ALTERNATIVES TO TRADITIONAL CAPITAL RAISES FOR RESTAURATEURS

HOSPITALITY LAW COMMITTEE

JULY 2018

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I. INTRODUCTION

One of the most common reasons restaurants fail, particularly during the first few years of operation, is undercapitalization. They either struggle to raise enough funds to open or to obtain the subsequent funds needed to sustain initial operations and support future growth. The restaurant industry is massive, with roughly one million restaurants across the country and approximately $799 billion in sales each year, according to 2017 figures from the National Restaurant Association.[1] Studies vary, but a report on a 2005 study from Ohio State University published in the Cornell Hotel and Restaurant Administration Quarterly journal found that approximately 26% of restaurants close or change ownership in the first year of business and 60% percent closed by their third year.[2] This study focused on restaurants in the Columbus, Ohio area over a three-year period and restaurants that were sold but which remained open under new management were counted as "failures."

A more comprehensive study from 2014 by researchers at the University of California, Berkeley, used data from the Bureau of Labor Statistics to examine the lifespans of 81,000 restaurants in the western United States over a 20-year period. They found that contrary to popular belief and other studies, full-service restaurants actually had a higher survivability rate than other businesses. They found that 17% of restaurants failed in their first year.[3] Although most restaurants do not fail due to any one reason, difficulty in raising startup capital and meeting ongoing funding needs can be significant contributing factors.

Startup companies and small businesses, including restaurants, typically raise needed capital from friends and family, bank and small business loans, the sale of equity, angel investors or venture capitalists. We provide an overview of these traditional capital raise methods to provide context for a review and discussion of the alternatives to these methods created by the rise of donation, reward, and equity based crowdfunding available through online platforms and portals made possible by regulatory changes to federal securities laws.

The federal Jumpstart Our Business Startups Act (the "JOBS Act") was signed into law in 2012 with the intent to "democratize" investment opportunity by easing some of the securities regulations to permit persons, start-ups, and small businesses to raise funds for a business or project from a "crowd" of individuals in the public over the internet. The intent of the JOBS Act is to make it easier for small businesses to raise capital and, in turn, spur economic growth through job creation. Title III of the Act deals specifically with securities-based crowdfunding.

In 2015, the U.S. Securities and Exchange Commission ("SEC") adopted Regulation Crowdfunding ("Regulation CF") to implement Title III of the JOBS Act, opening up securities-

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[1] National Restaurant Association News and Research, Facts at a Glance (http://www.restaurant.org/News-Research/Research/Facts-at-a-Glance). Retrieved March 8, 2018. (All websites last visited July 11, 2018)

[2] Parsa, H.G., Self, John T., Njite, David & King, Tiffany (2005). "Why Restaurants Fail". *Cornell Hotel and Restaurant Administration Quarterly*, Vol. 46, No. 3, 304-322.

[3] Luo, Tian & Stark, Philip B. (2015). "Nine Out of 10 Restaurants Fail? Check, Please". (http://onlinelibrary.wiley.com/doi/10.1111/j.1740-9713.2015.00813.x/full) The Royal Statistical Society. Retrieved March 8, 2018.

based crowdfunding to non-accredited investors with the intent of enabling startups and other early-stage companies looking to boost funding to sell investment securities to the general public through approved online platforms without having to undertake a full registration with the SEC, subject to certain SEC restrictions. The Regulation CF guidelines that went into effect on May 16, 2016 allow anyone (not just accredited investors) to make investments through crowdfunding platforms. Until this rule was enacted, typically only accredited individual investors, as discussed in more detail in Section II, who meet specific regulatory wealth thresholds, and institutional investors, such as venture capital (VC) firms and angel investors, were allowed to fund startups through the purchase of investment securities, subject to limited exceptions.

The website Crowdexpert.com, an informational website that tracks the crowdfunding industry, citing a 2015 industry report by Massolution™, a research firm specializing in crowdfunding and affiliated with Crowdsourcing.org, states that $34 billion was raised globally through crowdfunding in 2015, with $5.5 billion from donation and reward based funding and $2.5 billion from equity based funding and $17.2 billion of that global amount raised in North America alone.[4] The World Bank in a 2013 commissioned report estimates that global investment through crowdfunding will reach $93 billion by the year 2025.[5] Statista.com reports that the total crowdfunding volume worldwide from 2012-2015 was $16.2 billion and that currently there are 375 crowdfunding platforms in North America.[6]

For new and early stage restaurants seeking capital, the alternative capital raise models created by Title III of the JOBS Act may be a game changer by enabling easier access to investor capital for businesses that would otherwise have had a hard time obtaining it, particularly given the targeted audience and social media marketing aspects of the fundraising campaigns. However, despite the seemingly "universal" access to capital and investment participation created by Title III of the JOBS Act, crowdfunding is not without costs, risks, and limitations for entrepreneurs, including those in the restaurant industry.

Title III of the JOBS Act, the capital raise alternatives it has created, and their utility and limitations for restaurateurs, as well as a survey of some of the online crowdfunding platforms and portals available to restaurateurs are the focus of this paper. Although the authors explore and discuss these topics, this writing is neither, (and is not intended to constitute) a comprehensive and in-depth analysis of these subjects, nor legal advice, nor an endorsement of any of the means of raising capital or the websites discussed herein. Without limiting the generality of the foregoing, this writing does not address state securities laws and regulations applicable to capital raises. Anyone considering raising capital, including by any of the means discussed in this writing, should consult with financial and legal counsel to assist in assessing the utility and appropriateness of any of the alternatives discussed to the circumstances of the project or business they wish to fund.

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[4] "Crowdfunding Statistics 2015-2016" – Crowdexpert.com. Retrieved June 18, 2018 at http://crowdexpert.com/crowdfunding-industry-statistics/

[5] Ibid.

[6] "Crowdfunding – Statistics & Facts" – Statista.com. Retrieved June 18, 2018 at https://www.statista.com/topics/1283/crowdfunding/.

II. TRADITIONAL CAPITAL RAISE APPROACHES

Crowdfunding portals have shifted the paradigm and opened up a new realm of possibilities for alternative sources of funding for restaurateurs. These and other websites, including reward and donation-based "crowd-funding" sites such as Kickstarter and GoFundMe, as well as angel investors and venture capitalists are becoming important funding sources for restaurateurs. Although the medium of raising capital is expanding, it is important for restaurateurs not to lose sight of traditional ways to raise capital because these traditional methods are still significant and viable alternatives. Some of these traditional methods are: (a) sale of equity, (b) loans from friends and family, and (c) fully collateralized loans. Each of these funding methods is discussed in greater detail below.

