-security crowdfunding and none of them implicate the securities regulatory structure. [Speaker's subsequent correction to own earlier extemporaneous statement regarding interests in license income – passive interest in an income stream generated primarily by the efforts of others could constitute a security under the *Howey* test, would have to be examined in light of facts and circumstances of any particular proposed arrangement.] We also have something that was put in place by the JOBS Act called 506(c) and I'll touch on this briefly before we get to our main crowdfunding thing. 506(c) is part of Rule 506 -- if there's an offering that's going to go only to accredited investors, one is now permitted to use the internet to actually approach them. Under traditional 506, you could only go to the accredited investors as a practical matter, and I can answer questions about that later. And you could not use the internet. Using the internet was deemed to be a quote, "general solicitation." that would trigger the full spectrum of IPO rules. You'd have to do an IPO. So what 506(c) does is it says only accredited investors, but we will permit you to use the internet to go and find them. The JOBS Act of 2012 does not refer to this as "crowdfunding." It just says this is 506(c), we're creating this new ability. However, out in industry people are now actually using 506(c) to do offerings to procure accredited investors using the internet and they are referring to this as "crowdfunding." So you see, anything that uses the internet, people are very tempted to call it crowdfunding whether or not Congress calls it crowdfunding.

Alright. With that, we also have Regulation A+ that was put in place by the JOBS Act of 2012. Which is a form of IPO-lite. You have a whole bunch of proscribed disclosures you have to come up with, you have to file stuff with the SEC, you then become a form of public reporting. Because you could do a Regulation A+ offering using the internet, some people are calling that crowdfunding. Again, there are others who are sort of purists who say that's not crowdfunding. But you'll see some people are referring to it that way.

But let me turn now to the thing that Congress calls "crowdfunding" and the SEC calls "crowdfunding" and which is the focus of today's presentation. Which is new section (4)(a)(6) of the '33 Act. Section (4)(a)(6) is an exemption from Section 5 registration requirements and it says if you follow the following rules you can do an offering and you don't have to register it as an IPO. This is crowdfunding. The JOBS Act calls this crowdfunding and the SEC has now just recently, late last year, come out with the implementing rules under (4)(a)(6). And those rules, by the way, go effective May 16 of this year [2016]. So it is imminent and shortly will be upon us.

Alright, the major distinctives of (4)(a)(6) of equity crowdfunding. So we're talking now about the sale of securities, so you can use this thing to sell stock in the company, common stock or preferred stock. You can also use it to sell a debt security. All of those involve the securities regulatory structure. But if you do a crowdfunding within the meaning of (4)(a)(6) following these rules, you don't have to register it as an IPO. So major distinctions: (i) you can use the internet to do it; (ii) second, you are not limited to accredited investors. You can offer these securities to anybody. Anyone. Even folks of very low income, you can sell securities to them; (iii) third, the offering must be conducted through what is called the "funding portal." The funding portals are things that are going to be operated either by brokerages houses, investment banks, or by people who even though they're not brokers, have gone through the trouble of registering themselves as, quote, "funding portals," and these serve as intermediaries for the offering process and they provide what I'll call audit oversight, if you will. That's really the idea behind them.

The next distinctive is each individual investor investment is limited in amount. The idea was, in order to make it possible to go down to non-accredited investors, the way to protect the public is to say you can only invest a tiny little bit of your overall income in any given company, or frankly, any host of companies, in a given year. That is how you will be protected.

The final big distinction, and this one is actually significant and adverse, is that Congress and the SEC did not follow one aspect of Rule 506 that is the real genius of Rule 506, and I'll be turning to this again as we go through the presentation. The most important thing about Rule 506, the thing that made it really genuinely, truly attractive, and the reason that it is what is used overwhelmingly for all private capital formations in the U.S., is that the SEC said, when you do your offering, as long as you're only going to accredited investors, you have no specific disclosure requirements. You can't lie, the antifraud rules apply, but we will not require any specific disclosure. Which means you do not have to pay $100,000 to have a law firm come up with some private placement memorandum. Moreover, you have no ongoing disclosure requirements. You do not become a public company "lite." So you can conduct your offering in a way that is, from a legal cost perspective, economically very efficient. Very clean. That approach was not followed by Congress and the SEC with the new crowdfunding rules. I believe unfortunately, that, my perspective as we go further, what they have instead done is that they have gone for a form of IPO lite. Very lite in this case, but nonetheless there are specific prescribed disclosure requirements that have to be met by the little tiny issuer trying to raise money. And once they've done so every year, they're going to have to file another annual report with the SEC. All of this stuff is technically filed with the SEC, so it's not only a statement to your investors, but it's also a statement to the government. Which implicates some very sharp white collar criminal provisions. It can be truly terrifying.

So, what I think they have done, unfortunately, is to say that even though the initial instinct in the JOBS Act was to really open things up, they couldn't let it go out of control. They still want to protect people a little too much and they put a whole bunch of crippling little things on that I think are going to impact how much this gets used. I think it can be fixed.

Alright, so let me walk through then a bit more technical detail some of the aspects of the new rules. Just so everybody has contours of it. First, the issuer is limited to one million bucks per year. So a little tiny company that wants to raise money in crowdfunding can only do a million bucks per year of this stuff. Step back for a second. That means that crowdfunding stuff can only get used for very, very tiny seed level startups. It cannot be used to raise the much more serious money that is typically raised in venture capital financings for tech companies that are really powering up toward an IPO. We do a VC financing around 10, 20, 50 million, 75 million dollars. That's a VC financing round. You could never use this stuff, this new crowdfunding, for that kind of financing. You cannot. Second, there is a limit on each individual's investment, and the limitation is if your income or your net worth is below $100,000 per year, then in any given year you can only invest 5% of that amount in any of these crowdfunding offerings across issuers. And there's a floor of $2,000. You can always invest $2,000, but not more than 5%. If both your income and your net worth are over $100,000, then you can invest 10% of your income. But in no case an individual invest more than $100,000 dollars per year in crowdfunding. Moreover, the SEC said we're going to apply these limits not just to individuals. Even if you have a professional investing outfit -- say you have some investment fund or VC fund that wants to invest in crowdfunding stuff -- that fund will likewise face the very same limit, which is to say you're not going to have a big funding from a single source through crowdfunding.

What crowdfunding will always involve is spreading the investment around across a lot of people who invest in very small amounts. One of the upshots of this is, and we'll talk about this more, is it will profoundly affect the corporate governance of the issuer. What one has seen up until now with high tech startups is that you have the founders who really know the business and are running it, and then you have professional VCs who are very educated in the space, very often have both technical degrees and in business, and work tightly with the management of the issuer and it's a fairly closed club. And they know each other and they control what is going on in the company effectively. A company that manages to crowdfund is going to be admitting a whole bunch of relatively -- from at least an investment perspective -- relatively unsophisticated people into the company who are now going to have voting shares presumably. And it's unclear whether venture capital funds are going to later be interested in investing in a company that has crowdfunded because they're not going to be just dealing with the sophisticated couple of founders. They're now going to be dealing with the founders and a hundred and fifty other people who've invested a little tiny amount and who may be uncontrollable and erratic and may have ideas that are at odds with how the VCs would want things to be run. So there's a question: once a crowdfunder, always a crowdfunder? Do you limit your ability later to get VC financing if you go the crowdfunding route?

Alright. You have to use a portal. You're not allowed to do crowdfunding outside of the portal. There must be the addition of oversight. The portal is required to also put in place means of communications so that the investors in the company can communicate with each other back and forth as in current crowdfunding: what do they think of the company? What is the social media variant, if you will, of a private company investment? There is an online only requirement. If it has to be done online, then during the entire offering process you are not allowed to hold a roadshow or meet physically with the investors. It all has to be centralized through a single website, the portal, and it all has to be done online. The idea was to facilitate and encourage the wisdom of the crowd. They can communicate with each other and it can all be easily findable in one location.

There are some exclusions. Crowdfunding is not available to foreign companies or SPACs. A SPAC is where you form a company to do acquisitions of unknown other targets at some point the future. Most significantly though, you cannot use it to raise money for a (3)(c)(1) or (3)(c)(7) entity under the '40 Act. (3)(c)(1) and (3)(c)(7) entities -- those are exceptions to the definition of "investment company" that everybody uses when you're forming a private equity fund. So, if you're going to form a venture capital fund, if you're going to form a hedge fund, you're going to form an LBO fund, or any other kind of private equity or private investment fund or real estate private investment fund, you use (3)(c)(1) or (3)(c)(7) and crowdfunding is not available for that. What it means is you cannot use crowdfunding to step up your own little investment club. So if you and a bunch of buddies, once you get out of law school, say "Hey, we'd like to go to a bunch of doctors and lawyers and assemble a little tiny sort of investment pool that we're then going to use," you cannot use crowdfunding to do that. You're going to have to use your traditional 506 to get that.

Alright, on the disclosure requirement. Again, this from my point of view is really the killer aspect, which is you have to do disclosure during the offering, and you have to update the disclosures any time there is a material change. You're going to have to do an annual report depending on the size of the offering, you're going to have various levels of financial disclosure. You'll have to do more if the offering is over $500,000. You're going to have to have audited financials.

And the disclosure requirements, some are kind of general. It says, "description of the business." Ok, anybody can do that. You don't have to be a trained securities lawyer to sort of come up with a description of your business. However, other disclosure requirements are of the type that only somebody who is a trained, experienced, corporate and securities attorney is going to be able to fill out. Stuff where you're talking about the capital structure of your company, the respective rights of different classes. How they exercise the rights by one class might have adversely affect the rights of another class. How various potential corporate actions in the future might affect positively or adversely the class of securities that you're selling to the crowdfunders. Things involving how the securities were valued and how they might be valued under various corporate actions that might occur in the future. Really extraordinary stuff. There's no normal business person who just sort of is doing their business and is going to have the answers to any of that. Those were, moreover -- they're not just coming from the SEC. Congress in the legislation itself, in the JOBS Act, specified that these disclosures would be made, and so as a practical matter you cannot do a crowdfunding unless you hire a trained attorney. Like the gentlemen here [indicating co-panelist] to help you get it done, because otherwise you're going to be committing massive fraud. You're going to say things that are so crazy that you could be hunted down by the SEC. Moreover, again turning to the point about the white collar criminal laws, the way things generally have been is that you go under 506 when you do an offering. If you choose to make some disclosures to your investors, the principal risk you face if your disclosures are wrong is that they'll sue for rescission. You'd face a private lawsuit. But you haven't filed those disclosures with the government. If, however, you're quote, "filing things with the government," just like the new crowdfunding rules require, the government has some very harsh tools that they can use to go after people. One of them is 18 USC § 1001, the Federal False Statement Act. Which is a five year felony for recklessly making any statement to the government that turns out not to be accurate. That's a really hard hammer. Then there's 18 USC § 1519, which is a new 20 year felony provision for making any false entry in any tangible record, document, email, anything, that is with the intent to impede the proper administration of any matter under federal jurisdiction. This is shocking stuff. What it means is that there is a … you're playing for all the marbles when you're making these crowdfunding disclosures. You need to make sure that its being done properly and competently. And so again, you're going to need to have a trained securities attorney who can work with a business person whose heart may be in the right place, and has a lot of passion, and all the human foibles that human beings have, as well where they may not want to disclose bad stuff, or know that they have to or they may be tempted not to, and they need to have someone making sure the disclosures actually work. Moreover, the way the thing was drafted looks like not only the crowdfunding company might be on the hook for bad disclosures, but anybody acting as a portal may very well be, based on the way the statute is actually drafted, may themselves be liable if the disclosures by the issuer are bad. And that may significantly discourage people being willing to act as portals.

So, just to illustrate the point I'm making about the significance of the disclosure requirements: Every year in the United States there are approximately fifteen thousand or more offerings pursuant to Rule 506. Another exemption that the SEC created a while back that they thought would be wonderful for people, but involves specific disclosure requirements and ongoing disclosure, sort of an IPO lite, public company lite, is called Regulation A. Every year there are less than 10. Of 10,000, 10. That is saying you have 15,000 506, and effectively nothing Regulation A. It is not used. All of the other offering exemptions are not used. People just don't use them.

For the reasons I've articulated, here's what I think what should have been done…

I very much support the idea, the fundamental idea, of the JOBS Act of 2012 to liberalize capital formation and to go to people who are not accredited. I personally think it's important from a sort of fairness perspective, if nothing else. I also very much support the idea of using the internet.

Personally, what I think they should have done is they should have followed the genius of Rule 506 and created effectively a free fire zone, where they say, we will protect the individual by limiting the investment to a very small amount of your money so you can't get burned too badly. We'll limit you there. But we're not going to put specific disclosure requirements on the issuer. If they choose to say something they cannot lie, right. Antifraud rules always apply. But they don't have to hire a lawyer to tick through all of these specific described disclosures. I think if they had done that, I think you'd see much more activity about to take place.

Instead, I fear the rules may go the route of Regulation A. Where people may not use it because they can only raise a million bucks. They will have to spend more than a million bucks on lawyers, accountants, and whatnot. And so I think it can be fixed. I think they could amend the statute to scrub out the specific disclosure requirement and make it look like 506. Until they do that though, I'm concerned that it may go the Regulation A route and not get used as much as we hope. So those are my thoughts. I'll wrap it up there and now I guess after everybody has presented, we'll do the comments. Thank you.

Matt Morrow: Next we will have Mr. Coke come up here and make his presentation.

Thomas Coke: Mr. Coke is my father. Can you hear me in the back? By the way, he mentioned the thing about fraud. Let's commit fraud together. It's really cool. The SEC helicopters in and a bunch of dudes in navy coats with SEC written in yellow on the back. It's really quite fantastic. I'm not sure if that's ever happened…

Audience: Laughter.

Thomas Coke: But I'm going to talk a little bit about Title 3 of the JOBS Act, is what this is. Even though I'm a lawyer, I'm not the guy who knows all the statutes and all that stuff. I actually haven't been practicing lawyer, I'm in the bar, but I haven't really practiced or taken cases in, I think, 3 years, I've been in the startup world. And I used to be a regulator. There are two regulators here. They probably don't want me to point at them but, these are two former colleagues from the State of Michigan I worked with.

I'm going to talk about things from more of an entrepreneur's perspective because I think Eric covered a few really cool things. One of the things I want to touch on, that he spoke about, is Reg. A. There are new Reg. A+ that you mentioned, as well. One of the issues of Reg. A in the old days is there were a lot of states that did not recognize the exemption and used registration by qualification. Which my job with the State used to be reading registration by qualification, that had to stick with me for 90 days, figure out what you did wrong, and write you very nasty comment letters, and people and attorneys loved us. I looked at this and I think when the Job Act passed back in 2012 it was my second week on the job maybe and my boss handed me the San Francisco Chronicle, it had an infographic on crowdfunding and she said not only are we not going to train you how to do securities regulation but you now have to learn this and here's the only thing we have on it. Her daughter or son got it out in San Francisco or something like that. It was pretty exciting though because at the time, Michigan's economy was doing really well, as it always seems to be since 2008. Small companies needed to raise money and we needed to do things to energize the economy. It was really exciting because small companies wanted to start raising capital and doing cool things. There already were on some level, but this was increasing.

There's this guy named Rick Snyder who looked at us from the top saying make sure companies are raising money and Michigan becomes this huge startup hub that can be the Silicon Valley of the Midwest. And then when the law actually, when Title 3 actually got to the point where it's going to be enacted now in May, Snyder went this didn't really do what we thought it was going to do and they dropped these really awesome visual aids. Sorry, I thought I would steal some of his comedic thunder, but 685 pages. I didn't read my books in law school, I'm certainly not going to read 685 pages of stuff. Do they still have books here or is it all online now? Some momentum was killed. Again you can do this with, the term we use in some of the crowdfunding, nerdy crowdfunding meetups, is retail crowdfunding. I'm going to talk specifically on three things. One limit on deals, which Eric mentioned a little bit the size of your deal, the importance of portals and what that means, the burdens of portals as well as what they're going to have to do, and how you're going to have to work with them and in fact there are cheaper and easier ways to raise capital.

First of all, as Eric mentioned, if you're a growth stage company, someone that's high growth, some of these really hot high tech startups, a million dollars isn't really what you're going to be looking to raise. You're going to be, especially during the venture round, are going to be looking for a lot more money than that. So really a lot of lifestyle businesses and very my company—I'm the CEO of this company called Campus Starter—we're a rewards model crowdfunding site for college entrepreneurs. We're bootstrapping so we're not raising money. But we would be, well no need to have a million dollar limit but there are companies in the accelerator program that were in that and they're going to do one and a half million or two million, relatively early in their operation, to get to where they can grow in scale and become big. So this is basically…there's just almost no point doing this for them or even thinking about it. Especially because the cost. Eric mentioned audited financial statements…we all know a lot about what financial statements are. I can tell you, as a startup CEO, I don't want to be paying someone to do the financial statements for a long time. Even though I really have some good accountant friends. So that's a pretty big limitation cost… is going to be really high for the amount that you can raise. And that's one of the things that's been bandied about, I suggest that you google the cost of doing a title for a crowdfunding raise. Also I use the term SPV, special purpose vehicle. When I'm doing a Regulation D or 506(b) offering, we do special purpose vehicle. We go file an LLC in Delaware. And the investors invest in that LLC, then the LCC cuts a check to the company. That way you avoid sort of the messy cap table. You guys on the term "cap table"? That's basically the list of people who have invested in your company. Ok, so when you're going out to these venture rounds and these fallow on investors are coming in the later rounds you don't want to have the names of one hundred people, half of whom are in their underwear on their computer and thought your company was cool because these guys are going, "wait a minute, we want to get rid of these people, we don't want this to keep them around." It's going to make you look really unattractive. And Rick and Eric may have different opinions on that, but the VC route is what I want to talk. They don't want difficulty and complexity. And so I can also make things complicated for the issuer. You know you've got to do all this disclosure talking to all these people. What these people have is question ... one hundred people asking questions and trust me these people ask questions. Doing compliance work for even private securities with sophisticated investors, I would… there were days when I just wanted to shut my phone off because people from Manhattan with horrible east coast accents were calling me and asking questions that I didn't want to answer. That were stupid questions. But you're going to be dealing with that and you have to stop that. And of course the investors max out at $100,000. I can, I'll think I'm going to talk about it later but I have an odd opinion. If you're doing a conservative estimate maybe six percent of the population, if you're generous, and most of them live in Manhattan, and, by the way, being in an accredited investor standard in Manhattan—basically means you can afford a studio apartment in SoHo, a lot of them aren't investing; and what's really funny about that also is… I always use the story of my dad: my dad is just retired as an executive at a really small software company called Oracle. And my dad was pretty high up, made fantastic amounts of money – probably hate that I said that – but, my dad didn't know he was an accredited investor. And I've been in rooms in West Michigan full of the richest people in Grand Rapids, and there are many rich people in Grand Rapids, when I would ask, "who here is an accredited investor?" and like two hands go up. And usually their last name is DeVos. But everyone else. Just ok who meets the standard and Thomas enters and the more hands go up.