A. Sale of Equity

The sale of equity is one of the traditional methods for restaurateurs to raise money for their venture. Simply put, the sale of equity is when the owner of a restaurant raises capital needed by selling a percentage of the value or ownership interest in the restaurant. For example, if a restaurateur needs to raise $100,000 for their restaurant business, an investor may agree to pay that amount in exchange for a certain percentage of equity (ownership) in the restaurant. Through such an investment, a "purchase" of equity, the investor becomes an owner in the restaurant entitled to a percentage of equity in the restaurant, based upon the value of the investment made and the value of the restaurant, and any profit participation, distribution, or dividend rights that may be attached to such equity. The acquired equity interests may or may not have voting or management rights depending on the terms of sale and rights attached to the equity interests. Typically, an investor acquires a minority ownership interest through the purchase of equity unless the owner wants to transfer control of the business to the investor(s). In most cases, an owner would want to maintain a majority percentage of equity (fifty-one percent), which enables them to keep control over the management of the restaurant. But majority ownership is not necessarily a prerequisite to maintaining control.

A limited liability company ("LLC") is often the preferred legal entity for restaurants because they are relatively easy to form and maintain, not subject to double taxation, and convenient and flexible for raising capital through equity sales or offerings, and they provide limited liability for the owners with protection against the loss of their personal assets if the restaurant is sued, absent fraud or criminal conduct. LLCs also allow flexibility in governance and management because owners agree by contract on how the entity is operated and who may be admitted as an owner (or member), among other terms. A restaurateur can maintain control of an LLC by being the managing member, even if s/he has to cede more than fifty percent of the membership/equity interests to raise capital. However, the cost of forming the LLC varies greatly from state to state. For example, New York LLCs have a publication requirement, so the entity must pay to publish notices of formation in accordance with New York's LLC law. This adds another $750 to $1,500 to the cost of entity formation.

Restaurateurs may also incorporate at the state level as a corporation ("c-corp") or s-corporation ("s-corp") with ownership held by stockholders and management conducted through a board of directors and executive officers whom have limited liability protection from being held personally responsible for the debts and obligations of the corporation, absent gross misconduct or fraud. An s-corp is similar to a c-corp, except that unlike a c-corp, it is a pass-through entity for tax purposes similar to a limited liability company. An s-corp is not subject to double taxation because its revenue is not taxed at the corporate level (like a c-corp) and only taxed at the individual level when paid out to employees as salaries or dividends to shareholders. The elimination of double-taxation can result in significant savings for a startup or small business while the s-corp structure enables it to attract investors through the sale of stock. A company elects s-corp status by filing with the U.S. Internal Revenue Service for subchapter s corp status and meeting all of the requirements to qualify for s-corp status. The requirements include that the corporation have fewer than 100 shareholders who are all individuals, not other corporations; have only one class of stock; and be owned only by US citizens or resident aliens. These restrictions, however, may limit an s-corp's ability to bring in institutional investors or numerous crowdfunding participants.

Other common business forms used for restaurants are different types of partnerships including general partnerships, limited partnerships and limited liability partnerships. The different partnership types involve different roles and responsibilities in the day-to-day operations of the restaurant, different legal liabilities for the partners and different tax consequences.

There are several ways equity deals can be structured. The sale of equity can range from as low as one percent to as high as 100% equity. The percentage of equity is determined by many means such as the valuation or estimated valuation of the restaurant and the risk involved. There are several ways to calculate valuation of a restaurant business. Finance professionals and companies provide business valuation services on a fee basis; however, a restaurant owner could calculate a valuation on his or her own as well. If a restaurateur is seeking to sell equity in a restaurant that is already operating, it is easier to calculate the valuation because there is an operating income and expense history. The valuation of the restaurant would involve evaluating earnings and whether there is a positive cash flow. The calculation would also include the restaurant's assets including equipment, furniture, etc., and can also include real property if the restaurant owns the building where it is located. If the restaurant is a new restaurant that has not yet opened for service, valuation is more difficult to determine.

The valuation calculation is more difficult for a restaurant that has not yet opened because there are several factors that are unknown about the restaurant's performance. One of the most practical and commonly applied ways to determine valuation for a new restaurant that has not opened is the market valuation method. This method evaluates the performance of restaurants that are in proximity to the geographical location of the new restaurant and comparable in other ways. The methodology seeks to compare restaurants that are similar in size and in concept (e.g., cuisine type, fine dining or take out, ambiance, etc.). There are companies that compile and sell data regarding the clientele at these competing restaurants. The data typically includes information such as the age range of the customer, the average price per meal at the restaurant, etc. Restaurant owners can then utilize these projections to come up with a market valuation. The valuation of a restaurant is important for several reasons including the sale of the restaurant and/or sale of equity in the restaurant, potential disputes with tax authorities, and potential disputes between owners.

The sale of equity can prove to be a challenging way to raise capital for restaurant owners who are new to the industry. Selling membership interests in an LLC or equity in the form of stock in a c-corp or s-corp, are securities transactions that are subject to federal and state securities laws. Both federal and state laws have registration and reporting requirements for the sale of investment securities. Start-ups and small businesses often cannot or do not want to raise funds through public offerings of securities because of the stringency of these regulations and expense and complexity of compliance. Instead, they typically seek to rely on and comply with an exemption from the public offering regulations that enables them to make a private offering to a small targeted group of investors who meet certain qualification requirements. If a company can rely on an exemption, it may save time and expense because it will not be required to make detailed financial disclosures, file a prospectus or offering memorandum, or pay potentially significant filing fees based on the amount of funds raised.

Many startup and developing businesses rely on Rule 504, 505, or 506 under Regulation D that exempts many private securities offerings from the extensive and burdensome federal registration requirements for a public offering. Only Rule 506 also exempts an offering from any state registration requirement (although states can require a "notice" filing and filing fee).

The exemptions are generally only available to issuers that are not SEC reporting companies, and are subject to the equity securities-holder limits of the 1934 Exchange Act. Private offerings in reliance on a Regulation D exemption are still subject to certain compliance criteria, including limitations on the amount of funds that can be raised in any 12-month period, the number and type of investors to whom the offering may be made, including "accredited" and "non-accredited" investors, and the extent of the information disclosures that have to be provided by the issuer to potential investors, depending on what Rule under Regulation D is relied on for exemption. Some of the exemptions limit or prohibit the offering of the equity securities to non-accredited investors and/or require that a business take reasonable steps to determine whether the targeted investors are accredited or non-accredited.[7]

The term "accredited investor" is defined in Rule 501 of Regulation D and generally refers to investors who are financially sophisticated and therefore have a reduced need for the protection afforded by regulatory disclosure filings required with public offerings. An accredited investor is a person or entity that can invest in securities that are not registered with the SEC because they meet the requirements regarding income, net worth, asset size, governance status or professional experience.[8]

> The SEC defines an accredited investor as:
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> A natural person who has individual net worth, or joint net worth with the person's spouse, that exceeds $1 million at the time of the purchase, excluding the value of the primary residence of such person; or
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> A natural person with income exceeding $200,000 in each of the two most recent years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year[9].

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[7] Federal and state securities laws are extensive and complex and a detailed discussion of such laws and regulations is beyond the scope of this writing. *See* 17 CFR 230.501-508 for the text of the Regulation D statute.

[8] 17 CFR §230.501.

[9] 17 CFR §230.501(a)(5) and (a)(6).

A person who is a general partner, executive officer, director or a related combination thereof for the issuer of unregistered securities is also considered an accredited investor by the SEC.[10] An entity is an accredited investor if it is a private development company or an organization with assets exceeding $5 million and it was not formed with a sole purpose of purchasing specific securities.[11] Also, if an entity consists of equity owners who are accredited investors, the entity itself is an accredited investor.[12]

Compliance with regulatory requirements (including federal and state exemptions) may take time, require the services of legal and tax counsel, and add complexity and significant expense. Potential investors are being asked to take a risk which could include the loss of their entire investment; consequently, they may negotiate or demand a hefty price tag in the form of more equity or control to compensate or to mitigate the risks involved in investing in a new restaurant with an unfamiliar restaurateur. On the flip side, a seasoned restaurateur that has developed a brand and is well known in the industry, will presumably not have trouble-attracting investors and may use the leverage afforded by his or her industry standing and recognized brand to offer lower equity for a larger capital investment.

B. Family and Friends

Another traditional way to raise capital for a restaurant business is to turn to family and friends. Family and friends of an owner are often the first investors in a business and seeking capital from them is much less formal and typically less complicated than raising capital from a third-party investor. This route of raising capital, like any method, has its pros and cons. Unlike third-party investors that are not familiar with the restaurant owner or their work ethic or business acumen, family and friends have this inside knowledge and know the restaurant owner as a person. Often, family and friends are investing in the restaurant as a family business or in the owner as a person they believe in and wish to support, rather than investing solely in the restaurant for profit or the "thrill" of being involved in a restaurant. There are different ways for family and friends to contribute capital to a restaurant business. They may choose a traditional method of loaning the money to the owner or to the restaurant. In this case, the parties will have to negotiate the terms of the loan such as the amount of the loan, the interest rate (if any), the length of the loan, etc. Even though the parties may be hesitant to formalize the loan in writing (such as in the case of parents loaning money to their child), the parties should put their feelings aside and formalize the terms of the loan in writing. Typically the legal agreements for such loans would include a loan agreement and/or promissory note; and if the loan is guaranteed or secured, there may also be a personal guaranty and/or security agreement, and U.C.C-1 financing statement filing. The loan agreement and/or note is considered the owner's promise to pay back the money lent and sets forth the terms of the arrangement, including the principal amount, the applicable interest rate, and terms of default. A security agreement and U.C.C.-1 filing are utilized to collateralize the loan by securing the assets of the business in the event of default; the UCC-1 statement also creates a

[10] 17 CFR §230.501(a)(4).

[11] 17 CFR §230.501(a)(1)-(3) and 501(a)(7).

[12] 17 CFR §230.501(a)(8).

public record that some or all of the assets of the restaurant are subject to a lien in favor of the lender created by the loan.

The other method of raising capital from family and friends is to sell a percentage of equity in the restaurant to them. A partnership with a family member or friend can prove to be rewarding and mutually beneficial. However, it also may prove to be difficult to work with someone close to you. Another consideration in partnering with family and friends is that this group is usually less sophisticated than third-party investors. In some cases, an owner may need and seek a sophisticated investor who has been in the industry for many years and who will bring expertise or attract other investors or industry interest. These investors can bring a wealth of knowledge that is an added value to the restaurant owner as well as contribute capital. In the case of family and friends, they can sometimes be sophisticated investors but oftentimes, they neither have, nor wish to have, experience in operating a restaurant. This is another factor to consider when deciding whether to obtain capital from a third-party investor or family and friends. In the event that something goes wrong, you could jeopardize and potentially ruin an important personal relationship. These transactions with family and friends, as with third-party investors, also are subject to federal and state securities laws (or exemptions).

C. Fully Collateralized Loans

Generally, collateralization means securing a loan obligation through the use of assets or property of the borrower. Investopedia defines collateralization as, "the act where a borrower pledges an asset as recourse to the lender in the event that the borrower defaults on the initial loan. Collateralization of assets gives lenders a sufficient level of reassurance against default risk, which allows loans to be issued to individuals/companies with less than optimal credit history/debt rating."[13] Collateralized loans differ from unsecured loans because a collateralized loan is backed by some form of property or assets pledged by the borrower that the lender or bank has the right to take possession of and/or require the sale of in the event of default to satisfy the repayment obligations. It is virtually impossible for a start-up restaurant to borrow money from a bank to open a restaurant unless the loan is fully collateralized – i.e., the loan amount is secured by assets and/or property estimated or assumed to be equal in value to the full or principal amount of the loan.

In an unsecured loan, if a borrower defaults, the consequence is that the borrower's reputation and ability to borrow in the future or obtain credit may be negatively affected and the borrower and/or restaurant may be subject to a legal action by the lender for the loss of their money. In a collateralized loan, if a borrower defaults, the lender has recourse to claim ownership of the asset(s) that were pledged as collateral to secure the loan. The lender can take possession of and then sell off these assets to mitigate the loss and recover their capital. In determining the value of an asset a borrower is pledging as collateral, the lender usually reduces the value of the asset. Typically, collateralized loans allow for a better interest rate for the borrower than an unsecured loan because there is less risk involved for the lender. The collateral that is backing the loan ensures that in the event of default, the lender will not lose all of the amount loaned.

[13] https://www.investopedia.com/terms/c/collateralization.asp. Retrieved June 18, 2018.

Lenders prefer collateral that can easily be monetized. Types of collateral that a lender may accept to back a collateralized loan for a restaurant include: furniture, fixtures, and equipment; inventory, intellectual property, such as a tradename or logo; accounts receivable; bank accounts; a liquor license, leasehold, and real estate. Other forms of collateral accepted include automobiles, stocks and bonds, and insurance policies. For the borrower, in addition to the risk of the loss of the assets or property pledged to back the loan in the event of default, there is also the risk of over collateralization. Either intentionally or unintentionally the borrower pledges as collateral assets or property that have a value or appreciate to a value that significantly exceeds the amount of the loan. If there is an event default and the lender seizes the collateral, the borrower may lose any amounts in excess of the loan amount that lender receives from the sale or liquidation of the collateral. Employing legal and financial counsel to assist in negotiating the terms of a loan may help mitigate this risk, but this can be a significant added expense for a start-up.

It may be difficult for the owner of a new restaurant to obtain an unsecured loan because there is no operating history or proven source of income. Collateralized loans are an alternative means to provide such owners with a loan that they may not be able to acquire by other means, and they are also an option for restaurant owners with less than stellar credit. However, start-up restaurants with no 'track record' or no significant assets to speak of or assets that are not worth enough to fully collateralize the amount of funds needed, are unlikely to be able to borrow from a bank or similar financial institution the money needed to open and fund initial operations.