So, it's kind of weird, some people don't even know they are private investors. And they're not participating in this space. But a guy like Warren Buffett can only throw in a hundred thousand dollars, he's pretty sophisticated investors who had a little bit of success historically. So, we've seen in Michigan, we've had offerings that started out as interest and offering, a big investor came in or an angel group came in, and pulled that offering down and gave significantly more than a hundred thousand dollars. That supported us and what I'm on - sabbatical right now for my startup, but, I work with a company called Crowds and Connect, we build investment crowdfunding portals. I was telling Dean Spoon – they still didn't reckon, he was the dean of career services when I was here so I had to really know him intimately to get a job – but we built all these cool crowdfunding portals and really profitable portals that are doing five or six; some of them are doing some curation, some of them are putting together some forms for you, and documents for you, but there's not a whole lot of work that they're doing. So, one: there are types of crowdfunding you can do or you don't have to do a portal, you can do it outside of the portal, so portals in this preview, you have to go through a portal. Which can be a really bad thing if that portal sucks. And trust me, some of them will have to register with the SEC and FINRA and there you go, there's going to be a ton of burdens on their part. And there's a ton of responsibility that these portals have to take out. And so you're taking a lot of… putting a lot of trust in these portals. They're doing due diligence and vetting of companies. Both you know the issuers themselves for the bad boy provisions and things like that. They also have to educate the investors. That's something that a lot of people are talking about it that aren't talking about is they actually have a requirement they have to educate people who come on their portal and we don't know what that looks like or what the requirement is. They have to monitor investors because Eric talked about the income and, how much you can cap and what you can invest. How do these portals know how much you've invested already or, how are they tracking that for each individual investor. And of course reporting with the SEC and doing some things that require that I'm going to be reporting and when the JOBS Act was passed there were nine hundred websites. Using the word crowdfunding, by that December – that's eight months—there were nine thousand, and that number hasn't gotten smaller so there's a lot of sites that are calling themselves "portal" or doing some kind of talk about portal and not all of them are managed by good smart people. In fact, there are good portals that are run by smart people that have gotten in trouble and committed violations. Because somebody makes a mistake or something doesn't get filed properly. And, so even the guys that are really good and sophisticated at this, sometimes aren't good and sophisticated at it. We haven't seen a ton of Title Three, as there were when the law passed, a bunch of companies that said we're going to be a Title Three profiting portal. Right now, there aren't a whole lot. I've talked to the guy that started Seedinvest, talked to the guy that started to mount… if you guys have heard of other portals. There are a lot of portals right now because some of the requirements are pretty stiff and this you…

Eric Alden: We actually have a student, I think, at NKU who is going to be forming his own portal. He's going to be going through the SEC process.

Thomas Coke: Ok, Great… there's a couple others in Michigan that have that have gone through or started the process but they're really not planning anything out there, just the kind of people who are interested in this and want to see what will happen. If you're an entrepreneur or you have to be marketing yourself and thinking about where the best place to go to get investors is. So which portal you choose, that's something that's really important.

So, when you guys graduate if you're advising clients, you might find certain portals are just brutally bad you don't want to be involved with them and others are better. I'll use the example of yours. We built a site called Cannafani, which is a cannabis crowdfunding site and there were cannabis companies on angel list and cannabis companies and seed investors in all these other places. But because all the investors that were interested in that came to our site we want up being a place where people would refer companies to us and a lot of fun to see what's going on in that industry. There are better ways to raise. I think we've hit the accredited investor thing. It's less costly. There's a lot of portals already doing this. There's a lot of deals being done. As an example, and they do some work with the Michigan angel fund I actually have a lot of… I have to know angel and accredited investors all over the country. So I felt it helps initiate deals with desert angels. Guys there in Michigan angels and family offices in Chicago and other places, where people who never would have met each other maybe at an angel capital so-and-so meeting or some like that they might have. Shook hands. But now they're able to meet online. And they can say who is this person? Get to know each other a little bit. And you see, groups that maybe they will do the first $100,000 of a $300,000 deal. They syndicate the remaining two hundred thousand with somebody else, the internet's allowing you to do that. So it's more efficient to do. You know five or six offerings. In a lot of cases. In the old days you could raise $5 million but now the cap is $50 million. I don't think a lot of early stage startups will do it but. We've had a couple of them actually. Elon Motors is the big one that gets the press.

All the time but we've had a few companies actually go and raised on Reg. A+. And then there's the interest in crowdfunding. I have to give a plug for that because I helped write the bill here in Michigan and I worked on a couple bills around the Midwest and I get flown out to places to talk on interstate crowdfunding in places where there's like one offering. In the bills here two years old or so like that but. Companies are still doing this we've had some offerings in Michigan. Not very many but there are third. They are effectively going on and Rule 147 county governors it's an SEC rule – yes, do guys know Rule 147. You should, it's going to be on the bar exam just getting it's. It kind of governs these intrastate securities and what goes on and they're easing some of the problems on Rule 147 is the use of the internet. You have to be a Michigan company taking money from Michigan investors. And the second you use this god awful internet, my god the people in Ohio can see what you're doing. And that's a real tragedy. So they have to change those rules a little bit. That's a joke by the way people from Ohio aren't that bad. So we'll have to but, just so you know Rule 147 is going to change over time. Mostly because when they wrote the securities acts of '33 and '34, Facebook looked a little bit different now let's modernize itself. People want to use it to talk about what they're doing, part of the nature of proffering is you're talking about you're doing… you're on the internet you're telling your friends, are sending tweets out about it, all that stuff so. That will become something that's going to up the cost again. Biggest problem I see the guys at Seedinvest estimated that if you actually do a $1,000,000 raise, you'd only get $750,000 capital out of that raise. Because of all the professionals you have to go through and—you guys probably have opinions on that as well— and people should be using attorneys and should be using accountants and should be using professionals when they're doing the securities phase. It's kind of…it's funny to me that I meet with a lot of people who don't want to engage or pay anyone to actually help them out and some of these people…I mean it's amazing some of the people I see who do really bad things. But, I do tell the story; Renee, you remember this but there was a guy at home, a sophisticated hippie from Marquette, Michigan, actually I am going to see him in about two weeks. He did a securities offer under what's called Score. Guy wore a shell necklace and ran a food co-op. He submitted his initial paperwork for a securities filing in pencil. It was this thick and handwritten and all. And he was working with Foster Swift here in town which is fantastic because if there's an outstanding attorney there and she thought that was just the funniest thing. And he did eventually print it out —he didn't like copy the pencil. You didn't you know erase and like. He actually put together quite a nice offering so there are people who are sort of — you look at him and go, "Man, this guy's not going to be able to do this," but they become sophisticated. But many people aren't. So lower raises, the percentage that you can be paying for all the cost you have to be worth it. And it will; disclosures only cost if you have to do these annual disclosures. How many of you guys love to do annual disclosures... especially if you're a business owner I really like telling everyone what I'm doing and showing everyone behind the scenes what's going on. Maybe describing all the fights my partner and I have, all that stuff.

There… Seedinvest put together a spreadsheet. I don't mean to pester Seedinvest or anything, but I know the guys that run, and they're relatively smart, so they put together a spreadsheet of the costs. Entrepreneurs are still pretty excited about this which kind of shocks me but it's been tempered since the law was originally proposed and I think cost will become more manageable over time as people figure this out. One of things I was wary of is, especially with Reg. A+. I've seen these guys offering really low cost packages. It probably is the same thing in Title Three, tell people they get what they pay for if somebody is charging you a third of what everyone else is charging, probably you know it's kind of like buying a Geo versus buying a Cadillac. I think the rules will probably change or some other proposed bills and things that are being talked about right now. So some of the rules may actually change and lighten up over time. But, the other big thing that, this is what drives me crazy about this, will there be enough investors? How many of you guys are going to graduate with student loan debt? I mean a pretty nice income. But my disposable income is like, negative $40,000 a month. Just getting things I may know I've paid off my Sallie Mae, thank god but the federal government loans are still there. So what I want… there are lawyers out there who are making, you know, sixty, seventy grand, they're young associates who you think would be, "Oh this is a guy that's a perfect target for this and that can have a ton of disposal income you got a mortgage you guy got a teenage son. And a two year old my god my money. It's AAU basketball time my disposal income is going to the LeBron James basketball tournament in Akron, Ohio not to a crowdfunding raise. So there is a mezzanine to your investors who might be able to do this but I don't know how interested they will be. The reason I bring that up is when we wrote the bill in Michigan there was a lot of talk about "oh, Michigan has ten million people and if everyone were to put in, you know $10, look at how much money that would be, that we so much capital." But half the people in Michigan are kids who don't have, you know they're not going invest, and the remainder, about half those people are old people who are terrified of computers. So they're not going to do crowdfunding. And then you have a lot of people who, you know they'd rather spend their disposable income on Coffee or cigarettes or lottery tickets whatever it is. Maybe you can get some of the lottery to get people to come in but not a lot of non-accredited investors are really looking. There are some out there. I talk to people frequently that want to, but most of the time. These investors are really looking to get into in essence startups. And, by the way, startups can take a long time to pay back. And that's the reason why convertible notes usually have a really long… the repayment doesn't start for a while. Take your time to get to revenue so you can pay people back and not go in to total failure mode. And as a startup CEO, I can tell you there are days when my investors are asking me questions like, "We haven't failed you guys. It's been six months. Let's give it time." But some investors are going to be ready for that they want to return pretty quickly. Thanks for having me.

Richard Hoeg: I still have a little bit to say after these two. These fine presenters have already said their piece. Just to give you a little background on myself, I am a practicing attorney right now. I work out of Ann Arbor for Honigman and was motivated, coming out of school, to really start looking at tech and entrepreneurial startups. A number of my clients are venture capital in Ann Arbor and I have worked with private offerings a great deal. So much so that it was 2007, 2012 and '13 that my phone started ringing. And having both clients outside the firm and partners inside the firm start asking me about crowdfunding. This is going to the next big thing. I hear about it on CNN money—let's talk about it, "crowdfunding, crowdfunding, crowdfunding, it's going to be great." And so in that capacity, as a senior associate, not quite partner, I was asked essentially to read the JOBS Act and then read all the regulations that come out of it which I didn't realize at the time was going to be 2,400 pages or so as they went down the line and did 506 in regulations plus. And now, regulation crowdfunding, which is the official name for this regulation that they've put forth. Which is the 685 pages that is on both sides of the panelist table. At this point, this out of bounds a program we've got to keep the table up sure. So, as a practicing lawyer

I get those calls and, I think you heard this a little bit from the earlier presenters, but the very first thing you have to do is parse out what this person is really asking you. People use crowdfunding to mean about seven different things and I think you've heard descriptions of them all but it really does talk about 506, which is what I'm going to talk about primarily because I do think that that is the answer for what I represent and for what a number of us attorneys represent which is venture capital early stage tech biotech—biopharmaceutical here in here in Southeast Michigan, the MILES Act, which is the Michigan Invests Locally Exemption. That I got it right? Ok. Which is the intrastate exemption that is available only under the Rule 147 compliance regime. Which is the 80/80/80 rule you might have heard, which essentially requires 80% of revenues in assets, and a company to be located in only one state and, the reason that works is because it gets you outside of the Securities Act, which, based on constitutional parameters, says we're not going to mess with the internal decision-making of the states. Regulation A+, which is a variation on Regulation A, which is the mini IPO which you heard. We call it that because the disclosure requirements are so onerous that for $5 million it didn't make sense for anyone you heard less than ten as an offering number. I believe the last time I checked on this there was one Reg. A offering in 2013 and that was the last one for the last three years it was. It was something like that and ninety-nine percent of all money comes through 506, now 506(b). Because 506(c) has come in and kind of sat with 506.

So, you have to parse out what your client or your perspective client is asking you. Are we talking about an accredited investor exemption that you just want to advertise to? That's a 506(c). Are you running a brewery, in Tecumseh? And you want to have that money come in and you want to use? Are you thinking about an IPO? That you don't want to disclose 90-100% of? You only want to disclose 90% of it and still have the same requirements? Then we're talking about Regulation A+. A+ is new enough that I'm not, I don't believe anybody at Honigman would, and it would surprise me if many others at the other Michigan law firms have dealt with a lot directly. But that's going to be unlikely, to really be where your bread is buttered if you're representing small tech startups. And the last one is regulation crowdfunding. So my fellow presenters have talked about how the securities act works. But I have these bullet points here and I'm going to say some of them because this is all I have on my sheet. The basis for how the SEC regulates what the securities act is designed to do is to say, "Companies you can't offer these things to the public, unless you follow some rules that we give." And those rules are, we know as an initial public offering, registration requirements, disclosure requirements all the things that look so expensive to making money under that regime. But as you might note, then, if you're not offering to the public, you don't have to follow the securities act. And so the most common way of saying, “Hey, we don't have to file federally” is to say this isn't public. Look I know these guys. We had a meeting. They want to put in money, they're my friends, they're my family, they're my founders. Whatever it is. It's not public. And the easiest thing to do and it's not necessarily the one we recommend because of safe-harbors, which, I’ll talk about, is to say, “SEC it's not public.” And then you go to the various state regulators, which are known for blue sky laws, which is the reference we make to securities laws in the various states, and say, “Well, we're not public.” You go down, they’re securities rules, and in most states, I’d say 80% of states, will have some kind of exemption for a transaction that's relatively small. Michigan allows investment in Michigan for up to thirty-five investors and if you don't get clear of that thirty-five investor milestone, you can say it's not public SEC. It's not public in Michigan. We're good to go. And we're done. From a legal perspective, we don't like that because you centrally have to say, “We're not public,” and then the SEC says, “Yes you are.” And, for the most part, if you read the 685 pages on regulation crowdfunding, you read the 550 pages on Regulation A+ or however many pages there are for Rule 506(c). The SEC leans on this concept of facts and circumstances, “We don't know it, but we'll know it when we see it.” So if you're violating this rule which has all the onerous items that my fellow presenters talked about, if you're violating this rule, “We're going to figure it out when it happens.” And then you're going to be in trouble.

So as a lawyer, we're risk averse by nature but we're very risk averse when we're vising clients. We say, “Well, we go okay.” We can do that. Here's your exposure risk. Everything goes terribly, terribly wrong and though I don't like to use the f-word, fraud is an issue. And so you have to have that conversation with your clients in the case of 506(c). Which is the favorite at Honigman and my favorite for talking to clients about what they can do with a generally solicited offering today. The issue is slightly different. So 506(b), which is formally 506, where all the money has come in in the past is the safe harbor rule that allows you to say, okay, I see we're not going to get into facts and circumstances, we're not going to fight about what's public or private. If I meet this very general disclosure and I turn in my Form D. And then we both agree that, if I didn't lie blatantly on that sheet, it's going to be a private offering. We're going to go. And then federal law comes in and says, “Okay, state regulators if they use 506, you actually can't do anything about it, they can file that Form D with you. You can collect your pound of flesh for whatever you want to collect for a filing fee. Or if you're New York you can blatantly violate federal law and ask for $1,500. And then those people are going to be good; it's going be a private offering and you're going to be all set. 506(c) comes in because that Act, that federal preemption called NSMIA, allows you to preempt state legislator. State regulators come in and say 506 he's going to be allowed. We're going to allow advertisement. We're going to allow you to fly a blimp over Michigan Stadium or anywhere else you want to fly that plant. You can be able to advertise your offering. And as long as you only sell to accredited investors, then you take extra steps to verify that their accredited investors. Then we're going to call you a private offering. Even by any natural reading of the actual occurrence with that blimp flying and the billboards next to Tom Izzo face saying buy this stock. Anything else is going to be considered a private offering by statutory fiat and not by logic, so we talk to our clients and say, "Okay, 506(c) is going to be great. It's going to be something that we can possibly do. You're going to be interested in it."