Overall, restaurant owners seeking to raise capital for their venture should consider these traditional methods as well as the modern alternative of crowdfunding. Restaurant owners should perform their due diligence and use a pros and cons analysis to determine what method of raising capital is the best option for their goals.

D. Small Business Loans

Small business loans are colloquially term loans from a private bank or commercial lending institution that partners with the U.S. Small Business Administration ("SBA") which in turn guarantees as much as 80 percent of the loan principal. The SBA guarantee helps reduce the lender's risk and facilitates financing that otherwise would not be available to the business on reasonable terms. The SBA is a U.S. government body, with the motive of providing support for small businesses and entrepreneurs. For each loan authorized, a government-backed guarantee offers serious credibility, since the lender knows that even if the borrower defaults, the government will pay off most of the balance.

The SBA's primary business loan program is the 7(a) General Business Loan Guaranty Program that provides loans of up to $5 million to start a business or expand services; it also has a micro-lending program for short-term purposes that offers loans of up to $50,000, among other programs. The SBA programs are intended to encourage lenders, who are reluctant to issue loans to entrepreneurs and businesses who do not have a strong credit report, a financial history, or assets for collateralization, to make lower-interest rate loans with lower processing fees to small businesses. SBA financing programs are for business start-ups and to meet various short- and long-term needs of existing businesses, such as equipment purchase, working capital, leasehold improvements, inventory, or real estate purchase. These loans are generally guaranteed up to

$750,000. The guaranty rate is 80 percent on loans of $100,000 or less and 75 percent on loans more than $100,000.[14]

Despite the SBA guarantee, getting a small business loan is often as involved as getting a regular collateralized bank loan and can be difficult to obtain. Lenders are reluctant to lend to small businesses, particularly start-ups, given that the underwriting costs for evaluating, verifying, and processing a small business loan can be approximately the same as for a regular one. Consequently, banks are incentivized to increase their profits by focusing on regular loans to established businesses. Financial institutions evaluate small business loan applications on the basis of many of the same criteria used to determine regular business loans. Credit rating, operating history, source of income, business plan, management, available collateral, vendor references, and personal finances may all be considered. Although a small business may have a better chance of getting an SBA loan, a bank is still concerned with risk management and the ability of the borrower to pay back the loan.

III. KICKSTARTER, INDIEGOGO, GOFUND ME, KIVA AND THE LIKE

"Crowdfunding" generally refers to the use of the Internet by small businesses to raise capital from a large number of people through small pledges, donations, payments or investments made via Internet platforms and portals such as Kickstarter, Indiegogo, GoFundMe, Kiva and the like, as well as food and beverage centric platforms such as PieShell, inKind, and Barnraiser. Businesses use social media and word-of-mouth campaigns to generate interest and attract the public to their crowdfunding event.

As of May 2016, under Title III of the federal Jumpstart Our Business Startups (JOBS) Act of 2012, eligible companies are allowed to use Regulation Crowdfunding to raise capital through securities offerings, as discussed in Section IV below. However, prior to May 2016, the available options for crowdfunding did not allow for the purchase of securities, including an equity stake in the company. Instead, the most widely available options were generally rewards-based; offering specific rewards or experiences, e.g., dinner for two or a private dinner party at the start-up restaurant, in exchange for pledges of money, or donation-based — accepting pledges of money for stated causes without providing anything in exchange. The rewards-based model has its roots in arts patronage, recalling a time in when an artist would appeal directly to his or her audience in order to fund a project.[15] Both rewards-based and donations-based crowdfunding are discussed in this Section III.

[14] Information from SBA.gov. Retrieved on June 18, 2018 at https://www.sba.gov/blogs/sba-loans-explained-101-small-business-owners. See also SBA.com, a non-government affiliated website, for additional information on SBA loans.

[15] Garber, Megan (June 29, 2013) "Kickstarters of Yore: Mozart, Lady Liberty, Alexander Pope" (https://www.theatlantic.com/technology/archive/2013/06/kickstarters-of-yore-mozart-lady-liberty-alexander-pope/277389/). The Atlantic. Retrieved June 18, 2018.

A. Kickstarter, Indiegogo, GoFundMe, and Kiva[16]

Of the available platforms for rewards-based crowdfunding, two of the largest and most widely recognized are Kickstarter and Indiegogo. These platforms are similar and both are used to fund creative endeavors in exchange for gifts to the investor as opposed to an equity share in a given company. Neither can be used to offer equity, financial returns nor to solicit loans. Their website graphics are nearly indistinguishable but both detail fundraising campaigns via the use of a single photograph, a brief description of the campaign, and numbers detailing the amount raised, percentage funded, and days remaining in the campaign.[17] Utilizing either platform is a very public process that places the reputation of the small business or entrepreneur firmly on the line; campaigners are expected to create promotional videos, a thorough backstory, project description, and mission statement, and a variety of reward levels, all while constantly promoting their campaign via social media and word of mouth. With hundreds of campaigns available for investment, and a limited timeframe of at most sixty days in which to raise the funds, successful campaigns on either Kickstarter or Indiegogo require a highly persuasive backstory and a significant base of backers to spread the word.

The rewards offered by a restaurant usually reflect the restaurant's cuisine, wares, or services at a variety of pledge levels. For example, in the case of "All Hands," a Williamsburg, Brooklyn seafood restaurant that utilized Kickstarter to successfully raise $11,275 with a stated $10,000 goal, a minimum pledge of $10 rewarded the pledger with a postcard containing a unique recipe from the executive chef, while a $25 pledge could be redeemed for one dozen oysters upon the restaurant's opening. On the higher end, a $700 pledge could be redeemed for a six-course tasting menu with beverage pairing for four, while a $5,000 pledge was rewarded with a six-course private party for fifteen.[18] In the case of the Brooklyn Cider House, however, their attempt at raising $28,000 on Kickstarter wasn't solely for the purpose of providing the public with hard cider, but also to raise funds to adorn the walls of their cidery and restaurant with artwork. This goal was reflected to a certain extent in their reward levels, which focused on providing branded clothing and "an invitation to the mural unveiling party" as opposed to food products.[19]

Despite similarities, there are distinct differences between the Kickstarter and Indiegogo platforms; the most notable is their approach to disbursement of funds raised. Kickstarter is an 'all or nothing' platform; money will change hands only if the entire funding goal is reached, and

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[16] The platforms discussed, and websites cited, in this Section III appear in no particular order and are not meant to be and do not represent an exhaustive list of options or available platforms. This paper is not an endorsement of any of the platforms discussed in this Section III and is not intended to address whether one or more than one platform can or should be considered or used.

[17] "New & Noteworthy in Food & Craft" (https://www.kickstarter.com/discover/advanced?section=food-craft&sort=newest&staff_picks=1) Kickstarter; "Results for Food" (https://www.indiegogo.com/search#/?q=food) Indiegogo, both retrieved June 18, 2018.