But, unlike a 506(b) offering, we're you're not allowed to advertise and if you have a technical foot fault—you didn't fill out your form quite correctly, or you did something else that's right on the edge—and we can say, "Okay, alright, we didn't quite meet that safe harbor but we can make a pretty good claim that it's actually a private offering in the securities act, can't apply. You go in and you look at 506(c). And you say, "Alright, if we have a foot fault, if we have a technical error, if we didn't file a form correctly or if we said something else. The SEC says, "Boom you're out of the safe harbor and by the way now you've flown a blimp over a stadium and that's a public offering and let's talk." And so we have to tell clients that. And, we have to say "Alright, we can do this. This is going to be a good option for you." I have a number of clients that are doing it right now. 506(c) is having the uptick it's only a couple years old. But it's slowly growing in acceptance in my client base at least. But, you have to be really careful. You have to be really sure you know what you're doing. A lot of my clients are using what is known as the third party accreditation ability under 506(c) which allows honest people, such as lawyers, to verify the credit status of the investors. I'm sorry what was it was that I was. Oh, I forgot to mention the start of this since I am the third presenter and I am just kind of picking out various thing to say. If I say anything confusing or if you want to jump in with a question, or even a question for my other presenters here, you can do that at this time. I'm happy to take those questions and have that discussion. But yes, yes, you see actually, I singled out lawyers. Barred lawyers specifically honest and good representatives of the people to decide on "accredited investor" status. Which I thought was just lovely from the SEC. But 506 lives in that space where, if you make a mistake, you're going to be really, really screwed. And, so you want to be very careful with it when you're advising clients. That's something you have to tell…a lot of will take on that exposure risk there's money sitting there, that want to advertise, they want to put up that billboard. We've got to say, "Hey. Okay, this is a little bit more scary than real 506(b), in terms of regulation crowdfunding, I was afraid when I came in here today that I was going to wind up being the wet blanket. And being the lawyer, as I'm known to do, and put out the parade of horribles and bad things that can happen to you. And why regulation crowdfunding is… it's very unlikely from my perspective it's very difficult to predict the future but to have a significant uptake, at least in the in the outset, and it's going to be from people like me when the clients call up and say, "Hey, this is exciting. I'm interested in it." And I say, "Well, no we don't want to do that. Are you sure you can't find accredited investors, because if we can find a credit investors were golden."

And, unfortunately I wind up in the same place as my fellow presenters, which is to say regulation crowdfunding, as it's put into effect, has a number of issues. One of the things I didn't hear mentioned, which I did want to flag, was not just the investment company restrictions which prevailed prohibit an investment company or fund, hedge fund, whatever from using regulation crowdfunding. The SEC has also added on that if a company doesn't have a valid business plan, they are prohibited from using regulation crowdfunding. The SEC, as is their want, in the middle of that 685 pages then has three or four pages that says, commentators have said, "We don't quite know what you mean by a business plan? How specific does this have to be? We're small company or medium sized company. Does it change what is it?" And like the SEC very often does in their regulations in their promulgated they say, "Yeah, we don't want to limit you to a specific kind of business plan, so we're not going to tell you. We hope it's good. If you have something that approximates a business plan, we promise we'll be gentle." But you have to have a business plan or you're not going to be able to use it. And I sit back and I've Kickstarted a bunch of things, who here has Kickstarted or Indiegogoed or given any kind of crow funding to do a product or anything else.

Yeah. So, it's had a reasonable bond uptake and it always surprises me when I look at title three and I look at what congress asked for and I look at what the SEC has done. That the way the regulatory framework works, they are perfectly ok with me spending $10,000 on a lunch I might not ever have with a game developer in San Fernando. But they're not ok with me potentially participating in that company's upside. And that's just the way it works it's a historical accident, to some respect. But they can't touch Kickstarter because they're essentially pre-sales and promises to talk about products. And the one time that I did see a Kickstarter try to essentially sell an equity interest it was down in twenty-four hours when somebody said, “No, no, no, no, can't do that.” You know? So, it's an odd position that the government and the SEC finds itself in where. Kickstarter is very popular, Indiegogo is very popular. People are putting in real money. Presumably not all accredited investors. Have somebody that's always been your hero when they're offering to have a skype conversation with you at one in the morning, I don't know how you refuse that. And suddenly you're $8,000 in the hole, and you wonder why you're on Kickstarter in the middle of the night. So don't do it. Don't be on Kickstarter in the middle night.

But so, regulation crowdfunding comes in and says, well that's all well and good, but we need to really protect these people. We're going to require them to disclose their officers, their directors, their employees, their 20% owners. They're going to have to have a business plan. They’re to have to have a narrative specific description of the use of all their proceeds. They’re going to explain how they came up with their price. Or, if they don't have a price yet, how they're going to come up with their price. They have to have a narrative discussion of their financial condition which is not quite the same as saying something about your business that admit is probably easier but what they've actually described for a narrative description of your financial condition scares me and I’ve been doing this for ten plus years. Description of capital structures already mentioned I feel like I could get around that but the business people couldn't on their own. Financial statements is an interesting one and one of the things I would also impart on you in terms of lawyering and going into practice and representing clients is when you're on the bleeding edge you're looking at how the SEC or another regulatory body is interpreted in what congress has put before them. You have to somewhat play into reading between the lines and figuring out how this organization feels about these…these laws that have been put forth and I want to take a minute to say that, yes the SEC had their hands tied in a number of respects in the JOBS Act because the congress did ask for a lot of these disclosures. But in a number of additional areas they really didn't. And then they really made it harder.

One of the things I didn't hear mentioned is that they added on what we call a 10(b)(5) representation as part of the disclosure which says, “We've just close all this stuff. We put together an eighty page PPM. And you've read it all.” But we also have to promise that in case you misunderstood any of this. All the information that we've included is not misleading because we forgot some. And that 10(b)(5) representation that… representation that the way you read this can't be construed as misleading, has the same fraud teeth, the same ability to be found to have lied on it as any other representation. They’re making the disclosure and that wasn't part of the JOBS act. The SEC said, “We took it under advisement from a commenter on the previous version of the rules we tried to promulgate. We said hey we think that's a good idea and we added that. Very similarly you saw that the restrictions on participation in the capital of a regulation crowdfunding offering is, if you are either lower then I believe it's a $100,000 net worth, or income, then you're limited to 5%. And, only if you are both higher than those items, can you go up to the 10% limit. But if you actually read the JOBS Act, you actually read Title Three, Congress did a terrible, terrible job. They wrote that it's either/or at 5% or either/or at 10%. Which is completely impossible to logically separate. The SEC. looked at that and said, “Oh yeah we're going to make it the one that's harder for them to invest with.” And so you've got to take that into account. You're going to be talking to a client you're going to say, “Well, how do you think the SEC is going to feel about this when we actually get the offering in place.” Well, they added a 10(b)(5) rep. They took the lowest possible amount that they could actually implement under the JOBS Act. They added a number of disclosures that weren't required by the JOBS Act. And they added a bunch of other things that were kind of potentially contemplated by the JOBS Act but not really. You're only allowed to use one portal. You can't use multiple portals. It's a little bit unclear exactly how you can shift between portals and avoid integration of offerings. As my colleagues pointed out, that can be an issue. Some of these portals are not going to be very good. You're going to want to switch between them. Or potentially, you're going to want to have two offerings but that's not going to be permitted under the regulation. And that wasn't allowed by the law itself. So you have to do a little bit of reading between the lines from where I sit and when I’m representing a client say, I don't think that the SEC is all on board with what the JOBS Act is trying to do. And so, unless you have a hellfire need to get this money. Under regulation crowdfunding you want to be the first out the door. My recommendation is find accredited investors. We can do some fun stuff with 506(c). And, if that's not available to you, let's let somebody else take the bullets for a little while and see what the SEC does. And unfortunately, I think that's what you're seeing writ large among the general advice given at the front end to clients that are interested in pursuing this… I was speaking with Thomas, before this started, and I jokingly said, "Yeah, I was tasked by Honigman to start reading up on this in 2012 and, you know how I made the money if I build anything?" So well, I make enough money on the one hour phone call where I say no don't do this, let's do something else, and you know that accrues very slowly if you're looking at things from a billing perspective, but obviously you don't want to charge a client for getting halfway through something that isn't going to make them money. And those numbers you saw 750,000 out of a million. I think in some ways they're generous, especially at the front end because you're going to have to do everything, I's dotted T's crossed. Be very, very careful because if the SEC is hostile to this, or if you just have people in there that are potentially hostile of this, they're going to looking for examples. And you don't want your client to be that example. And so you have to take that under advisement when you're giving that advice.

I think the last thing I just want to mention, I didn't see it pop out here, just in terms of the costs, but mandating that a portal be used is going to take something off the top. I think Kickstarter currently takes 5% I don't think there's a limit in regulation crowdfunding for what the portals can take. But, I can be corrected on that. There is a limit under the Michigan Invest Locally Exemption, I think of 5%. But it has its own disclosure issues. But that's very that's really the state of play as I see it as a practicing attorney. A lot of people are interested. It's a lot of buzz words. It's very useful to know because your clients are going to be asking you about it because people want to make money. They want to have their dreams come true. They want to raise capital and lawyers that are practicing are going to need to know that this either isn't a good idea for their client or potentially it is under very specific circumstances. For a million dollars maybe you have something that you're just trying to do a capital raise and adding to a building or something that's adding to an existing structure that's already revenue positive. But you're going to need to know it. And so I still think this is valuable. Even though at the end of the day my recommendation is generally no this is not the direction you want to go right now. And I think that's all I have to say. So that we can move on to questions of the rest the penalty thank you thank you.

Audience: Clapping.

Matt Morrow: Thank you to all the members of our panel for taking time to show their presentations today. We're now going to open up to questions portion of this panel. Does anyone in the crowd have any questions that starts off with them?

Professor Spoon: I've got a few more options. And you need to come at this from this highly different perspective. Although all come to roughly the same conclusion. So my first question, to the extent that you may know is. So what's going on in Congress? You know with this is. This is just political grandstanding. You know somebody had to know or… that staff were… was it? You know they need to do some of these things to give to the President to sign the act. Any insight about that?

Thomas Coke: I talked to a couple…well Rep. Hizenger from our side of the state, that was on their services committee and he gave me some insights but you don't want to share any of it. Well we actually went on to some of the things like the million dollar cap. There she thought there were only like half a million and that was going to have negotiated point they're going to start a million. So there was a lot of things that were sort of planned that were going to happen that the law actually became. Like they're… like well they let us look that through. And, I think the writing of it was a little bit poor because they thought the things were going to change and there's a meal because they get along so well right now. And so at the time Gary Peters and present over a course of two different parties were both on that committee and there, you know, there was usually more contentious but those two guys are going to work together.

So, I can't speak to congress directly one of the things I probably should've raised is that the rules that are being promulgated, I think was last October, to go active in in May of this year. Are actually the second bite of the apple that the SEC has tried, the JOBS Act required them to get rules done, I think within eighteen months, they've been missed out a little bit. They put out rules. And from both sides of the coin commenters went nuts. They said, “It's too low,” if he can't work. The SEC is own advisement committee said, “Well, no this is leaving people too far in the open. We have to make this more stringent.” They've got very strong comments on both directions. They wound up in somewhat of a rarity…it happens but they pulled those rules and they never came back. There was a thought...one of my presentations from about May of last year basically said I'm not positive regulation crowdfunding is ever coming back. I think they might have thrown A+ at us to just make us, "Title three? What's title three?" And so from the SEC's perspective you read their letters, you read their comments, you read the rules that they've proposed. I get the feeling that many aspects of the JOBS Act, but specifically regulation crowdfunding, is viewed at least in certain quarters in that group as anathema to what their mission is: protecting people from themselves. Keeping people from being burned by shady securities offers. And this move by congress, it's mandated they have to go through with it, is in some respects against what they believe their mission to be. And so they're going to add, they're going to try to make sure it's protected even with the rules that Congress has put in place. And again that's reading between the lines and just kind of trying to figure out where everybody's coming at it. But to the extent that that's true you can kind of figure out why the SEC might be hostile to what they're looking at, because they view it as essentially Congress mandating things that is not what Congress should be mandating.

Thomas Coke: And Congress did yell at them quite a bit. It was actually, they originally had one hundred and eighty days to get it done. It was a very short period of time and they blew that. It was completely baffling too. Yeah, there was actually people that thought it was going to get done in that amount of time. Which was awesome.

Richard Hoeg: Yeah, so it's something in the history there is that there have been problems promulgating these rules at all and so it's not a surprise that it has these problems with the final promulgation.

Eric Alden: Yes from my perspective, I very much agree with your comments there about sort of the institutional thought process or perspective at the SEC. My experience was, I think, you know, they're excellent people. They're smart. They're hardworking. They have high integrity. I really felt very at home and very good at the SEC. But a problem is that the vast majority of people there have not spent a huge amount of time working in practice. So they don't know what it feels like to be regulated. They don't know just how onerous it is, how expensive it is. And so they're kind of like the greyhound chasing the rabbit. "Catch the rabbit! I'm chasing the rabbit! We're going to regulate, regulate." And, I was actually brought into the SEC as what's called an "attorney fellow," which was a program set up by Congress specifically for the purpose of bringing in outsiders. So, partners from big law firms and big accounting firms. And seeding them into the agency at a fairly senior level to try to bring that outside perspective, to say what's really going on in practice, and what is the impact of the SEC regulatory structure on private industry. And it was in that capacity that I got brought in. I think that's a good program, I think more of that would be helpful. Because I think that the folks at the SEC just very often don't understand just how much of a pain it is to try to comply with this stuff. And just how expensive it is.

You see that particularly in their cost estimates. I've written before, their cost estimates are not just unreasonable, they're not rational. They're so low that they just bear no relationship to reality whatsoever. And you have to almost do a five X or a ten X sometimes on their cost estimates to even get in the neighborhood of what it would really take to comply.

I think also in terms of drafting the JOBS Act, I think the initial impulse was members of Congress – and again I'm speculating, so correct me if you have heard things that sound wrong based on "not to be disclosed" private knowledge – but there were certain things involved. I think there were certain members of Congress who had a very deregulatory impulse. But in order to get the thing through, there were a whole bunch of people of a less deregulatory mindset in Congress, and also the crosstalk with the agency of people at the SEC saying "Well we have to make sure there's no fraud. We have to make sure nobody ever gets hurt." And it ended up getting laden down with enough of these specific, prescriptive disclosure requirements I think they've kind of killed the goose that lays the golden eggs. But again I think they could fix it fairly easily by just stripping away the specific disclosure requirements. Keep anti-fraud as a general requirement, that's always there; 10(b)(5) is always there. But strip away the disclosure requirements. And then I would sharply jack up the $1 million limit. I would make it so you could really use crowdfunding to fund the company through. Because I do think it is, "once a crowdfunder always a crowdfunder." I'd knock it up to $5, $10, $25, $50 million, or somewhere, or pump it way up. But again, the way to protect the public is to keep everybody's individual investment tiny and limited, and use that vast power of the internet to reach a large number of people so companies can raise real amounts of money. Anyway, that's just my view.

Richard Hoeg: Just one comment on what he said in terms of practicing law. One of the pieces of advice I've given actually to clients with respect to MILE. Because it has similar disclosure requirements as long as the securities are outstanding and the "once a crowdfunder on are always a crowdfunder" kind of concept is one of things we work through with clients is potentially having a strong company option redemption feature as pretty much mandatory in a crowdfunding environment. When that VC comes in, when that institutional investor comes in, when you want to get out of reporting your compensation to the state of Michigan, you have something that says "all right, we bring all those back. You maybe get a little bit of money." But the company has that power. And of course, that's going to impact negatively the marketing ability, the upside, of the actual security going out the door. But in terms of legal compliance and cost that we talk about with clients, that's one of the things that we've kind of worked through.

Thomas Coke: Well, actually in some cases it won't hurt the marketability because one of the big questions of the MILE Act is, "What am I going to get for this? I just bought a share of a pizza place in Ludington. Great. And they're successful what does that mean for me." So, if there was I mean they're not going to get good player money, but if there is some company like that were you get some kind of return at all. Because a lot of these things are never going to get return.

Richard Hoeg: It's like owning the green bay packers it's very useful. Exactly. Very much.

Matt Morrow: Thank you. The question I had for you guys. Eric touched on a little bit and we've heard a lot about today that a lot of issues that have come up with the Crowdfunding Act. And Eric did go into some fixes that he knows, what he was hoping to see. The other members of the panel speak to. What you would do to fix it? What you would hope for areas of improvement that you, in this position, would like to see?

Richard Hoeg: Well I'm a dirty corporate lawyer. So I mean you have to start there. In all honesty I'm a bit more wild west than I think even my esteem colleague is. Which is to say what I said as a joke, in my presentation, which is when a Kickstarter exists, when Indiegogo exists, when we're talking about getting a signed cocktail napkin from somebody you like for $5,000, I think the separation between church and state, between security and non-security, it doesn't make a ton of sense. And, so I think what you're seeing, which is really brilliant, which I really enjoy watching in terms of Kickstarters, is people in that class which are not investors traditionally speaking. But over the last five years, looking at what's been proposed, saying "Oh my god. I want to gain more. I'm a dragon in a virtual environment that's going to be great." And, the investor is the person coming up with that idea has no background, is actually a financial advisor for a bank somewhere. You say, "Yeah but that dragon game is going to be sweet and we've got a drawing" and, "Oh I earned $2 million and then the net goes poof. I actually underestimated what it costs to create their virtual environment. And then the very next time those same investors go and they look at similar type things and say, "Well, if you don't, I need more than that. And let's see a prototype. Let's see a background. Who's your team?" And you can see that happening. Without the SEC involvement. Without a hand from an in parental locus coming down and saying you need to be careful here. Saying I got burned from that $2,000 I spent. I need to see more on this. And so I think that the wisdom of the crowd at the SEC points to something that actually naturally happens and why you can have a kind of limited regulatory framework to make sure people aren't lying. I'd like to see most of it stripped out completely.

Matt Morrow: Thank you with that I had a follow up with that then, would you be in favor of some type of structure that has initial investors being more protected? You're the guy that puts in $2,000 on the dragon. Are you in favor of a $1,000 limit on the first dragon investment type of idea so you don't get burned as bad your first time, so I know that I've had success my first time and a more graduate type level investor? Or if it's too hard a framework to work with the internet? Your thoughts on that?

Richard Hoeg: I think, and people are going to have wildly different, well-educated reasoned responses to that very same question, I think that prescriptive rules are always going to be over inclusive and under inclusive simultaneously. And you're going to get into a situation where I should be allowed to spend $2,000 on that drawing. Warren Buffett should be allowed to spend that $2,000 on that dragon. And X person that maybe you don't think should spend that money on that dragon, really shouldn't. But finding an ability to put in a law, put in a regulation, the ability to distinguish between those two and the kinds of things you'd have to do to distinguish between those two would probably be unsavory. I'm in favor of essentially letting people, kind of do their own thing with their money and outside of a very high cap. Letting it go.

Matt Morrow: Yes question.

Steven Dean: Same question and I know this is not in reference to what you're doing up there. But I was curious if you know that other jurisdictions are doing outside of the U.S.? And if any of those are hitting that sweet spot you're talking? You know maybe or maybe not me. I've been so focused on are crazy regulators are up to, that it's hard to see. But any incites from anywhere else.

Thomas Coke: So we've built sites in Britain. And seems to be working very well over there. The regulations are a little bit lighter, I think. I'm a partner right now on a site in Ireland. And the Irish government wrote a letter saying basically all safe, do whatever you want and expecting, you know the site, to educate people who are in fact, giving the CEO 50,000 euro to build this thing. We're kicking off in about week to build on that. So, different jurisdictions treat things very differently. Western Europe seems to be relatively open to it. And then you have Australia, would which has had some kind of regime for a while. But Australia, which hasn't had any instances of fraud, is looking at the rules again and making changes and there's a lot of destruction going on. So, we're a little bit behind. The U.S, is behind a lot of things like this, especially like the new technology world. Very painful. But here's definitely cool stuff going on. Check out the U.K. crowd cube and some of those sites that are doing really awesome things.

Eric Alden: Yeah I think in the U.K. there are a huge number of debt offerings that are being done in crowdfunding. We tend to be more equity, sort of an equity culture. They've got a lot more of debt stuff going on. But yeah, it's very cool.

Thomas Coke: But for very non-sophisticated investors I think debt is fantastic. I think a lot more issuers are looking at debt when it's something they do. Equity, of course, is always more exciting as if you're the CEO, "Yeah I will take all the equity I think I can in my company," have fun. But you know. Sorry about that.

Eric Alden: No, it's great, it's great.

Thomas Coke: Maybe I am not as well lawyerly as that. I mean we have seen industrial companies for instead of trying to expand a plant and they already have revenue and they're like we love debt. Let's pay these people off and get rid of them in a couple years. We know that if we expand, our planners got in on a plant in Adrian that's doing pretty big offering and we need like $2 million or so. He basically is going to double his output. His revenues are, you know you can predict, are going to be pretty good he's been active in that exact situation so. He loves debt because he can get rid of all these people. You know in a couple years as he pays them back.

Richard Hoeg: The only thing I would say on that is a bit tangential to it. I haven't gotten any great deal of experience with international capital funding. I do have a great deal of experience with software technology and data protection. And one of the things that would concern me with anything European and European Union base is that they they're rapidly becoming very onerous with respect their data protection policies. Which I imagine would hit pretty significantly depending on what kind of information collecting through anything related to it, to an internet portal and I think that's going to have a pretty significant effect on their capital raising ability in the next couple years when those go in to affect.

Thomas Coke: And also intellectual property. Not every place respects intellectual property or treats of the same way we do. And that's something that our crowdfunding sites, you know, can really affect someone if they have something they should protect than they didn’t in the appropriate manner. It's fantastic. Some of the . . . we have to raise right now, where it's a product that anybody could replicate. And if the guy puts it up and he fails in this crowdfunding race, guess what? Someone trying is going to make it for cheaper. And be into the punch and they’re going to be able to make money, and he's not going to. So, it can be pretty scary.

Audience Member: I’m going to stand up so you don't have to be straining to hear me. So you mentioned about how much investors can invest in. Are there regulations requiring portals to commute with each other? How are they going to regulate that aspect of it?

Richard Hoeg: That was why the SEC said one portal. It was for the wisdom of the crowds and so that you couldn't play games with the amounts of the investors have so that you're only allowed to have the one offer on the portal. I think there's still some confusion exactly how they're going to keep track of the $100,000 cap. But you're going to have to have to essentially certify that you haven't cleared that cap and that’ll come out in the wash in the first couple of years as well if there's any kind of popularity to this.

Eric Alden: Yeah, sort of specifically what the rules say is that the portal has to get verification from the investor that they fit within the limits. But you will be allowed to rely upon those representations from the investor.

Unless you, quote, "have a reason to suspect that they might be lying to you."

Elliott Spoon: Tom, you mentioned there's two funny portals that you're aware of. That are gearing up or whatever that the broker-dealers can participate in this. Can you tell me if you are aware of any of the broker dealers that are gearing up to do this? Are they doing any marketing? You know, at this point since that start date is coming up?

Thomas Coke: I've had many conversations with people looking at it. But not necessarily planning to do anything because they're going to have their clients on both sides, you know the buy and sell sides. You know how are we going to talk to our clients about this? So I don't know of any off hand today that are planning their own portal or anything there was one that I knew of at one time it came out in 2012 and obviously it wasn't the time and so they scrapped it. They didn't spend a ton of money and there was a big one in the Detroit area that they built, they had built a technology. The guy had access to a bunch of young technology oriented entrepreneurs who were building it. But I think he's completely gone dark I think je just stopped, though, altogether. But they're looking at it and they've got a lot of smart people working at this figuring how can we play in this space? Do we play in this space? Is it worth our time? I know they were looking at 506(b) and 506(c) portals quite a bit.

Eric Alden: Yeah, the student we have at NKU who's going to be registering as a portal, he's deeply interested in this. So he's been doing all the research and whatnot. What he tells me is that it's radio silence from the big boys. So the big banks, they're not going for it. And it may be that they view it as a threat to their own business model. And it may be that they view it as something that's not going to fly. Or they might view it as something that might fly, but that it would be these small dollar numbers and it's kind of not worth it for them. Whatever it is. But again, he's done the research, I haven't personally, but he says he's not hearing any of the big outfits ramping up to do it. So that's why he sees it actually as a huge market opportunity for somebody like himself. To actually go in and start offering in the space.

Richard Hoeg: And, just to add a little bit of color that we already talked about the SEC cost estimates on these things being interesting and somewhat only tenuously reality based. But one of the numbers that they actually have on what it would cost to have a funding portal, again it has to register with the National Securities Association, is $592,000 to start.

And when we talk about, up there in the presentation, that there's some real questions about whether companies are going to pursue this at all. You're taking a leap to start a funding portal. And maybe first mover is the best and you've got the leap in on May 16th. But it's a real question. And one of the things I would question in terms of this working at all is, if you have to use a funding portal as the SEC mandates, is if there are going to be a market for that at the end of the day period? Because they don't have enough companies seeking to use their services.

Thomas Coke: So in the portals that exists in some of the other, especially the state portals, none of them have made any money. In fact they've spent a heck of a lot more on trying to get up and running and answering state questions and so forth because some of them didn't do a very good job of informing the state what they're doing. I see how their nodding their head yes. But I know a couple of them did bring in attorneys and they’re spending so much money they're never going to make money because there’s not enough offerings. And that might be the case in Title 3 as well.

Eric Alden: You know, an idea that I was going to toss out, if people want, is picking up on this issue about corporate governance and sort of how it would affect the company. Which is actually not a securities regulatory question. But instead, is a tax and corporation law one, which is: what security are you going to sell folks? Those issues have not been worked out yet.

The traditional VC model what you do is you issues huge blocks of very, very cheap common stock to the founders. And then you issue a different class of preferred stock in series: Series A, Series B, etc., of preferred stock. That's got a whole bunch of bells and whistles on it and is inherently worth a lot more money. And so what you set up is a bifurcated capital structure with what I'll call the sweat equity class and the money equity class.

And this is fundamental to the entire growth mechanism of tiny startups because what you do later, when you try to bring in employees, smart people, motivated people -- you know, the hot CTO that you've got to have -- it's a very risky proposition for that person to give up their job at Intel or Apple or wherever they are and go in with the tiny little startup. A lot of startups fail. And this is really risky, people have mortgages, they’ve got kids, they have to be able to feed themselves. So the way you incentivize somebody to come in is you offer them options. And the options, you can get a lot more bang for your buck if the options have a low exercise price. But that means it's options on common where the common stock is not worth a lot of money. So the common stock is cheap now. But, if the company does great and goes through an IPO, then the common becomes worth a lot. And your option is worth a lot. And so as long as you keep the value of your common stock very low, you are able to give options with low exercise prices and, for the amount of economic bang you're giving the employee, you're having much less of a dilutive effect on the preferred stock, for instance.

You can mess that up in a hurry if you start selling your common stock for real money. Your common stock is not cheap anymore. And you cannot be granting those cheap, low exercise price options. So if you start using common as the vehicle for funding your company, you have, to a significant extent, hobbled your ability to use equity compensation to incentivize people to come join the company.

On the other hand, if you're going to sell preferred stock to the crowdfunders, what is that preferred stock going to look like? I thought a very interesting idea was what you mentioned about this redemption possibility. But again you've got to have some pretty serious disclosure to your crowdfunders that, "By the way, if we start doing good, we're going to cash you out and you don't get see any of the upside." Ha-ha-ha.

Richard Hoeg: That's correct. That's the disclosure.

Eric Alden: That's a pretty brutal disclosure, if you're going to be otherwise selling them real preferred with a liquidation preference on it and protective rights and all the goodies that the preferred stock ordinarily has. And then you go out later to the VCs, VCs are going to be, "I don't want these several hundred folks, who are sort of sitting at home in the middle of the night on the internet, necessarily sharing control over this company with me. And I'm not necessarily comfortable with what the arrangements are going to be." And I think those things are going to have to get worked out. And I think there may be some very creative efforts on the structuring side of things as people try to figure out if we're going to do crowdfunding. We've got to give them a real security, but we don't want to give them a security that will make the VCs uncomfortable about coming into the company later. And again, I'm not sure that that can be squared, and so that's why I think personally, in order to really open up the power of crowdfunding to the non-accredited, I think that $1 million cap has to be radically jacked up. Such that if you choose to go the crowdfunding route you could take that all the way to going public and you'd never have to go to the VCs. That's what I think has got to be done now.

Audience Member: So getting towards. There is a stream of Delaware cases with venture capitalists and their treatment by the board of directors companies as to their preferred stock and options under that and some of the strictness that some of the Chancery Court has to run not really protecting their rights. How do you think that plays into that whole how to use crowdfunding as maybe a good alternative to having a term to the VCs and VCs are reluctant to take on preferred stock? More so because of recent cases saying that preferred might not be a very good option. How does that play in their as well to disincentives its use from being involved in the crowdfunding realm? Do you know what I mean?

Eric Alden: I'm not sure I understand entirely. Certainly historically the VCs very much want the preferred stock because it's got all the goodies, in particular the liquidation preference. That means, if the company gets acquired, they get to eat first, a huge slice of the pie. And then they'll actually take one of your pizza slices off your plate, too, before you get anything.

And so the VCs also want control over the company. The VCs are the board of directors, along with the founders of the corporation. The board is a highly negotiated item and it's governed by provisions both in the charter and in the voting agreement that you typically use. So you actually specify, you know, Sally and Bob, the two founders, are going to be on the board and Maggie and Vic from the VC fund are going to be on the board. And then one fifth party is going to be mutually acceptable to the others. And it's all highly negotiated. In terms of, "Do I think the VCs would want to do something other than preferred for themselves?" – no.

I think the real issue is how are the VCs going to react to the presence of potentially a couple hundred folks who are in the company and who may be erratic and unpredictable. I mean, these are folks who might decide to bring a lawsuit. You know, they decide that they've been gypped in some way. Whether or not they really have. It might be a misperception. But, you kind of don't know who these folks are. And if and to the extent they have control, they might be voting for or against things in a way that is not what the VCs want or expected. You know, the VCs might say, "time to sell the company." And you might have these other folks saying "No, no, no. We want it to go public." And the VCs might be like, "We wouldn't have this problem if it was just us and the founders." That's my concern or my thoughts on it, if that's responsive to the question.

Audience Member: Yeah, that is kind of what I was getting at. It does require good contracting from both of these documents that you were talking about. And I think it kind of muddies the water a little bit.

Eric Alden: Yeah, I think if the thing takes place at all, there's going to be some very creative, fun work for corporate and securities attorneys and business people trying to think, "So how do we address these business issues? Are there new things we can do? New structures that can be put in place?" And maybe at some point somebody does sort of, you know, figure out the Rubik's cube and come up with a model for the capitalization structure and the governance structure of a crowdfunding company that is also still attractive to the VCs. It may be that somebody figures a way to do that, but it's going to be a creative process which hasn't been done yet.

Richard Hoeg: Right. I think that that's part of the fun. You know we've gotten to have these conversations with clients. We've talked about Series (c)(f) or whatever. Whether designation you want to put for crowdfunding source. We talk to clients that we're going to go through MILE and a lot of those features you talk about are exactly what lawyers around Michigan and around the country are talking about. We talk about redemption feature, Vis a vie, we want to sell the company. We think it would basically be mandatory to have it be subject to a pretty strong drag along provision. Meaning that if specific controlling entities voted for a sale, or a merger, or what have you, then they have to come along. All these things would have to be disclosed as pointed out as part of the regulation crowdfunding requirements. They have to be disclosed in a very specific legalistic way. But then also if it's too legalistic it would probably be deemed to not have informed them properly. So there's a lot of small gaps to try to get in to make the SEC happy; to make the people informed; to get the company the money it needs while still not losing control. I do think it would almost certainly be a non-voting class for most of what we would recommend to a client. It would probably bear a look similar to what you would imagine a Friends and family or an angel round to look like that's not interested in a liquidation preference and really wants to be common. But we don't want to give them control. The good news from crowdfunding if you were to get it to work is that you don't have that VC that owns thirty-three percent of the company, to come and complain you have the guy that owns point zero four percent of the company to complain. And you have a lot of them. But they don't quite have the same Umpf in any one single capacity so that crowd separation might actually help you to get done what you want to get done from the corporation and from the corporate lawyer's perspective.

Eric Alden: Yeah I think those are great ideas, the stuff you're talking about. Like non-voting…

Richard Hoeg: I get paid for those I was paid.

Eric Alden: I've had similar thoughts. You know, it's clear our minds are sort of going down the same pathways.

Thomas Coke: I want to say something from the entrepreneur's perspective that frustrates you about finance. A lot of Angel investors, VCs. You're not always looking at them as a check for money. It's "what can they do for you?" And, many of them are going to do the same thing. And the problem with crowdfunding is you don't have . . . like . . . Angel investors that I meet with for my company are going to make introductions for me and do things and talk to other people for me. That helps me out and that's what good angels do, that's what good VCs do, they don't just say, "Here's $5 million, good luck." They're involved, they want to help you out, and so with crowdfunding you lose some of that element. You might have some great fantastic people that can really help you out rather than people that you're just getting money from. And so, yeah, I mean, that's something the gets lost in this process sometimes the new entrepreneur's perspective scares me a little bit about crowdfunding.

Richard Hoeg: Yeah I'm biased. I said at the outset I represent venture capital firms. But, I think that's exactly right; they get a bad rap and it's deserved in certain circumstances. But a lot of the time they put in their money, they have somebody on their team that has specifically done board of director's duties with biotech startups. They come in they sit down there and say all of this is idiotic we need to rethink this. And it turns out to be the best thing the company ever heard and that $5,000,000 becomes $50,000,000 really quick. Because of that sophistication, because that advice that some of these venture capital firms can put in place and generally control is an interesting issue my clients don't tend to like to be minorities with veto rights in terms of control. So, we don't actually control everything we can just stop you from doing anything that you want to in a specific way. So it's you know… But, they do put those people in place; they do help out companies that maybe don't have that sophistication, don't have that experience. They have a brilliant professor out of this University or the University of Michigan, with a brilliant idea. But, hey I've done this before and I can give you that advice with our $5,000,000. And that's very useful to a lot of companies and it's very unlikely to happen through crowdfunding.

Thomas Coke: I'm always amazed that VCs get a bad rap because they're in it to make money. And they're not in it to destroy companies or do horrible things to people. They're in it because they want to invest in the company and help them become really successful so they can buy another yacht. I mean these aren't bad people. Not always some of them are like that but most of them are really good, they want to help you, and they want to be succeed. And so it's kind of. Yeah. I mean. You have to careful with some of these things that you're talking to.

Richard Hoeg: They do and a bad rap comes from that guy coming in and saying you were doing it all wrong for the last eighteen months and the founders say, "Whoa this is my baby" and the and the venture capitalist is maybe not as tonally gentle as one would hope in those conversations. And so there's often a lot of stridency with that and very often that comes out as a generic venture capitalists want to take your money and take your baby and take it all away on their yacht.