[18] "All Hands Restaurant – Now Open in S. Williamsburg, Brooklyn" (https://www.kickstarter.com/projects/1789032811/all-hands-restaurant-coming-soon-to-williamsburg-b?ref=category_location) Kickstarter. Retrieved June 18, 2018.

[19] "Brooklyn Cider House: Craft Cidery with Restaurant and Bar" (https://www.kickstarter.com/projects/457498676/brooklyn-cider-house-restaurant-bar-and-cidery?ref=category_location) Kickstarter. Retrieved June 18, 2018.

the funds will not be released until the end of the campaign. If a project does not meet its stated funding goal, the committed backers are not charged. Generally, this makes Kickstarter a more attractive platform for backers as it comes with less risk because money pledged will only be utilized if the project is fully funded, although the campaigners must still make good on their promise of rewards.[20]

In contrast, Indiegogo offers users the option of fixed or flexible funding; while the fixed model is essentially identical to that of Kickstarter, the flexible approach allows one to keep all of the money raised irrespective of whether or not the campaign goal is met. This model can be useful as a punch-up of sorts for projects that could make a restaurant better, but are not essential to opening if the funds are not raised in full. For example, Petit Loulou, a Parisian-style café in Purcellville, Virginia, successfully opened in 2016 despite raising only $3,205 of a $20,000 goal with the flexible funding model. The $20,000 was less than ten percent of the restaurant's budget and would have been used for items such as tables and chairs and decorations; all of which may have helped from an aesthetics standpoint, but were ultimately not crucial to getting the doors open.[21] Another difference between the two platforms is that in contrast with Kickstarter's method of cutting off funding at the campaign deadline, Indiegogo allows successful campaigns the option of continuing to raise funds after said deadline via their "InDemand" program.[22]

A third option, and currently the largest crowdfunding platform in terms of dollars raised, is GoFundMe, which is distinct from Kickstarter and Indiegogo in that it is not an incentive based crowdfunding website — i.e., nothing is provided in exchange for funds received. Instead, it allows individuals to raise donations for small businesses as well as for personal life events such as tuition costs, medical bills, and challenging life circumstances, in addition to personal creative endeavors such as self-publishing books and music albums. Unlike Kickstarter or Indiegogo, there are no set deadlines or time limits for one's fundraising campaign; it will remain live until the user elects to stop donations or removes the campaign entirely. Furthermore, reaching the fundraising goal is not required; the user gets to keep every donation received. And while both Kickstarter and Indiegogo require a defined category in which to fundraise, GoFundMe essentially allows fundraising for any personal cause that one can think of, provided it isn't against the law. A five percent processing fee is deducted from each donation received; a percentage comparable to the fees assessed by the other two platforms previously discussed.[23]

The microfinance platform, Kiva, is another method of crowdfunding that is not rewards-based. Kiva is a non-profit organization that crowdfunds interest-free loans to individuals and entrepreneurs across the globe. The loan contributions can be as small as $25 ("micro"), and loans

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[20] "Kickstarter Basics" (https://www.kickstarter.com/help/faq/kickstarter+basics?ref=faq_subcategory#Kick) Kickstarter. Retrieved June 18, 2018.

[21] Krystal, Becky (February 9, 2016) "Restaurateurs Want Your Crowdfunding Money, But What Are They Using it For?" (https://www.washingtonpost.com/news/going-out-guide/wp/2016/02/09/restaurateurs-want-your-crowdfunding-money-but-what-are-they-using-it-for/?utm_term=.126020a1804c) Washington Post. Retrieved June18, 2018.

[22] "InDemand – How it Works" (https://entrepreneur.indiegogo.com/how-it-works/indemand/) Indiegogo. Retrieved June 18, 2018.

[23] "Pricing and Fees" (https://www.gofundme.com/pricing) GoFundMe. Retrieved November 20, 2017.

have a historical repayment rate of 97%. Working in conjunction with a network of field partners, Kiva is active in 83 countries and has funded $1.06 billion in loans since its inception in 2005, fulfilling its mission statement "to connect people through lending to alleviate poverty."[24] On a world scale, Kiva funds loans for individuals that may be financially excluded or without access to fair and affordable credit in a number of categories, some of which include agriculture, education, social enterprises, and conflict zones, the latter of which entails supporting small business owners in regions affected by violence and instability. The loans can vary in amount and be for a variety of causes including personal hardships and emergency aid for refugees. In contrast, in the United States, Kiva is restricted to businesses, offering interest free small business loans of up to $10,000 to entrepreneurs that Kiva determines will make a social impact in their community.[25]

Refocusing on Kickstarter and Indiegogo, for an enterprising restauranteur, some of the immediate advantages to utilizing a rewards-based crowdfunding platform is the absence of both traditional bank loans accruing interest and of private investors demanding both updates on the project and a share of the profits. The campaigner won't be taking on any debt or giving up any ownership of its business, and gains immediate capital, in addition to a built-in community of enthusiastic supporters. One would seemingly only need to be concerned about fulfilling the reward levels, and not promising any rewards they will be unable to provide.[26]

However, while Kickstarter has raised approximately $125 million in food-related projects since its inception, less than 25% of campaigns in the category of food were successfully funded. Raising awareness of a campaign will essentially be a full-time job for the thirty or sixty days it is active, the competition is fierce, and as of November 20, 2017, of the 6,030 successfully funded Kickstarter food projects, only 70 raised over $100,000; just barely over one percent. Given the often six to seven figure costs of opening a restaurant, even a successful Kickstarter campaigner may still need to chip in from personal funds, take out bank loans or seek private investors.[27]

B. Food and Beverage Centric Platforms: PieShell, inKind, and Barnraiser.

As of this writing, there are notably a few reward-based crowdfunding sites exclusively for food and beverage entrepreneurs, including PieShell, inKind, and Barnraiser.

i. PieShell

PieShell (www.pieshell.com) is a rewards-based platform devoted to food and beverage businesses that also seeks to provide a community for people who are passionate about food, innovation, and giving. The platform welcomes a spectrum of food and drink related projects, "big or small, restaurant or truck, fresh or packaged, app or website." Although at the time of this writing (June 2018) PieShell does not list any restaurant projects (past or present), they do raise

[24] Waghorn, Terry (November 4, 2014) "Premal Shah: Loans That Change Lives" Forbes. Retrieved June 18, 2018.

[25] Kiva U.S. (https://www.kiva.org/lend/kiva-u-s) Kiva. Retrieved June 18, 2018.

[26] Tatti, Emily (June 10, 2015) "Crowdfunding for Restaurants: How it Works" (http://blog.typsy.com/crowdfunding-for-restaurants-how-it-works) Typsy. Retrieved June 18, 2018.