Thomas Coke: And many times their telling this CEO to go away. Because their first thing is, because guess what, this brilliant professor probably isn't a really good CEO. And I was with a startup where the CEO was just horrible and all the VCs were really he's gone. Really he knew it and he was going to get compensated, it wasn't that they was going to throw him out the door. But you know it was hard for him to, "Okay, for the betterment of the company, of the thirty employees we have, I'm not going to be here day to day." You know some of the employees were like please go. But most of us liked him and he was a friend of mine and it was tough because… But, that's what happens but you know the VCs are there to help not hurt.

Richard Hoeg: Yeah, love is sometimes tough love and they do that. Absolutely.

Audience Member: So the question I have is you listen to what your frustrations are current and what the current regulatory is, and what you think the ideal would be. But what do you think the actual catalyst would be to change from the current structure to where you it should be.

Eric Alden: I think the catalyst is going to be, you see this getting used as much as Regulation A gets used. That goes on for a few years. You need somebody to have a deregulatory, sort of, cast of mind. Getting up in Congress and saying, "We've got to take the handcuffs off," I think.

Richard Hoeg: I'm not even that optimistic frankly. I don't think this one is going to get adopted in the end and I wasn't expecting the SEC to actually make rules last year, at the end of last year. I've really thought they were going to try to let it fade into obscurity. So I don't think it's going to be used. I agree absolutely. I think the catalyst would be a fundamental sea change in both kind of the thought process of what securities law means and probably congress just in general, when we're making those laws means. And I don't see them as terribly likely… I also think that they can sit back and say, "We gave you 506(c) that's going to be great for you guys, what do you want? And to some extent that's going to be true. 506(c) I might be very, very useful. And I think that uptake is going to continue. I think it was already two percent of the 506 offerings in the last couple years. Which going from zero to two percent of, you know, billions of dollars is pretty good.

Thomas Coke: Yeah, 506(c) will come more widely used. They're going to change the accredited investor standard.

Richard Hoeg: That's something that I wanted to mention. Yeah.

Thomas Coke: That's going on right now. The big thing though is, entrepreneurship has actually been declining despite all the media attention that it gets and so has actually been declining as far as number of people. But the generation, the millennials are much more entrepreneurial at least they think they are. And they're talking about starting companies trying to do things. So I think you look at the way that the U.S. was built. I mean Henry Ford is not a producer. We all forget that that was like a little startup at one time and that Detroit was like the Silicon Valley of 1919 or whatever it was. But you know, every politician has that sort of "small business startups as apple pie and motherhood. We need this for America." So they're going to start doing things that continue to push out are to be made easier. All of those are regulated quite heavily. But, it's beneficial to everybody for this kind of thing. If you talk to cities where entrepreneurship, especially some of the tech entrepreneurship, and what we're seeing in Michigan with some of the automotive stuff. They're rising. The boats are lifting everyone. You know tides are lifting everyone. Because we have these entrepreneur endeavors, JOBS come. People have, more well-educated, better lifestyle. Businesses that, you know, better restaurants better schools. All the stuff that comes around that. And a lot of places where the economy isn't the greatest they need things like that to come and start things and kick it back into gear. And, because we're not going to have, I mean, a lot of things that people did in the sixty's to make an income, there are JOBS that don't exist anymore. I mean sometimes sixty percent of JOBS every thirty years turnover, don't exist anymore. So, we need to continue to have entrepreneurship and the government pick up on that. That's the soapbox though.

Richard Hoeg: I think you heard me. I'm all in favor of it and, again I’m just a dirty corporate lawyer who is a bit risk averse when it comes to government action, and I suspect it's going to be longer than we would like from this table.

Thomas Coke: And with based on what you're seeing in this election there may be some angry people in the United States. It's something that…

Eric Alden: You know, just a slight segway off point from securities law, again with respect to the impact that the legal infrastructure can have in terms of encouraging entrepreneurship. Something that they do in California that I'm a big fan of -- having lived there for a long time and seen the impact -- California has declared that non-competes are illegal. Per se illegal in the state of California. Can’t enforce them. With the single exception of a shareholder of a company who sells the company, which can have sort of a limited one, for a limited period of time. But as a general matter imposing non-competes on employees, you can't do. The whole rest of the country loves non-competes, and they’ll enforce them. But what it means is that anywhere else, it's very difficult to leave a company and go start your own business. Because they're going to be hunting you down because you can't compete. And in California, that means it's much easier to go out and start your own business.

There's also, in California, a limitation on the ability of an employer to say that they own everything in your head. So if you are an employee and you come up with an idea on your own time, and you use your own computer at home for anything you're doing rather than your stuff at the office, and your idea is not sort of directly related to or competitive with the company, a sort of a different idea, you own it. And the employer cannot lay claim to it, no matter what they may have put in your employment agreement. They cannot lay claim to that idea. Again, it's very powerful thing allowing people to come up with their own ideas on the weekend and then go start a new company. And I think those are great. And I think states would be very well advised to follow California's lead in that respect in conjunction with stuff that you do in the securities space, to make it possible for people to start a business. You know, that was my soap box.

Thomas Coke: So my dad was an oracle. He knew a number of CEOs that he was the boss of. There's a couple big ones Marc Benioff at Sales Force. He was Marc Benioff's boss at one time. And Marc Benioff now runs Sales Force, has obviously done pretty well from some of those companies. They are encouraging people to do things and they want people to be actually really bringing in virtually incubators in-house. Do all this stuff to promote that. It's very Silicon Valley thing to do all the companies and they have their own venture wings and they're funding things, and my dad, now that he's retired, gets on the board of all these companies because they're like hey I used to hate you when you were my boss and I want you around to tell me how to really run this thing. It's really cool to see that kind of stuff happen and there are companies like that in Michigan that are doing that kind of stuff as well. Some of the auto companies do that.

Richard Hoeg: I come at it from a slightly different perspective in so far as I like non-competes in certain circumstances and investors like non-competes in certain circumstances. Because they don't want Bob to run out the company and start doing something else. They want him to be at the company. So they're like everything has its place. But I can tell you one of the things we've talked about with our venture capital clients and with our institutional investment clients is potentially being a little bit more nervous about a company or an enterprise if it's actually operating in California. Not only because of that. California has a number of its own issues it's not just non-competes. Is also all employment law really. But, it's one of those that's a bit of a double edged sword once you're an existing enterprise and you're trying to raise money.

Elliot Spoon: I like to shift back to crowdfunding if we could for just second and talk at journal business and securities law conference next year on the effectiveness or the activity under regular crowdfunding, what do you predict?

Eric Alden: My own prediction is I think it's going to follow Regulation

A. I think that people are going to find that $1,000,000 cap is so low. And the amount of hassle you have to go through is so extraordinary. Some people will try to do it. There will be some activity. Some people will be doing it, but it's not going to ignite. And so I think that's my own prediction, a year out, I think. I would like it to be otherwise. I would like it to ignite. But I think they've put too much on it for now.

Thomas Coke: I largely agree with that. I think will drive more people towards the 506(c)s and things like that there are going on and I think more people become educated about these types of offerings in general which are that you're seeing even accredited investors who didn't know a whole lot for they're using the JOBS act, these new laws to like let them learn about that and the want of looking at other I mean crowdfunding in general has grown tremendously after four years.

Richard Hoeg: Yeah, based on the buzz I hear from those calls from people that are interested in crowdfunding I think that there's a good chance that there will be a burst of activity of people trying to pursue it. A funding portal starting and thinking that they can make this a viable platform either for the raise from the company side or from the funding portal side. I would suspect that that will die away with potentially one or two successful Kickstarter type platforms. That work in a very specific small slice of companies that are ok with the disclosures or otherwise have sophisticated people running their operations. Can work with only a million dollars a year. So again, people that are adding a wing of a successful revenue positive company that just need a million dollars and don't want to deal with anything, and can't necessarily sell it to accredited investors because it's not sexy. You know it's a manufacturing plant or it's something that the venture capital is like, "Well that's not that's not cool. We don't want to do that." And with that possibility there could be space for small level successes. But I would say small in number as well as in volume of the money being raised and one thing I did want to add before it passes again is the accredited investor standpoint that the definition. What we talk about with respect to 506(c) the accredited investor definition is under fire it's been under fire for years. I think it was set at the levels that it's currently at which is $200,000 of income and a $1,000,000 in net worth, minus your residence so your house doesn't count. At what was set with the exception of that residence exemption in the eighty's. And so people have fought against it for a while as essentially saying, "Hey you know $200,000 isn't really as sophisticated as we would like for people investing in a new biotech startup with no revenue and no promises, of revenue for seven years."

We need to start raising that. The very last one I heard I think was in December last year that Congress was seriously contemplating $500,000 In terms of income and $2,500,000 in terms of net worth. With certain promises that they would allow for sophistication to otherwise account for accreditation. But with not a lot of contours given that in those discussions so to the extent that that number gets raised a lot obviously 506(b), 506(c) start to be less attractive. That number, that six to seven percent, and I'm not even sure it's necessarily that low right now, starts to get really low at those numbers. And so when those stop being viable opportunities, one effect could be that crowdfunding is more attractive. I suspect will it'll actually just be a significant down pressure on all of close corporations, small companies start of financing in the entirety.

Eric Alden: Yeah, I mean I hear that I very much. Just from the perspective of economic democracy. I mean, it seems to me that the regulatory impulse by protecting people out of the market is really doing a lot of Americans a disservice. I really would like this to work. But they have to take handcuffs off.

Matt Morrow: Well thank you very much the panel. This time we're going to close the questions feel free to approach the panel over lunch to the extent you still give them a little bit of time to eat. We will now break for five minutes for lunch to be offered outside at about eleven. And then we'll come back at noon for the afternoon for the panel on the nonprofits. Thank you very much to the panel.

PANEL 2 – NONPROFIT CROWDFUNDING:

Matt Morrow: Alright, if everyone's finished with lunch, we're about to begin the afternoon portion of our symposium here with the second panel. Which will be focusing more on nonprofits, opposed to this morning which was equity funding. I'd like to take this time to introduce our panel.

First we have. Mr. Steven Dean from Brooklyn Law School. Professor Dean's expertise lies in Tax Law. His Scholarship addresses a range of tax and budget issues and has appeared in a number of leading Law Reviews. Recent work with Dana Brakman Reiser has explored the special challenges and opportunities presented by social enterprises, ventures that simultaneously pursue private profits and the public good. Professor Dean is a member of the Executive Committee of the New York State Bar Association's Tax Section. Before joining the faculty he worked as an associate at Debevoise & Plimpton and at Cravath, Swaine & Moore.

Next we have Mr. Ebrahim Varachia. Mr. Varachia is the president and co-founder of Patronicity, a civic and community based crowdfunding platform that works to bring local patrons and sponsors together to support great initiatives in their communities.

And third and final member of our panel today is Mr. Jonathan Fowler. He obtained his Juris Doctorate and MBA in Finance right here at Michigan State University. His practice focuses on helping startups and entrepreneurs develop intellectual property portfolios to effectively protect their innovations and maintain a competitive advantage while preventing legal issues. Mr. Fowler also partnered with the Law College for a program called *The Hatch* which helps students, entrepreneurs, and startups. The Hatch is a creative co-working space for students and entrepreneurs.

At this time, I'm going to hand over to Professor Dean and we'll get it kicked off.

Professor Steven Dean: I just want to take a second right now to thank Matthew and Katila and all the rest of the team for putting together a really interesting day so far. It's already half over. It's been great so far, and I've learned a ton. I don't know about you guys, I'm not a securities person so the first panel really helped me learn a lot about what's possible here and what isn't possible. I think I rarely find myself at the pessimistic end of the spectrum; maybe that's being a tax person.

I think I have a slightly rosier view of the possibilities for crowdfunding and maybe it's partly because of the perspective I'm coming from. I'm thinking about crowdfunding from the perspective of social enterprise. While I was listening to the first panel, I was thinking about an exhibition I saw last year in New York about how cats took over the internet. Anybody here ever watch a cat video on the internet? You don't have to admit to it. I know. Some of you guys don't want to admit to your cat video fixation. It's okay, we all have our weaknesses. It's one of those funny things that it's possible, and we can decide how we feel about it after I've talked about the work I'm doing with Professor Brakman Reiser. But it may be that the million dollar crowdfunding, Crowdfund act exemption may work better for social enterprises than it does for pure for profits and I'll talk about why that is.

What I'm talking about here is part of a book that I'm doing with my colleague Dana Brakman Reiser, *Social Enterprise and the Law*. What we're trying to do is understand—I think a lot of business schools and some law schools like, the law college here, have really embraced the notion of social enterprise and what it is, and what the law can do to serve it. But there really is a lot more that can be done, and we're exploring a variety of ways, both private and public, how the law can help nurture a social enterprise. This is one possibility. The question we start with in this specific context is—is it realistic to think about retail investors being involved in social enterprise? And we think there is some reason for optimism and to view a few factoids here. The Federal Reserve in 2013 noted that just under half of U.S. families owned benefit oriented stock. Obviously, not directly but that's at least some suggestion that you could actually have retail investment in social enterprise. Just as consumers, folks are used to bundling. Social enterprise is a double or triple bottom line orientation where you're not just about profits, you're also about public good. People are used to doing that. So you have the old fashioned one, Product Red, Amazon Smile, and I'm not sure I quite understand what that is. It's some kind of bundling, your consumption with some kind of outward directed donation. Just taking a more direct connection between the two—the form for sustainable and responsible investing. If you're looking at responsibly invested assets, the numbers are impressive and growing. So if you're thinking about whether you can have retail investors and mom-and-pop investors investing in social enterprise, there's at least some data out there to suggest that it's possible. Think about impact first—and I know Ebrahim may talk about this—what it is to be an impact first organization. Are you going to be able to have that in the retail investment space?

You obviously have socially responsible mutual funds. You might think this might be a way of getting the retail investors involved in social enterprise, but it's difficult. It's difficult because the regulations that apply to mutual funds really require a highly liquid investment. And certainly the kind of social enterprise that we're talking about, that I'm thinking about here, that are start-ups, it's a totally different universe. This is not the kind of liquid investment that a mutual fund, even a socially responsible mutual fund, could invest in. Pension funds, obviously they have a different set of regulations that they have to deal with. ERISA (Employee Retirement Income Security Act) is probably the most important. That would make it difficult for individuals to invest in social enterprise through their pension funds because the requirements imposed by ERISA. They require the managers, the pension fund managers, to prioritize profits. And even though there have been some recent changes trying to strike a closer balance, it's still not at all clear that they can pursue a double bottom line. Nor that they should necessarily, that’s a sad point.

So you just sell stock to the public. We talked about that this morning. Etsy is a social enterprise that has gone public, and I’m not sure where you put them in terms of a good example or a cautionary tale. Laureate Education is a pretty… isn’t necessarily the kind of organization you would think of as a social enterprise. Although they are a benefit corporation, the specific kind of organization under Delaware law that is supposed to blend public and private motivations, one of their colleges has the second highest student debt load in the nation. I’m not sure you would think of them as a double bottom line enterprise, but there are possibilities. The problem, and this is what we were talking about this morning, that even under the Reg. A+ and IPO light organizations, it’s really expensive. It is expensive. If you really are a double bottom line venture, the idea that you’re going to hire expensive lawyers and get all this done, it’s just not going to happen. So, the picture changes. I won’t belabor this, and people who know more about this than me have already talked about it. The changes they have tried to in Reg. A+, have tried to reinvigorate or invigorate Regulation A with A+ and they have softened the requirements somewhat but you still have initial offerings you have to prepare. And certainly for a Tier 2, you can raise a little bit more. You have to have audited financial statements. Which I’ve gathered from this morning, are really not something you want to have to get if you don’t have to. Still less expensive than what Etsy did and what Laureate Education might do, but still not the kind of thing that a real double bottom line enterprise would probably consider. The Crowdfund Act is an IPO Light. You can raise a million dollars a year, as we talked about, you have to use this new class of intermediaries funding portals. You have streamlined disclosure obligations. Ongoing porting is limited in interstate regulation and if your organization has under twenty-five million in assets, you’re out. Again, this is focused on small start-ups, or at least those that are not thinking necessarily about growth, but about pursuing multiple goals.

What my colleague and I are working on are different ways to bring, what we think of as impact first and entrepreneurial investors together. We have some confidence that there are both impact-first investors and those who want to put their money to work not just to make money, but for a cause. They believe in business methods as a way of driving impact, but not necessarily just purely about profit. We also believe there are entrepreneurs out there that are interested in this base as well. The question is how to bring them together. The good part about this is—like this old cartoon of a dog sitting at a computer and he's in a chat room, back when chat-rooms were a thing. He sort of confesses that on the Internet, nobody knows you're a dog. The question is, especially in the crowdfunding space, how do we know that these guys find each other. And know that the investor you're talking to, or many that you're talking to, really are dedicated to impact-first. And if you're the investor, how do know that this entrepreneur is somebody who's really going to put impact first? It's hard to know. We have some ideas about how you can do that.

One idea, and I told you up front I'm a tax guy—I see tax everywhere, is what we call SEC 3. For social enterprise there's an added tax stick. Again, the idea is to try to create the possibility for impact-first investors and entrepreneurs to find each other. We think they can do this by using this. It sounds kind of crazy but we think it can work and I'll explain why. The good news is you have an exclusion for $250,000 for mission-driven income and because this is a social enterprise you get an additional 1-for-1 exclusion. For every dollar you exclude on your mission, you also get an additional exclusion up to a half-million dollar from income. Some tax jargon here, but this is good news. Good news to the tune of up to half-million dollars of income not subject to tax. Again, a social enterprise would generally be organized as a for-profit. Not as a non-profit. If it has income, it's subject to tax. Good because you have income, bad because you pay tax on it. So this is the carrot. You would say I'm interested in an impact-first. I like the idea that this company is going to have, and that it's going to get this carrot to the extent that it does do what it says it will and prioritize mission. If you prioritize mission, you get exclusion; if you don't, you don't. If on the internet, no one knows if you're a dog problem, you know that if you're committing to pursing this exclusion then you at least have some indication that this is what you're doing. You really are what you say you are.

The stick, and I don't know how scary this sounds for those of you who are not tax folks, is that the stock would not be a capital asset. Does that sound scary to anyone? So the way this is a stick is that you pay a higher rate of tax on your gains. If you sell your stock, you're going to pay, rather than something in the 20s, you're going to pay something in the 30s. Again, you wouldn't agree to this deal if you really were dying to cash out and get rich. It would be kind of stupid if you were planning to do that. But, if what you're planning to do is something over the longer-term and you really want to prioritize mission you might agree to this. This is just some indication that you are not in fact a dog.

The dividends also coming in at an SEC 3 would be taxed at ordinary rates rather than capital gain rates. Again, kind of technical, but this is just the stick. If you're agreeing to paying higher taxes on your shareholder profits, it is some indication that profits are not your end-all and be-all. So that mission is rewarded. Profits to shareholders get subject to a slightly higher tax rate. All of which is about solving what we think of as the central problem in this space. Which is this—we see the social enterprise conundrum, what's keeping the sector from realizing its potential is a stag-hunt. You have probably heard of the prisoner's dilemma. A variation on this is the stag-hunt. Essentially what it says is that if you are what you say you are, and that you're impact-first that they want to be in the top left square (of the prisoner's dilemma). They want to combine doing well and doing good. You could also have the traditional scenario where everyone wants to get rich, that's the bottom right. And if everyone wants to be there, that's all right too. The assumption is that social enterprise space that both the investors and the entrepreneurs want to be in the top left quadrant. That's where they want to be, but where they really don't want to be is either in the place where the entrepreneurs pursue self-interest where you have a lot of money and the sad face. That's bad. Or the other way where the investor takes over, kicks out a CEO, and says without that pesky social mission we could really make some serious money here. That is the concern. How do you make sure everybody really wants to be in that top left quadrant? We think that we have a few different ways of doing it.

To give you a little bit of context: If you're a sophisticated investor and a big enough enterprise, what you can do is create your own investment. This is one that my co-author and I created and called *Flypaper* because it makes the mission sticky. What it does is it sends a signal from the lender that this is debt, not equity. The signal from the investor is that you're going to accept a modest, deferrable yield. You have no control because it's debt, not equity. You have a long-term in our flypaper deal. You're handing money over to a social enterprise and you're willing to accept a low yield. You're willing to yield control and you're willing to be patient. You're going to get your money back and some modest amount financial return, but that's not really why you're doing it. What you're doing is trying to lock in this entrepreneur into pursing a mission. So what the entrepreneur does is they agree to take this money, which is very nice of them, but there’s a contingent conversion feature. The short version of what this means is that if the entrepreneur, because they still own all the stock, if you try to sell or if you do sell, they get to eat your lunch. I’m mixing metaphors here. The debt converts to equity and a lot of equity when the entrepreneur sells their shares. If they don’t wait until the flypaper is matured, pay you off and send you on your way, then you get to take all the money they got from selling out.

The goal here is to create reliable signals from both the investor and entrepreneur that you really are looking to be in this top left quadrant. If you're lying about that, you wouldn't take this deal. Right? The investor wouldn't agree to take a low financial yield and wait fifteen years to get their money back and give up control. And the entrepreneur wouldn’t agree not to sell their shares, at least without the consent of the investors. They can all get in the room, this a fairly small scenario. Everyone can get in a room and decide that it’s time to cash out and take your money into a new social enterprise. But you couldn’t leave somebody in one of those sad-face quadrants. That’s the goal. That’s what you’re trying to avoid.

This is all great if you have a fairly small amount of deep-pocketed investors. But we're talking about the crowd. That's why we're here, we're talking to the crowd. Which is why we use this SEC 3 mechanism. We’re basically borrowing the power of the IRS. So let them do some good for once, right? So the idea is that they’re going to help lock everybody into that upper left quadrant with the carrot and the stick. Just like the signals you sent with the flypaper. By agreeing to meet in this tax regime, you are committing yourself to, not quite the same as the flypaper, but you can do it without getting everybody into a single conference room. That’s the goal. The entrepreneur creates this, pursues this SEC 3 status, and by doing this they send their signal. And the investors when they invest in this sort of organization, they send their signal and they’re locked in and can’t get out. This allows the same sort of signaling that happens with the flypaper to happen over a broad group. You’re imagining you’re one of these funding portals, you’re having big enough trouble making sure you’re satisfying all the obligations you already have outside of the social enterprise space. So what you do is, you will rely on, you will again borrow the power of the IRS to screen out fake social enterprises. You can say we’re going to accept capital raisers as long as they’re SEC 3s. If they are, we know that they are either very good liars willing to suffer for their dishonesty, or they really are about more than just rapacious capitalism. You wouldn’t agree to this if you weren't.

I'm just going to run through a couple of examples of how this might work. At the risk of putting everyone to sleep after lunch, this is dangerous. If I'm losing you, just raise your hand.

Imagine, the numbers are fairly small, that's consistent with the million dollar number we're talking about for rising, say we have a $100,000 of revenues. They have expenditures of $50,000. Ordinary deductible expenditures for employee salaries and so on, but they go above and beyond. They choose to operate in a way that increased their cost, but supports their mission by 50%. So they're spending an extra $25,000 that might or might not be deductible. But if it's on the border, they don't have to worry because it's going to be excluded because it is mission driven. This something above and beyond that they do to protect whatever their mission is. The environment, workers, or whatever. So they get a $25,000 exclusion, and the 1-for-1 which makes a few thousand. So these guys are basically tax exempt. They're not actually, but in this fairly small respect, they are. They get the two exclusions and that's good news for them. This also works in the context of folks who are doing discounted or free services. So here it works a bit differently, they just have lower revenues. They're mission driven. Expenses are the $25,000 of low revenues, but you still get the 1-for-1 exclusion that brings them to the same, essentially tax exempt space.

One of the other features comes from a reasonable question—why the heck would you want to use the corporate income tax (CIT) to do something like this? One of the reasons is that the CIT has been dealing for many decades with folks who are trying to avoid sticks and unreasonably get carrots. That is what the CIT is all about. It's designed to prevent these kind of chips. So a fairly straight forward, by CIT scenarios, is that you can't take money out of the SEC 3 directly without paying a higher tax. That would just be a dividend to you today or ordinary rates, although not today. But it was designed to be that way. What you do instead is, you have the for-profit buy stock of the SEC 3 from you. Why would you do this? This sounds crazy, but the good news here is that this is a fairly old fashioned way of avoiding the stick. This is a way of winning the stick because you get, instead of getting cash from the SEC 3, you're getting cash in this sale. This is something that the CIT figured out and fixed a long time ago, and there are other examples like this. Could you form an SEC 3 and then a companion for-profit? The CIT knows how to integrate those into a single taxpayer and at least subject them to the SEC 3 stick as well. The big concern here is that you end up with folks trying to eat the carrot, and serve the stick. And the CIT does a pretty good job of enforcing that. Even in the crowdfunding context where you can't reliably get everybody in the same conference room to get them to agree to a deal that you believe they're going to stick to. So you get the carrot and we also get the stick, which is going to help you bring impact-first investors together with the impact-first entrepreneurs. Okay, thanks very much.

Matt Morrow: Thank you very much Professor. Now for our next presenter will come up and give his presentation.

Ebrahim Varachia: I'm just gonna hang out here. Thank you Professor Dean. And thank you guys. Thank you Matthew and Katila and the team for inviting us here. So I'm going to be offering a very different perspective on crowdfunding. Patronicity, my company, is a donation and reward based crowdfunding platform. Right off the bat, there's very little legal restrictions and considerations with donation and reward based crowdfunding. It's a lot more of equity based. Patronicity doesn't offer or look to equity based crowdfunding just yet.

You guys covered the model act earlier today, that's nothing that we have to do. What I'll talk about is a little bit about donation-reward based crowdfunding and how we've worked with nonprofits, the State of Michigan and different municipalities to run crowdfunding campaigns. We're similar to Kickstarter and Indiegogo. Where projects or people, individuals, nonprofits, organizations run campaigns, connect with their donors, and we call them donors not investors, to raise money for their project. What is unique to Patronicity, we have a partnership with the State of Michigan Economic and Development Corporation up the block from you guys and MHSTA as well where projects actually apply to Patronicity and we manage a grant program for them. If they're approved, we do a vending process for them, if they're approved they can receive matching funds on a dollars that they crowdfund. It's a pretty unique model. Patronicity has partnered with the State. It's very innovative. The State of Michigan really went out on a limb to partner with Patronicity. Them as a government entity, they're very slow-moving. And we're a start-up we're very fast moving. That's been a very fun relationship to have and to continue it. So a lot of credit goes to them and their innovation there. With online-giving and crowdfunding with nonprofits, there's been a tremendous increase in the last few years. People want to be able, and donors want to be able to give dollars in a very simple, easy way. As simple as it is to buy something on Amazon. We've seen things like "Giving Tuesday" emerge after a heavy shopping weekend. It's another way for nonprofits to connect to their audience online and allow them to give, and gain access, an easy portal to make their donations very transparent. Right off the bat, when anyone asks anyone who runs a campaign with Patronicity, when they ask how does this work? What legal considerations do we have? What tax considerations? We immediately tell them you should talk to your tax attorney and accountant and they will give you the best advice and direction in that sense. Usually just income tax. We work with a lot of businesses, nonprofits, and municipalities. Then individuals as well. And they run campaigns.

Some interesting things on online giving and crowdfunding and what it's allowed people to do and nonprofits. Americans give about 2% of their wealth to charitable organizations a year. And that number is slowly increasing after the 2008 economic downturn. What crowdfunding does, is it empowers people to see what is happening. Donors want to know where their dollar is going. They're not investors. So when they're giving a contribution it's for that warm-fuzzy feeling or that tax break at the end of the year if it's to a nonprofit. Or for a reward. So oftentimes you'll see on Kickstarter, which has grown into more of a product-based crowdfunding platform. Someone invents a brand new item, gadget, the new hover board or something, and everybody wants to buy it. So it's a product their buying right off the bat and that's very business oriented. For Patronicity we work with a lot of organizations that are looking to garner more support and reach a wider audience through social media. As well as non-traditional mechanisms of fundraising. That has the potential to reach a lot more people.

The old ways of fundraising are very much a part of crowdfunding. But as innovation, or as technology innovates fundraising, crowdfunding is that next step for individuals to donate and for nonprofits and organizations to reach their larger audience that might normally or traditionally be out of their immediate reach in their locale. I think there will be more questions, and you can ask me questions about that. There's less legal structure behind it, and I'll let Jonathan take it from here.

Jonathan Fowler: Okay, so I recently have been working at Brooks Kushman, an intellectual property law firm, and helping a lot of startups and entrepreneurs with their businesses, and part of that is the crowdfunding. This morning you guys did the investment crowdfunding, the equity and the debt crowdfunding so I will be talking about the nonprofit and reward and donation. The nonprofit crowdfunding.

Just really quick to start off, crowdfunding is different than crowdsourcing. You guys probably know this but, there's just a differentiation between getting information and ideas from a large group of people, Wikipedia is a great example, or the crowdfunding where you're getting monetary contributions from a large group of people and Kickstarter and Indiegogo are two great examples. So again talking about the different types of the crowdfunding, the donation based is really something that you need to provide a feeling, that warm fuzzy feeling that Ebrahim has talked about. You've got to have a really great story or some sort of cause that people are going to want to give a monetary contribution to. And in the reward based, there's usually some sort of token reward that you get for your contributions whether it's a t-shirt or whether you get a demo product, or something like that. And those are the reward based. I'm trying to think there's a, I forget, the name escapes me but there are rewards for meeting a celebrity or you get a limited edition CD that this artist creates so that's the reward based, and then you talk about the debt and equity this morning. So to compare the types of crowdfunding the benefits of the donation and the reward based is that there are very few legal obligations that you need to meet in terms of towards those people who are giving you contributions.

So aside from fraud you're not really doing your social enterprise or you're not really creating a product. You don't have continuing obligations to provide your financials, you don't have continuing obligations to pay back the loan with interest, or you don't have the obligations to people who are going to own part of your business with that equity. The other pro is that it's a very large growing market. Ebrahim talked about it. It's really exploded in the last five years, the crowdfunding. Who here has personally either tried to raise funds through crowdfunding or has contributed to something on Kickstarter or Indiegogo. Okay, so yes, a number of hands. It's really exploding, there are so many sites now. And you can just find any number of options, and when you go to those you're going to have to look at which one is going to match what it is you're needing. Different sites will have different percentages of the donations that they get to keep or they may be keep it all, or you only get to keep the funds that you have generated if you meet each… if you meet your funding goal.

So there are different options and there are also cons to the reward or donation based kind of funding. Some of the negatives of the donation and reward based crowdfunding are that you need a really great cause or you need a really great pitch. So, there have been people who have raised a ton of money to create potato salad; that was a big to-do on the internet. Somebody raised money to make potato salad. Or you have people who are raising money for very noble causes like fighting any number of diseases. People who need funds for legal problems they're in. I know someone who has raised funds online for their child's dental needs. You know, the kid has ten cavities and they can't afford all of it right now. So, you need a really great story though. And you've got to pitch it really well in order to get somebody to have that fuzzy feeling and give the money. So that's the donation and reward. And then the debt and equity you covered that this morning as well, along with some of the pros and cons there. So some examples are Crowdrise it is a donation based and then we just heard Ebrahim talk about a very interesting platform he's got here. In terms of the order of seeking funding, you covered some of this this morning, I know, in the investment crowdfunding. The donation base crowdfunding is really great for startups and entrepreneurs because you're able to get some capital without some of those requirements of reporting, the cost of the attorneys and the accountants, and so forth. So this is just a quick diagram. The donation is best because you don't have to create a token product to give back to them. The reward is better as well. Now the angels and venture capitals I think are still possibly better than some of the new investment crowdfunding because of the requirements that you have but there are limits on how much you're able to raise with the equity and debt crowdfunding.

Now there's also been some litigation. This is not entirely directly related to non-profit but, there's been litigation on cases involving crowdfunding. So it's really popular, so *Kickstarter, Inc. v. Fan Funded, LLC*. So Fan Funded was actually one of the first platforms for crowdfunding and essentially you were able to go on there to contribute money to an artist's new album or song. They were one of the first. From there came many other variations, so the *Kickstarter v. Fan Funded* case was actually an intellectual property case that Fan Funded had claimed that Kickstarter used their model and they had an actual property rights in that model. It was ruled that the model was not patentable and so Kickstarter was able to use that model. But that's just an example of the large proliferation of crowdfunding websites. So there's also crowdfunding for litigation. These are some crowdfunding sites or organizations that get funds in order to provide legal services. Let me look at my notes here for some of these. So some of these are very interesting. CrowdDefend, they are a nonprofit and they get donations for criminal defense. CrowdLaw, they do small-scale criminal defense cases or non-profits who have legal political campaigns. And Fundraiser, they do reward crowdfunding and they have a legal category. Gofundme, they do donation crowdfunding. And they're popular with legal campaigns. So those are kind of unique for lawyers but, it just kind of shows the proliferation of crowdfunding that even lawyers are now getting funds for people's cases and providing services.

So that's all I have for the slides but, there were some other things I wanted to say. It is a very great resource for startups entrepreneurs, particularly because you are able to get those funds without those obligations. Now, in doing that I'm going to talk a little bit more about the benefits and risks. So there are a lot of options. You need to consult with someone who is going to be able to get you the best platform for you, whatever cause you're doing. And it may be that you're looking at the cost structure, this platform is going to charge seven percent of the donations, this was going to be five percent. This one won't let me keep whatever I raise even if I don't reach my goal of donations. Some of it is also going to be the marketing. So you need to market to people, so if you choose a less popular platform that may impact how many funds you are able to raise if you're on a more obscure site than Indiegogo or Kickstarter or that nature.

There are also things that you would need to consider in terms of the benefits. You have little obligation to people. You can bootstrap your company essentially; so you're going to be getting funds for products before you make them and then you'll be able to use those funds to make them. So it's a really great business model in some cases where, instead of "I need to go and borrow money and then make some goods to sell," I'm able to get the funds first, without the obligation, create the products, and give them to the customer. Because usually you need to get the products out to the customer first, then get the funds. And then run your business off of those funds so it can be a really great way to kind of bootstrap your startup or your entrepreneurial venture.

And then marketing. It can be a great marketing tool. With millions of people going to these platforms, looking through Indiegogo or Kickstarter, it can provide a lot of marketing for you to say "Hey I've got this new idea." Or if you're going to a nonprofit based platforms there's going to be people who are already going, they're interested in those things. So you're going to be able to reach a large audience. In terms of risks, there are some things that are very important to consider. So they're not completely risk free, I guess, for your venture. And one of the things is tax. So a lot of people, they don't think about that impact. When you crowdfund all of these…the monies and then it's going to be taxed if you're not a nonprofit. So that's a risk. And then another risk is the intellectual property. So when you're doing a crowdfunding venture something to take into consideration is what you're agreeing to when you're using these platforms. You may be giving away rights to copyright materials. You may be giving away rights to use of your trademark. Or you may be disclosing to the public ideas that you might be able to get a patent for. So if you go out and you do a campaign on Kickstarter. You've got this great new idea. You raise a bunch of funds and you start making your product and this is really great. And then somebody else starts copying you and you're like "Oh, I should patent on my new product" and then you find out that you missed the one year window for filing for a patent after your public disclosure. You presented to the public your idea in your Kickstarter campaign and so your clock started ticking. So there are things to consider about that.