[27] Kickstarter Stats (https://www.kickstarter.com/help/stats) Kickstarter. Retrieved June 18, 2018.

funding for specific food products, online food courses, and food apps. The platform clearly states that contributions made through PieShell to businesses are considered gifts. PieShell claims that "75% of food projects fail on today's crowdfunding sites," and that it is changing this statistic by improving the chances for success through its three-pronged approach of pre-launch incubation, stepping-stone model, and supportive community. It prides itself on being a "food-centric community" that "delivers an undiluted pool of supporters to each project." The company uses a "stepping-stone" model, which lets the entrepreneur set realistic and obtainable goals on his/her way to funding a complete project. As soon as a stepping-stone's goal is met, the entrepreneur is guaranteed to receive those funds when the project is over. All projects must follow PieShell's pre-launch step-by-step blueprint, which is an incubation approach intended to ensure that each project has all the necessary elements (for example, video, social media, gifts, etc.) in place before the project launches.

Campaigners are charged a 6% fee on successfully raised funds. The project raising the funds is deemed "successful" as soon as it reaches each "stepping-stone" goal. In addition, PieShell donates 1% of that 6% fee to a food or beverage non-profit organization that shares PieShell's commitment to building a diverse and inclusive community through food via training programs, mentorships, etc. Standard credit card fees also apply, as imposed by the credit card processor used by the company: 30¢ per transaction and 2.9% of the value of the transaction.

Little additional information about the application and launch process is presented on PieShell's public website, and various questions posed by the public have been posted on the site with limited or no responses. They ask that persons with an idea or project submit contact information through an interface so that a member of the PieShell team may directly contact such person to discuss the idea. As of June 13, 2018, the company lists one current project/campaign, and approximately sixteen past projects, all of which met or exceeded their stated fundraising goal. None of the projects listed are restaurants, and the past projects have raises ranging between $2,000 and $25,000. The examples provided on PieShell's website, including in its promotional video, are mainly regarding packaged food and beverage products as opposed to restaurants. As a whole, therefore, it appears that PieShell, while promising, is still too new to form much of an assessment of its model for use by restaurateurs.

ii. inKind

inKind (www.inkind.com) distinguishes and promotes itself as presenting the opportunity to "expand one's business with financing designed by fellow restaurant owners," and "0% financing for growing restaurants." This platform aims to enable a restaurateur to harness the power of their customer base through selling high dollar gift cards. The idea is that the restaurateur gets the capital they need up front, and their customers get to enjoy more of the restaurateur's products and services. inKind claims to have helped dozens of companies all over the United States, financing more than 50 local businesses, deploying capital in over 20 states, and deploying over $3 million for growth and expansion.

After owning their own restaurant in Washington, D.C., the team behind inKind realized how difficult it is for a local business to obtain "fair financing." At their own restaurant, they started selling high dollar gift cards. They perceived that their biggest supporters in the community were happy to receive large amounts of food rather than cash returns as investors. Based on the success of that project, the idea for inKind was born. inKind claims that its model not only provides a business with funding, but also targets customers at the right time, which can significantly increase the customers' lifetime value to the business, increase check averages, and bring in repeat or long-term customers while building the brand.

inKind was formerly known as "Equity Eats," and previously had a founding mission to allow anyone to become an equity investor in a restaurant. But in 2015, it changed its model, finding that the tax implications of equity investing in restaurants were too burdensome on all parties involved. In 2016, Equity Eats began encouraging investors to convert their equity investments into food and drink credits, which is in line with its current mission as "inKind" (which became its new name in May of 2017).

In its current incarnation, the company expressly focuses on restaurants. It neither follows an equity crowdfunding model, nor debt funding model, but rather promotes itself as providing cash up front to restaurateurs and helping the restaurateur build a loyal customer base through its innovative financing structure designed by fellow restaurateurs. inKind directly provides between $5,000 and $250,000 in funding to the restaurant by "purchasing" advance credit for goods and services from the restaurant, and does not take any equity in the business being funded. The entrepreneur gets cash in exchange for credit for its goods and services. inKind then divides and sells that credit as high-dollar value gift cards in the form of "House Accounts" to people in the local community to recoup its money, using its marketing expertise in that area. Customers who purchase credits for the restaurant can then redeem the credits at the establishment. The restaurant business incurs a cost when the credits are redeemed by the customers for goods and services.

According to inKind, this model allows a restaurateur to keep their equity, as well as their cash, since inKind's primary source of repayment is through its sale of House Accounts to the restaurateur's own customer base rather than through an interest bearing loan, and through leveraging inKind's marketing and promotional experience, particularly in local communities. The amount of credit inKind takes is a multiple of the capital inKind provides which enables inKind to offer bonus credits to customers purchasing House Accounts. inKind states that they never take more than 8% of a restaurant's annual sales in credit, which they claim should limit the number of tables using House Accounts to one or two tables per night. The cost to the restaurant when a customer redeems a House Account credit is supposed to be just the cost of the ingredients the restaurateur uses to make the food served, according to inKind, which inKind claims is typically around 30%. So if inKind takes $20,000 in credit, the cost to the restaurateur is approximately $6,000; the actual cost might be lower, according to inKind if customers do not use all of their House Account credits.

inKind provides a custom-built website for the restaurateur where customers can establish a "House Account" to load with credits to redeem at the restaurateur's establishment. A customer is incentivized with bonus credits for purchasing and loading credits – thereby helping to establish their loyalty to, and long-term patronage of, the restaurant. inKind provides a mobile app through which customers can manage, redeem, and gift the credits the customers have accumulated. The mobile app also tracks and manages the usage of customer credits so the restaurant does not have to do so.

inKind is a registered "B corp," which, according to www.bcorporation.net, means it is a for-profit company certified by the nonprofit organization B Lab to meet "rigorous standards of social and environmental performance, accountability, and transparency." It is operated by a group of small business owners, and on its website states that since launching it has financed 61 local businesses for a total of $3.6 million across 22 states.[28] The platform's marketing methods include on-table check presenters explaining the House Accounts and offers, posters, email campaigns targeting the restaurant's customer list, and social media messaging. The platform charges an additional fee for check presenters, posters or similar materials provided by platform.