One example is I have a colleague who was at the business school with me a couple years ago. He is now working for a startup. It's called Torch and essentially it's an electrical heater that you can stick inside your jacket. He went to a wedding, he was cold, in Michigan and he wished he had a heater so he created it. You can kind of stick it in Velcro or something and they got a potential, they got a provisional patent. So after, they had the provisional patent they were able to do a crowdfunding campaign and they just recently closed. They met their funding goals and now they are manufacturing these new electrical heaters for your suit-coat. And so that was something that they had to consider, though, is if they had just gone out and done a campaign they may not have been able to do that, but they did the provisional first. And through their funding, part of their goal was getting enough funds for their utility patent so that was something great. Then just one last thing is the tax benefit, and Professor Dean talked about that, is there can be some real tax benefits to using crowdfunding if you're a nonprofit, or even if you're a for-profit but you're doing the reward donation based. And that can be a nice incentive as well saying "your donations may be tax deductible." So that's all I had for now, but I'm happy to answer questions and we can go to the panel for questions unless Matt has something else.

Audience: Clapping.

Matt Morrow: Thank you to the panel for all the giving those remarks. For now, I can open it up for questions.

Professor Spoon: I have a question for Professor Dean. One of the things that is very, very interesting, and I would give some to the legislative body to do, you know pass it, that would be very remarkable but, I would…

Professor Dean: Expect the unexpected in politics, right, and you never know.

Professor Spoon: Well you know when they get in, they're going to win, win, win. So one of the things that strikes me is that it is so definitional, right. So how? How do you qualify for that? You know, which missions qualify for that? What is mission driven revenue and those kinds of things? You used Etsy as a social enterprise. I am a frequent user of Etsy and I think everyone seems to be making money off of me. I don't know which mission I am furthering there. But I'm curious about how you've formulated that.

Professor Dean: Yeah, I think that's a very good question. We heard that there are many different versions of what crowdfunding is and I think there may be more on social enterprise. And some of that is just definitional, but there really is, I think, you know it's not just superficial disagreement. There's a really fundamental disagreement about what social enterprise is and how big of a tent it is. When we talk about it in our work and research our focus is on impact first. So, in theory we would love to see a perfect balance of mission and profit-seeking. But we want to make clear is that we are, it's not the same thing as CSR or corporate social responsibility. We just promise not to, you know, not put terrible chemicals into the river. Right. We're hoping for something a little more than that and the idea is to make mission really a part of the organization's core, rather than just something that is an add on, a sort of a marketing scheme. That is something designed as sort of a policy reputation and one of the reasons that we like the approaches that we take. We're not specifically interested in any one definition of what kind of mission is appropriate. We're just trying to take greed off the table. Right, so you can think of it in the socially responsible mutual fund context, the way they do this is that they have negative screens.

So if you invest in a responsible mutual fund, they're not going to go and look for a specific kind of social behavior necessarily. They are just promising not to buy tobacco and gun stock. That's sort of what they're doing. So it's a shorthand way of saying we're going to be slightly less rapacious than the next guy. And our work both with Flypaper and SEC 3, and some of the other work we've been doing, we haven't tried to define which missions are okay and which missions aren't. We're really just trying to make sure that investor-entrepreneurs can get together without having to fear that one or the other is a sheep in wolf's clothing, or rather a wolf in sheep's clothing as a sheep in with clothing isn't that scary. But a wolf in sheep's clothing. And just to make sure that they can trust each other, to build that trust. As in the nonprofit sector, one of the great parts about it is that you can do almost anything, except, I guess, in some extreme cases. And we want the same to be true here. That's our vision of it. But if you've got ten people in a room you would get twenty answers. But ours is that, you know, we want impact first investor-entrepreneurs to be able to come together around whatever it is that they think is smart. I think the beauty of it is that you can't know what's going to succeed. You know that's why it's an entrepreneurial driven space because somebody is going to come up with an idea that most people think is crazy, but it turned out to be great.

Ebrahim Varachia: I can add on that a little bit. It is definitely definition driven. A couple of examples, I think the model, like a social impact benefit corporation, is Patagonia. For them environmental consciousness is their number one thing. So they would actually give trade secrets away to other companies, competitive companies, to better the environment or for their mission driven purpose. I mean there's a lot of articles in the…

Professor Spoon: It is certainly not reflected in the prices of their clothing.

Ebrahim Varachia: It is certainly not reflected in the price.

Professor Dean: But I disagree, it is reflected in the price of their clothing.

Professor Spoon: Yes, it's higher.

Ebrahim Varachia: Yes, because it's more expensive to look at, you know, down that is traceable. I think there's a lot of articles and talk around Kickstarter, which just became a public, no, a benefits corporation. And there was even questions to their investors like "how does this make you feel?" because they made an IPO now. Or they have different considerations whereas an investor you may have wanted to make a lot of money off this great idea that Kickstarter has but now they've changed, or that they've had from the beginning but they've openly said "Now, we really want to support the arts first" and that is more important than making money. On a personal level with Patronicity we've been having a lot of team discussions. We're a double bottom line business, or triple bottom line, and in our mission and our in our vision meetings we talk about what do we want to do and how do we want to do it. So if an organization wants to give us a lot of money for a project that we want to do. Do we take that because the money will, you know, make us smile or is it against some of the work that we believe in at our core principles? It comes down to that organization's seed and it's very much is definition based.

Matt Morrow: Yeah.

Jeremy Belanger: First, Professor Dean, I disagree a sheep in wolf's clothing is scary because how did it get there. But my question is, what obligations does a nonprofit owe to the investor or owner when they make an investment in their company?

Professor Dean: For a nonprofit?

Jeremy Belanger: Yes.

Professor Dean: Well, I guess you are worried about… generally the way it works is you have no…I'm not a nonprofit expert but my co-author is, I learned so much from her so apologies to her if I'm to get this wrong. You have no obligations to your donors. You have an obligation to your mission. So if the donor has read your mission statement and they understand what you're about, you have an obligation to stay true to that mission. The protections that are built into the nonprofit space and the word nonprofit is a misnomer. You can be a very lucrative tax exempt organization and just not pay taxes. It's not about, you know, trying to lose money. That's not the point. The point is about pursuing your mission.

So there are two methods of enforcement that try to make sure that you are going to do what you say you're going to do. One, you can't distribute profits out to anyone. And you can have owners but you certainly can't attribute profits at anybody if you're a tax exempt organization. Under state charity law that's how it works. But the other is the state attorney general will come and find you if you're not doing what you say. You say "really?" And yeah. I mean the answer is that they're not going to do it all the time but that's the enforcement. The enforcement is the state's attorney general making sure that you're not pilfering tax exempt funds and that you are staying true to the mission that you said you were going to. But there's not a possibility for a shareholder derivative suit as you would a for-profit space. That said, there have been a couple really interesting examples where there's been essentially a profit, a fight for mission control of a nonprofit. The Sierra Club I think it was. There was a battle for control of the board using the voting rights of members to turn, to emphasize, anti-immigration efforts to make that part of the core platform of the Sierra Club I think it was. The vision being that more people in the U.S. is worse for the U.S. environment. And it was a really fascinating exercise in how that works. But generally, donors, you give money and you get a deduction. That's the government saying thank you. Subsidizing the capital being provided to nonprofits. But there's no direct authority between donors and no obligation directly. There's an obligation to the mission enforced by the A.G. and the A.G. will also enforce the ban on profits to insiders.

Ebrahim Varachia: There is no obligation, but jumping off of that, donors want to probably know where their dollars are going. I think one of the opportunities that crowdfunding allows for is that it's a very transparent model. So they can very much see where their dollars go by the story that they tell. If you help us raise twenty thousand dollars we will be able to do x, y and z. And they know their dollars are going there. On the other end, I think it's a 1090 for the nonprofit and when they file it it's a public document that you can see where their dollars are actually spent. And so sometimes you will see non-profits, they'll spend maybe 11%. I was just listening to a thing on NPR, there's a vet organization that only spent 11% of all their donations towards the cause that they were part of.

Audience Member: Are you thinking of Wounded Warrior?

Ebrahim Varachia: Yeah, that sounds very familiar. And so as a donor or supporter of that organization you might feel "why of my hundred dollars are only eleven dollars spent to help these wounded warriors or these vets?" and "do I want to continue to support organizations like or would I rather support other organizations?" It's not an assigned obligation, but it is a public document. That's their obligation to the government I believe.

Matt Morrow: Great, that leads into one of the question I was going to ask. You know we have a bit of trust issues with that, you know. We saw, as we were going through the presentations, that one of the main benefits of the nonprofit and donation based/reward based is no regulation, which we talked about this morning. No one wants burdensome regulation. We all don't want that, that's not very good but, on the other hand there is, of course, on occasion need for some regulation, you know, for locks keeping honest people honest. Things of this nature saying there is. It seems to me much of… very much so of the perspective of "I invested with this person and I'm not going to do it again next time." I don't see anything in place right now, would any of you speak in favor of anything like being able to recoup some of those costs? I pay one hundred dollars to Wounded Warrior and only eleven dollars went towards that. They weren't following their mission. I kind of want some of my money back right now. I don't want just to not spend one hundred next time. Can you speak of anything on that or if you have thoughts generally? What do you hope for? Or anything along those lines.

Ebrahim Varachia: I think something that was interesting in terms of reward-based projects was Kickstarter. It was a few years ago, one of their most famous projects was the pebble watch. And it was just a new innovative watch that came out a couple years ago. And they raised over a million dollars towards this watch. They promised their donors, or there backers, as that's what they call them, who bought the watch that they'll have them out within six months. They exceeded a goal, I think was two hundred percent above, or two thousand percent above what they wanted to raise. They couldn't produce those watches in time. They didn't have a manufacturing base. A lot of those people were like "where's my watch?" and two years later they started shipping those watches out. That was something a lot of people kind of held on Kickstarter as well as Pebble. We supported this thing. I wanted this watch. You sent it out when there's ten new versions of this, like updated versions, and other companies have already created better pebble watch features. That's something that Kickstarter, even with Patronicity, that's in our terms. Some of the rewards, some of the donations, the responsibility is held by the organization running that campaign and you'd have to talk to them. If you want your money back, per se. In terms of for us, we've done refunds where we lose money to have good customer relations with our donors. They're not donating to us, but they're donating towards a project that was with us. And so sometimes that is something, a cost that we eat. But, that's I guess that.

Jonathan Fowler: Oh, I was just going to say that there may be some traditional remedies still available so you may be able to have some sort of false advertising claims if somebody is really doing something egregious where it's very clear that, okay you had this campaign and you haven't taken any action for me. You went and spent all the money personally. Things like that, there are traditional remedies that may be available. But going forward, a lot of it is terms as well so what are the terms of the platform. And they may differ from platform to platform, which is something to be aware of. And often the platforms are having you absolve them of any responsibility for the organizations who are using that platform for crowdfunding.

Professor Dean: So I have a question, I really don't know the answer to this and I'm curious. So for donation based crowdfunding that serve nonprofits will normally allow donors to take the deduction. So to qualify for the deduction they have to file a 1023, which is their original "this is what we promise to do" and as soon as you get that you have a provisional status and you can accept donations. But what happens if it turns out that they got that provisional qualification, thought that they were eligible to start taking donations, and then it turns out that they weren't? Is that something in the terms? Would that be something that would be between the donor and the nonprofit or would that be something that you would get involved in as the platform?

Ebrahim Varachia: So Patronicity, and I think a lot of platforms; we serve as a pass through. Their donations are tax-exempt… and I think. I mean deductible. Even if they are applying in the process, I think it's 18 months, that might be a Michigan thing or it might be a national thing. 18 months, that if you collected dollars before/after it's filed, those are still deductible. Along with that, our partnership with the State of Michigan as a Michigan economic corporation, one of the requirements for qualifying projects is that they have to have a solicitation license that they have to get from the A.G.'s office. And that's a Michigan license they have to apply for. It's very simple. Most non-profits already have it. There are exemptions for that. We've run projects with universities or municipalities, they also exempt from having a solicitation license. It's not required for everyone but if you're soliciting more than $20,000 dollars per year you need it. And that, I think, is a simple thing to fill out.

Professor Spoon: Firstly, you mention that if you thought maybe the crowdfunding statute or regulation problem might be more compatible with your social enterprise. I'd like to explore it a little more because on the surface to me, the yields are smaller, the cost of doing it is still great and it might have more impact, in my mind. Maybe it has an outside impact in a negative way under social enterprise.

Professor Dean: Sure as I take your point and that's certainly true. What could be happening here, and of course these are not types of organizations that are for profits in the way that they see that happening. But so it just played out, you can imagine them trying to raise, you know, not even a million dollars, a few hundred-thousand dollars and would they be able to do that without bearing the high cost? You could imagine there would be. There is a network of, for example, attorneys that I've encountered in New York, and those are the folks who work at big firms, but by day and by night they love helping social enterprises.

So, you know could you get law firms to do some of this work they do for their fully-paying clients? Most of the time. But, just talk to these folks and they are open to it. Could you possibly persuade some of these firms to provide services like these sophisticated services at some sort of discount? It's possible. There are a lot of ifs here, but it would be easier to make that pitch to a law firm if you have some ability to demonstrate your commitment to a double bottom line instead of that you really are just, you know, a fully profit driven enterprise.

I was thinking of the old Grace Jones song, and if anybody here knows Grace Jones, "you know I'm not perfect but I'm perfect for you" is what she says. And so we've agreed that this one million dollar cap route to funding is not perfect, but it seems a better fit in a lot of ways for a social enterprise than it would be for a fully profit driven organization. One of the other ideas that came up this morning was if you use the Crowdfund Act fund raising tool, you're stuck with it, right? You're stuck with that and you are not going to be able to go to venture capital investors. But if what you're trying to demonstrate is that you really are a double bottom line enterprise, and you're not, you know, don't have one eye on the IPO, or at least on the next round of venture fund investing. Honestly, one of the things you could say is well listen we've taken Crowdfund Act funding, and we can't do that. So once we've done this, we're committing to not taking money from venture capital investors because they won't touch us anymore with you know you crazy pajama-wearing Crowdfund Act investors.

So it's kind of a strange pitch to make, but if what you really are saying is you're about more than just making profits, in kind of an odd way using the Crowdfund Act fundraising approach allows you to show that you really are committed to more than just profits. So it's not perfect, but in the same way that the internet is oddly great for cat videos these days, maybe the Crowdfund Act million dollar exemption could be a very good fit for double bottom line enterprises, not perfect but a good fit.

Matt Morrow: Going with that, there is a question that I was kind of thinking in my head. You know law students, law professors love to put new hypos at you. Throw some facts that you never talked about.

Ebrahim Varachia: Especially involving cat videos.

Matt Morrow: Certainly. I might try to work that in, not sure I'll be able to. But the problem I was wondering is the social media aspect talked about Crowdfundings out there. Like on Kickstarter, whatever you have the page, the donation being made, and the people are talking about the product. Some of that I would have some concern about whatever that product is, you're getting feedback on it. The social mission being changed a little bit by how the donations are coming in and people are saying "Oh this is great but if they did this I'd give more." That's always kind of out there, you know, you always hear rumblings about it, but do you have any concern like social missions being changed and things that are having influence upon it by where the donations are coming from? Because, like you said once you're in our venture capital, they really believe in our cause or are out. Now we got this you know, the Crowdfunding which the "pajama guys" say they change their minds now they think that's not cool anymore, you got to change your mind on this and you can't get back out to venture capitalists. Is there, you know, concerns how you can battle that? Are there issues that some of the nonprofits are having or are considering? How responsive are going to be to the crowd what the next big thing is?

Ebrahim Varachia: Yeah, I think one thing that crowdfunding did on both the equity side and the donation reward side, which are very separate by the way. So there's equity based platforms, they solely you know deal with that, and there's donation reward based and they solely deal with that. I don't think there's a single one that overlaps right now. But there's thousands of platforms. What both of them did, and this ties into that, is in the beginning with Kickstarter, it allowed any individual like you and I to become patrons towards the arts. And so, in the first five years that Kickstarter was around, they put one billion dollars towards art projects worldwide. And that was seven, and the next year, the sixth year, they put another billion, so they equated what they did in the first five. And they're growing very fast. But that allowed anyone to become a patron or a philanthropist towards the arts. And it opened up that huge space. With equity Crowdfunding, it's allowing any individual to become an investor, where it was, and there's rules to it, but that was a space held only for sophisticated investors or, I think that's a term.

Jonathan Fowler: Accredited investors.

Ebrahim Varachia: And now it's opened those gates. That now allows for more input into what that company is doing. There's less input even through social media on donation or reward based. There may be feedback, but there isn't a stake that they hold in it that with equity crowdfunding there is a share or even a debt relation whether there's revenue sharing. There is some sort of stake within that company and they do, I think, send out voting options just as you would get if you own stock in any company. With donation based, you very rarely see that maybe someone would post "oh it's great. I would love to see this." It might adapt and grow their company, but they're so small in the larger scheme of things it might have very little to none effect on that.

Professor Dean: I want to… Oh.

Jonathan Fowler: No go ahead. No, seriously.

Professor Dean: I was just going to say that, that's one of the kind of the pros of the reward donation bases; that you don't have any obligation to do it. Those donors, they don't have any control over the decisions that the organization is making for the person. So, you know, they might have or throw out these ideas, "oh you should really change it and work on this social mission or you should change your product and have it do this fancy new thing." But you don't have to do that. But that is also a great benefit that comes to a lot of organizations, and you know, startup entrepreneurs having that input from people who are contributing funds to your mission or to creating this product.

A lot of times when you start a business, you know, you're an entrepreneur you are not going to be doing what you started doing if you're going to be successful. And you start your company, you start your venture and you go out, try to sell something, and you get feedback and okay, nobody needs your product. Very, very, very seldom do you have an idea about a product or company and you go out and you start it and it's exactly what everybody needs and you don't have to pivot, you don't have to change, so that's that can be a really great benefit. Saying, "Hey these are people who maybe aren't customers but in some cases they are customers." You know you're promising some sort of future product, but they're at least willing to give money to do what you're doing and you can kind of figure out your market niche better. You can figure out ok maybe, maybe I need to not be doing the, you know, there's a startup, that I know of, they had to pivot, they were doing tech repair and they had a model where people would pay for the tech repair. And they needed to switch the model and they were then considering an insurance model like people maybe pay upfront and then they do that and so it just is a great benefit I think that you can get some more reliable feedback of people who are willing to pay and get feedback and you can kind of get your market better and improve and pivot so I think that can be a benefit.

Ebrahim Varachia: Corporations spend millions of dollars in customer development and here are people who are supporting or buying something. Initially in the beginning, they would probably be willing to give you feedback on how to better that model and that's what a growing, you know, a startup would love to have. It's very valuable for them. To get that for free is definitely a benefit less and less of a harm, I would say.

Jonathan Fowler: Well and just building on what we talked about or what was on top of the morning panel, one of the benefits as described makes perfect sense to me that when you get investment from a VC or Angel Investor, it's not just they give you a pot of money and walk away. They also give you advice. They make introductions and you can't necessarily get introductions from a crowd, or maybe you can to more of the crowd. You can, you know, invite your friends along so it may be that, as you are saying, the inputs not even that it's just for free, they pay you to help you. If they're giving you money but they're also you know if not financially, they're emotionally invested, they're actually invested in what you're doing. Certainly for nonprofits, even though they have, one example is the Barnes Museum in Philadelphia. It was in the suburbs for a long time and the person who created it, that was what he said. He said it must stay here, not in center city because he wanted to be there and folks that are running museums decided that was a terrible, terrible idea although that was what he said he wanted. He's dead of course. So they got to do it despite being the exact opposite of what he wanted. And so, even in the nonprofit context, change is possible and maybe a good thing. I'm not sure when it comes down on that specific example, but I will say I don't know if I scared anybody I didn't tell the story the end of the story the Sierra Club. I don't think they're anti-immigrant now, so that it was actually a big, big battle but I don't think it was successful. Anybody who knows I'm wrong can tell me.

Ebrahim Varachia: What happens with VC investors, they do have a larger stake? I have seen young startups get a lot of money and they have to change the direction of their company because the one who just gave them two-hundred-thousand dollars wants them to do this. And it might be completely different from what they had envisioned, but they now are in the pocket of someone else. And so that is a, I guess, if you're an investor that's a benefit you know you can craft what you want here. Now almost all employees, and they're not your employees but the company that you've invested, can craft and guide their direction and make them pivot if you know you had that authority.

Jonathan Fowler: And just, you know the trust, the control it's complicated and getting a right is, is really difficult.

Professor Spoon: Obviously there are many nonprofits who will adjust their mission based on who's giving them money.

Jonathan Fowler: That is very true.

Professor Spoon: You know, it's not, you know, cut and dry by any means. And you raise money directly for nonprofits. I mean you sell out in effect, crowdfunding for nonprofits? Or is it only through the state partnership?

Ebrahim Varachia: No we, there are a lot of organizations, nonprofits, that don't qualify for the matching funds. That's a huge incentive. As Jonathan mentioned, there's and it's very discouraging as an owner of a startup crowdfunding platform to search "what other confident platforms are there?" Because they may be tens of thousands of them. And when we started it was what differentiates us from these large, very successful platforms like Kickstarter and Indiegogo. We happened to start from the inspiration from Kickstarter. We recognize what their contributions towards the arts was and we wanted to take that to community development and having that niche was really important. And there's ones that have grown there's ones that have failed. We're still around and I think that might be because of our crowd granting model and that's something, you know, we’re new into that space nobody's ever partnered with a state organization, or a granting organization to manage a grant. So we do more grant management now than we do crowdfunding but all the projects crowdfund to get the grant.

Yeah we work with them. Unique to Patronicity, we work with every single project from the beginning to the end. Crowdfunding is not very difficult, but I would equate, I always tell people it's kind of like riding a bike first time you do it probably going to fall. So we like to see ourselves as the training wheels. We provide the best practices, what makes crowdfunding a crowdfunding projects more successful. That inspiring emotional sexy story sells. It inspires donors, backers, and supporters to give. And whether it's for your local business, we’ve done coffee shops or a nonprofit, there's a project right here, is a project live right now if you want to go to www.Patronicity.com/popupart. It's a project in Lansing and they're trying to raise seventy-five hundred, Lansing art gallery to put up newspaper kiosks. And they have little give backs, if you give twenty five bucks they will write you know a thank you letter or we've seen things like that. Reach Art studio center in Rio Town is one of the most, one of our favorite projects that we've worked with. And they develop their art gallery and expanded the work that they do. But we work with them to kind of give them those best practices and help them crowdfund. Some things that we've seen from the research is Kickstarter has a lot more projects.

So you're on Kickstarter one of eight thousand, ten thousand projects. And very rarely do people go to Kickstarter with their hundred dollars and say, “Where am I going to spend this today?” And that's the same with Indiegogo or Patronicity. You know, almost always, unless you have a viral project, almost always people are directed to Patronicity or kickstarter.com/Project, URL name. Almost always and so there has to be that connection. And when people ask us like, well should I be on Kickstarter because there's a lot more you know traction there's a lot more traffic. It could work, it couldn't. And my prime example is I had a friend who ran a campaign on Kickstarter. And Kickstarter, every day they have a project of the day. It's 365 projects they feature. Now there is I think a little bit more because there's a slide. But he was a project of the day he was so excited he was raising $25,000 for a film about kids and going to prison or something and recidivism rates. And he was like I'm going to be funded like that because it's going to go viral. And after that from that, day to the end of a campaign, which was like nine days later, he raised $100. And he was like I thought I was golden, right, I'm on this platform to get tens of thousands or hundreds of thousands of viewer like traffic, you know, individuals, users. Why don't I gain that traction? And it's definitely that personal connection.

There are projects, and they're more product based, that should go like "this is so cool I got to tell everyone about it. Not because I care about the work that they're doing, but more because it's just so cool I have to have it." The ones that do it, you know have that emotional story—there was a project in Detroit this man walked twenty-one miles to work and just it was such a sad story everybody wanted to donate to it and that got viral. You know that went viral but that's very rare, unless you have a cat video.

Matt Morrow: A question off that. I wanted… go.

Audience Member: I was just going to jump off of what you said that there are so many platforms with and they're all different and some of them are like we do everything under the sun. Some of them are very specific types of crowdfunding. Patronicity, I haven't heard of any that do grant matching, so that is really unique and amazing.

Going off of what you said as well, you have to have this great story there are companies out there that will do a story for you. They'll manage your crowdfunding campaign you pay them and they'll do crowdfunding campaign for you. There's companies out there that will do these terms of white page or something or,

Ebrahim Varachia: White Label?

Audience Member: Yes. They will make a crowdfunding campaign website that is just your organization, so instead of being on Kickstarter, you've got your own, it looks like your own crowdfunding website

Ebrahim Varachia: That can work well for like churches. They want to have their own crowdfunding platform but there's other considerations.

Jonathan Fowler: Yeah and then the story's so key, that if you don't have a great story you can go on, and then just, you're one of so many other projects. Nobody's gonna.

Ebrahim Varachia: I always tell people, is no such thing as free money. So there's this idea of, I can put it up and I'll get funded. And Jonathan mentioned this idea of the potato salad. And this was a famous project where Kickstarter had really high success rates and by success I mean projects that reach their goals. It was an above sixty-percent. Which is incredible. Because Indiegogo, Go Fund Me, a lot of the other platforms their success rates are under ten percent. Go Fund Me is one of them. They raised two billion dollars, they're raising a lot of money. Their success rate is four percent.

And so Kickstarter, used to have requirements so you have to be an art project, and you would get rejected, and you wouldn't be allowed to post your project on Kickstarter if you didn't meet the requirements. When Indiegogo started growing, they took that requirement away to open up and to deal with the competition. That's when the potato salad came on. And that was a $10 project where a kid wants to just make a potato salad. It went viral. And he raised $55,000. And his rewards were like I'll send you a picture of the potato salad. I'll tell you one of my ingredients in the potato salad. And people just thought it was comical. But what you started to see were potato salad projects like crazy. Everybody wanted to do it. Then they started being dozens and dozens of potato salad because everybody thought "hey my potato salad project or my cat videos going to go viral." That's not going to happen. And so that you know, that's something that is just rare, but it deals with what happens to crowdfunding.

Matt Morrow: That was very precious I'm glad I let you guys keep going. You've tied very much into my next question. Like you were saying with advertising. So to you Ebrahim, did you ever, had you ever have considerations or do you guys do. So if you pay us extra amount of fee, whatever, will advertise, like we'll help pay for like ads on Google and things like this, trying to get your name out there at random like as the site yourself. Or we'll do the advertising, we'll do for you or are there reasons to do that, reasons why or why not just for the advertising public you're saying you need to have this big story, but what if I don't really have a good story can you still help me?

Ebrahim Varachia: Yes. Marketing, marketing is where money is made. Google. They're made, themselves from advertising. And corporations spend tons of money on advertising. How much do you think Kickstarter has spent ever to advertise for themselves, for Kickstarter the brand?

Matt Morrow: Zero?

Ebrahim Varachia: Zero. And so, that's because everybody is saying "hey go to my project on kickstarter.com and there's free advertising there." In terms of us advertising for those projects, yeah we do that. We don't charge them anything extra. For Patronicity, I mentioned we are a… social impact is number one. And so for us, we don't necessarily. We want every single project to do well. And we want them to do the best they can. We just, we don't want millions of projects just running campaigns to see how much they can raise. We want to work with every single project and so quality is important for us more than quantity. And in that, because of that because we put that social impact first, we will advertise for free.

There are things that we do like Facebook ads, we know how to target them and make them more successful so sometimes we'll say "hey if you want to add $25 we'll take that exact $25 and target it towards Facebook ads, and we won't charge you a dime beyond that." For us it's great because our name is attached to all of those things and so that is something that we've been doing, right now working a pilot program. We're very local-based so we want to create more like print media for projects to give out to their local communities. We find that a majority of donations, 90% of donations come within a five-mile radius of our projects. We have, then obviously the rest come from people maybe ex-pats of that community or whatnot. Locally impacts are very important and so we're doing this thing where we just generate postcards for projects. They've printed themselves but that, you know, content development is free.

Jonathan Fowler: To go off to what you are saying, there are like I'd said, companies that will do all your marketing for you. So you say ok, I want you to do a crowdfunding campaign for me and, as Ebrahim said, the personal connection is so important because it's so hard to go viral. Crowdfunding so big now. So they'll say ok input all, import all of your Facebook connections, import all of your LinkedIn connections, your Instagram, your Twitter, any other social media platform you're on, your email list you know give us everything, we will send them a great ad at the beginning of your campaign, halfway through will send them updates will tell them "hey it's just about to end we're almost there help out you know, so…"

Ebrahim Varachia: There are consultancy agencies, they are private and they're around.

Matt Morrow: I have one other question a lot of you have touched down at different parts in a way you know just being here as we are in a law school, and how the way I understand this could tie very well into the legal profession. That being using this crowdfundings to support legal activities like legal aid, indigent legal aid, things of that nature. You all talked about, I don't know if any of you thought about this, I don't know as a professor, would be such a great way to, you know, start new ways because it, as you were saying doesn't have that influence. Which obviously you can't give donations to lawyers and have influence over the representation. So seems a great way to be able to you know help gain some interest from people who have social interests, you know, helping the needy in general. I guess also do you have any of those products? Have you worked them yet as in your particular ventures or not? I guess open to the whole panel your ideas on that in general. How can we do that facilitation of greater access to justice be used and harness this power of crowdfunding?

Ebrahim Varachia: So Jonathan mentioned of about five different platforms there's probably more that focus on legal covering legal fees. The lawyers don't run those campaign, it's usually the defendant right?

Jonathan Fowler: Client.

Ebrahim Varachia: We don't because our niche, and we would tell a project this is not a project that fits on Patronicity. Just says if it wouldn't fit on Kickstarter, you would find the right platform for you and that may be one of those. I have a friend who runs another crowdfunding platform. So who's heard of Serial Podcast? And yeah. So on his platform called "launchgood" they are running a campaign for, and they started it there at the end of the Serial podcast, the first season for, announced it, and funding his trial. It just went to appeals; I think it's up for an appeal right now. But that funding would go there and they've raised $200,000 like $100,000 towards that. And I know, I think there are organizations like the Innocence Project. There's stories like that where people would want to give because they want to see, and they want to let an innocent man get out of prison or fund his legal fees. And you do see that quite often but not with Patronicity.

Jonathan Fowler: Yeah. Some of them that I'd mentioned, Go Fund Me is popular with legal campaigns and fundraiser, their rewards crowdfunding but they've got a legal category. There's like a 5-7% fee, and then the cost of 2.9%, and then, so it's a third, and then you have thirty cent donations. There's also a, I think I mentioned Funded Justice. So there's a Chicago attorney, Michael Helfand, I believe, who raises money to hire flat-fee attorneys. 5% fee, 2.9% costs, 30% donations or thirty cents donation.

And there's CrowdDefend. So a former Google executive, Hiraa Khan, who spent three years on the board of ACLU in Northern California and he saw that it's very difficult for people, normal people to secure legal advice. It's really hard for the average person to go out and get attorney, have their day in court, or fair trial without spending money on an attorney so he started CrowdDefend. And it's keep-it-all funding, so you don't have to reach a certain amount you don't have to reach a goal you get whatever you can crowdfund. And 7% fee, again 2.9% cost and thirty-cent donation. So there are places out there that are doing it. I'm sure there's more now and I also did an aside, but I think that there are platforms out there where people are asking for funds or they're offering a part of their compensation, a part of their earnings, once they're an attorney for funds to go to law school. So there is like everything under the sun, so there are legal access to justice campaigns out there. As Ebrahem was saying, there are a lot of individual, not organizations, where someone just goes on these legal organizations, "I have this really tragic legal issue and I need help with that."

Professor Steven Dean: And I don't know where and what if we are winding down I'm afraid to be too much of a downer at the end, but I do it anyway.

Matt Morrow: We're alright.

Professor Dean: I guess, you know, when I hear this I am of two minds: on the one hand, I think it's fantastic, the idea that you could get support for defending somebody who can't get help elsewhere. You don't have to have everybody agree that this person is somebody who needs defending, but it worries me a little bit as well. Who's going to get the funding? And I wonder whether it's going to be truly the most deserving of that kind of support or whoever, the study abroad student in Italy, would she get a lot of support? But somebody who is a little less photogenic and perhaps be maybe a little bit more deserving, and would get less. I would, I would worry about those kinds of damp dynamics in this context. You know it's not bad if it's a plus, if it's something that's in addition to all the other systems we have in place to offer legal support to those who really need it. Those who you know maybe really did a very bad thing, not in Italy, and need defense and probably could not get it through, you know, a moving appeal to the public. That's just what would worry me about that, although if it's just you know add on to an otherwise well-functioning legal system, I would be less worried about it.

Matt Morrow: Oh great professor to help bring us back up from that downer there. I would say a good idea to go about it then possibly be like you were saying, the funding going towards an already existing institution for indigent defense, as opposed to for specific cases saying our mission as a nonprofit is to provide into defense to the people in Ingham County and Washtenaw County, Wayne County. Things like that could be a way to help head off someone's issues. Because of course you don't want, you know a very, you know, photogenic someone like you know very charismatic and no one's ring along and now you're defending and no one is really happy about that anymore. Or is it something you're trying to avoid, clearly. So that was just somebody as you know a general fund more than individuals, which is what you know what you're balancing here the crowdfunding of my individual play versus you know entire companies that can be helped at the same time so maybe that would be something more agreeable we could think about.

Ebrahim Varachia: Yeah. The one thing is you rarely will see an organization, I think like the Innocence Project, they are nonprofit law firm. They're not going to run a crowdfunding campaign. And of course they generate their revenue from donations and that helps fund that, and it's rare that you will see individuals, but it's their story and you don't know, there's always two sides to the story right? And so you don't know if, hey I'm going to give money to them, and the people that do give are the people that are connected to it. Unless there's you know crazy emotional story. Took so much, it took a whole NPR podcast that was the most famous podcast in world history to generate you know this new trial, for that individual. But there is a concern that you know people have; where is that money going?

Matt Morrow: Well great. Thank you very much. I like to take the time to thank our second panel for being here today, for hanging out with us after lunch. Thank you. And that will conclude our symposium for today. I would like to thank everyone for coming and hanging out with us today, for those who made either both sessions, or just one, whatever it was, we're glad to have you. I want to give a special thanks to Katila Howard, our executive editor, for pulling everyone together in putting this on. Did a lot of great work for all of us. And I would like to personally thank all the JBSL members that are here and, of course, our wonderful faculty advisor Professor Spoon for being here with us today. With that, I thank everyone again for being here. And I hope everyone has a great rest of their Friday, and good weekend. Thank you for coming.