The application process for restaurateurs involves initially applying online through www.inkind.com, and providing information about the business and its goals for inKind's underwriters to evaluate the business. The initial questions ask, among other things: (1) if the business is open and how many years it has been open, and if it is not open, whether it has entered into a lease; (2) how much funding is sought; (3) what goal will be achieved with the additional capital; (4) for the location and name of the business and the name of a contact person; (5) for a phone number and email address; (6) whether the business is behind on rent; (7) what was revenue last year; (8) what is the average check size for one person; (9) how many customer email addresses does the it have; and (9) how does your business improve your community. The company then reviews the initial information provided and responds to the restaurateur. Based on the restaurateur's timeline and his or her responses, inKind may then provide funding. In the application process, inKind considers various factors in determining whether it will provide funding and how much, such as the terms of the restaurant's lease, the menu, its existing social media presence, brand recognition, community footprint, and health inspection status.

inKind is the most experienced restaurant-focused crowdfunding site reviewed. That said, its model is very different from most crowdfunding platforms, and offering credits and House Accounts may not appeal to all restaurateurs. inKind claims that another part of its value added has to do with "gift card breakage." When a restaurateur sells their own gift cards, the restaurateur is less able to take advantage of what inKind states is 20-30% typical gift card breakage. Most states require a business to give left-over card amounts to the state after a few years. However, inKind claims that its gift card structure allows the restaurateur to reclaim those benefits and thereby save thousands of dollars. The platform also claims to have a predictive model for selling gift cards which allows inKind to be confident in its ability to sell a restaurateur's gift cards and to give the restaurateur a lump sum upfront, before inKind even starts marketing the restaurateur's business. According to inKind, utilizing this model does not hurt a restaurateur's cash flow and results in an effective interest rate of less than 1%.

inKind's website includes a blog that is updated with useful articles for restaurateurs about such subjects as "Word of mouth: getting the right people through your door" and "Tips for Applying for an SBA [U.S. Small Business Administration] Loan," as well as posts on ways to increase revenue and employment matters.

[28] Information provided at InKind.com/about.

iii. Barnraiser

Barnraiser (www.barnraiser.us) was launched in 2013 and is not just a crowdfunding website, although crowdfunding is a feature contained within the site. Barnraiser focuses on "healthy food and living," and markets itself as "the ultimate place to get discovered by fans of good food and healthy living." It provides an online profile of businesses that fit that description, with the aim of showcasing the business's story to connect with millions of people who are seeking a healthy lifestyle and making it easy for such people to "discover, share, connect, and fund businesses that are shaping the way we eat and live." Barnraiser's underlying philosophy is that consumers want to be more connected with their food and its origins. Consumers can engage with Barnraiser brands as funders, customers or simply as persons interested in healthy living and sustainable food sources. Businesses can engage consumers and build their brand on the platform through their stories and profiles even if the businesses don't need immediate funding.

Through Barnraiser, project organizers may, but don't have to, offer gifts and rewards to funders as incentives. Barnraiser encourages businesses to offer rewards that will help establish and maintain a relationship with the funder, such as an organic farm that offers a seasonal cookbook to use the farm's produce throughout the year, rather than just one-off gifts. Each project must seek to raise a minimum of $2,000 (although, the site is not consistent in this regard and on another page of its site indicates that the minimum is $1,000).

The site strives to be inclusive and claims that since its launch millions of dollars have been raised through the site to support approximately 30,000 food projects of all kinds—artisan food businesses, farming and sustainability projects, edible education, food apps, nonprofit policy and advocacy groups, among others, across 40 states, and that 65% of those have succeeded in reaching their funding goals. As of this writing, approximately 199 crowdfunding projects are listed with funds raised ranging from approximately $1,500 to $93,000.

Barnraiser's business model combines revenue from premium services, such as better placement in search engine results, and sponsored content with revenue from the 5% transactional fees charged to all successful crowdfunding projects. Barnraiser's payments processor also applies payment processing fees of between 3-5%. However, if funding is not successful, no fees are charged. There is no fee to list a profile of a food business, farm or product or to list a project for a fundraising campaign.

Finding success through Barnraiser, according to the site, depends on how well a project's story is articulated. The better the story, the better the connection to the audience of potential funders. The challenge is presented as finding and inspiring a community, and letting the appeal and impact of a business' story spread primarily through social media sharing. The site provides significant support through web-page guides, webinars and offers one-on-one phone consults to farmers and entrepreneurs. One also can search existing and previous campaigns based on location, type of food, and maker, as well as most popular, successful, or recent campaigns for ideas and guidance.

The platform welcomes projects from around the world and states that it is [a]ny project that moves the needle forward toward healthy, sustainable and soulful and humane food and farming is welcome." Categories included on the site, without limitation are:

- Farms & Food Hubs (Urban Farming, Small & Family Farms, Cooperatives, Young Farmers, Sustainable & Organic Farming, Heirlooms, Exchanges, Gleaning, and more)
- Community Based Projects (Food Justice, Community Gardens, Cooperative Kitchens, and more)
- Artisan, Local, Farm-to-Table, Healthy Foods (Craft Spirits / Beer, Cafes, Bakeries and Sweets Shops, Artisan Producers, Restaurants & Food Trucks, New & Healthy Foods, Food Systems & Distribution, and more)
- Food & Farming Education (Educational Farms, School Gardens, Healthy Lunch, Curriculum, and more)
- Food Media (Art, Books, Television, mobile applications, and more)

From a scan through a random sampling of approximately 30 of the project descriptions, the majority of the projects were not for funding restaurants, although a few of them were (for example, funding a community room to be built within an existing restaurant; or funding a "farm to fork" kitchen).

IV. THE JOBS ACT AND REGULATION CF

A. Summary of Key Provisions

Under the federal securities laws, every offer and sale of securities, even if made to just one person, must either be registered with the Securities and Exchange Commission ("SEC") or conducted pursuant to an exemption from registration. Section 5 of the Securities Act of 1933, as amended (the "Securities Act"),[29] requires a restaurant entity looking to raise capital through the offer and sale of securities, such as its own stock or LLC membership interests, to register such offering, unless an exemption applies. While some restaurants are able to conduct exempt (non-public) offerings such as private placements under Section 4(a)(2) of the Securities Act and/or Regulation D, others cannot meet the stringent exemption requirements or cannot afford the legal and financial counsel needed to take advantage of these exemptions. In recognition of these limitations, Congress passed the Jumpstart Our Business Startups (JOBS) Act of 2012 (the "JOBS Act")[30] that provides, pursuant to its Title III, an additional exemption from registration in the form of Securities Act Section 4(a)(6). The SEC thereafter adopted regulations, specifically Regulation Crowdfunding[31] ("Regulation CF"), to implement Title III requirements, in 2015, effective 2016. As noted by the SEC, Title III and Regulation CF are expressly "intended to help alleviate the funding gap and accompanying regulatory concerns faced by small businesses by making relatively low dollar offerings of securities less costly and by providing crowdfunding platforms,

[29] 15 U.S.C. 77a. *et seq*.

[30] Pub. L. No. 112-106 (2012).

[31] 17 CFR § 227.100 *et seq*.

a means by which to facilitate the offer and sale of securities without registering as brokers, with a framework for regulatory oversight to protect investors."[32]

i. Eligibility

Generally speaking, an offering made pursuant to and in reliance on Title III and Regulation CF ("Crowdfunding Offering") must (1) be undertaken only by an eligible restaurant company (an "Issuer"), (2) comply with certain dollar and time limitations, (3) raise funds from investors themselves subject to certain dollar and time limitations, and (4) be conducted online only through a registered broker-dealer or funding portal.[33] Each of these requirements is discussed below:

(1) A restaurant company is eligible to make a Crowdfunding Offering as an Issuer only if it is a U.S. company that (i) is not subject to the reporting requirements under Sections 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), (ii) is not an investment company under the Investment Company Act of 1940, as amended, or excluded from such definition under Section 3(b) or 3(c) thereof, (iii) is in compliance with Regulation CF's annual reporting requirements for the immediately preceding two years, (iv) has a specific business plan that does not contemplate a merger or acquisition with an unidentified company(ies), and (v) is not a 'bad actor' and subject to disqualification under Regulation CF.[34]

(2) An Issuer can raise no more than $1,070,000 in a Crowdfunding Offering in any twelve month period. This dollar limit includes amounts raised by companies controlled by or under common control with the Issuer and predecessor of the Issuer in Crowdfunding Offerings during such time period. This dollar limit does not include amounts raised by the Issuer in offerings made in reliance on other exemptions from registration under the Securities Act.

(3) An investor's ability to invest in any Crowdfunding Offering is subject to net worth and income requirements[35] (each eligible person, an "Investor") that cap investment amounts across all Crowdfunding Offerings in any twelve month period (the "Investment Cap"). If an Investor's annual income or net worth is less than $107,000, then the Investment Cap is the greater of (x) five percent (5%) of the lesser of his/her annual income and net worth and (y) $2,200. If both an Investor's annual income and

[32] https://www.sec.gov/rules/final/2015/33-9974.pdf pgs. 528-529

[33] 17 CFR § 227.100. Note the dollar limits for both Issues and Investors are subject to adjustment for inflation every 5 years.

[34] 17 CFR § 227. 503 The disqualification provisions of the Regulations are substantially similar to those in Rule 506(d) of Regulation D.

[35] An Investor's net worth and income are calculated using the rules for determining if a person is an 'accredited investor' (as such term is defined in Rule 501 of Regulation D). An Issuer's net worth and income may be calculated jointly with his/her spouse, but their joint investments in Crowdfunding Offerings will be capped at that related level. If an Investor is an entity rather than an individual, annual income and net worth are replaced with revenue and net assets as of the most recent fiscal year.

net worth are greater than or equal to $107,000, then the Investment Cap is the lesser of (x) ten percent (10%) of the lesser of his/her annual income and net worth and (y) $107,000. An Issuer may rely on its Intermediary (defined and discussed below) to determine that the Investor's investment in the Issuer's Crowdfunding Offering will not cause the Investor to exceed its applicable Investment Cap so long as the Issuer does not know otherwise.

(4) A Crowdfunding Offering must be conducted through an online platform, such as certain of those discussed in Section V below, run by an SEC and Financial Industry Regulatory Authority ("FINRA") registered intermediary that is ether a broker-dealer or funding portal and complies with the requirements of Section 4A(a) of the Securities Act and Regulation CF (an "Intermediary").[36]

ii. Reporting

Once an Issuer decides to make a Crowdfunding Offering, it must provide and file certain initial and ongoing reports required by Section 4A of the Securities Act and Regulation CF.[37]

An Issuer must file the initial report, known as a Form C,[38] with the SEC and provide the same to its Intermediary and Investors at least 21 days before it commences the Crowdfunding Offering. This report must contain certain information,[39] including without limitation (1) identifying information regarding the Issuer, (2) identifying information regarding the Issuer's directors, officers and record holders[40] of 20% or more of the Issuer's voting securities, (3) the Issuer's capitalization and ownership, (4) the Issuer's proposed business and business plan, (5) the type, amount and price of securities to be offered in the Crowdfunding Offering, the target and maximum offering amount and the deadline for the Issuer to reach the target, and if and how oversubscriptions will be accepted, (6) the purpose of the Crowdfunding Offering and the proposed use of funds raised, (7) risks associated with the Crowdfunding Offering, (8) the Intermediary's name and identifying registration numbers, the compensation paid to the Intermediary in connection with the Crowdfunding Offering, and the interest in the Issuer held or to be held by the Intermediary (if any), (9) exempt offerings by the Issuer within the past three years, (10) transactions between the Issuer and related parties, and (11) a description of the financial condition of the Issuer and certain other financial information on the Issuer. An Issuer may use the "Question and Answer" format included in the Form C or it may use another compliance format of its choosing to provide the required information and disclosures. All Issuers must also include certain legends in their Form C regarding, among other things, the risks involved, no evaluation, approval or endorsement of the offering by the SEC, and the Investors' reliance on their own examination and evaluation of the risks and merits of the offering and the information provided by the Issuer.

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[36] 17 CFR § 227.300, 227.400 https://www.sec.gov/divisions/marketreg/tmcompliance/cfintermediaryguide.htm; http://www.finra.org/industry/funding-portals

[37] 17 CFR § 227.201; 17 CFR § 227.203.

[38] 17. CFR § 239.900. https://www.sec.gov/about/forms/formc.pdf

[39] For a complete list, *see* 17 CFR § 227.201.

[40] 17 CFR § 240.12g5-1.

Crucially, an Issuer must provide certain financial statements with its Form C, with the level of required outside review of such statements based on the aggregate amounts sold in Crowdfunding Offerings by the Issuer in the immediately preceding twelve months, including the maximum offering amount in the contemplated Crowdfunding Offering. If this aggregate amount is less than or equal to $107,000, the Issuer must provide either (1) the Issuer's financial statements that have been reviewed or audited by an independent public accountant or (2) if the foregoing is unavailable, the Issuer's financial statements and the amount of total income, taxable income and total tax from the Issuer's federal tax returns, as certified by the Issuer's principal executive officer. If (x) the aggregate amount is greater than $107,000 but less than or equal to $535,000 or (y) the aggregate offering amount is greater than $535,000 and the Issuer has not previously made a Crowdfunding Offering, the Issuer must provide either (1) the Issuer's financial statements that have been audited by an independent public accountant or (2) if the foregoing is unavailable, the Issuer's financial statements that have been reviewed by an independent public accountant. If the aggregate amount is greater than $535,000 and the Issuer has previously made a sale in a Crowdfunding Offering, the Issuer must provide the Issuer's financial statements that have been audited by an independent public accountant. All financial statements must be prepared in accordance with U.S. generally accepted accounting principles (GAAP) and cover the past two (2) fiscal years.

Once the Crowdfunding Offering has launched, either (1) the Intermediary must post frequent updates on its online platform on amounts sold to date or (2) the Issuer must file a Form C-U with the SEC, its Intermediary, and its Investors within five business days of reaching each of fifty percent (50%) and one hundred percent (100%) of its stated target offering amount. Regardless, the Issuer must file a Form C-U disclosing the total amount sold in the Crowdfunding Offering within five business days of the offering deadline disclosing the total amount sold.

In addition, an Issuer may file a Form C/A with the SEC, its Intermediary and its Investors to provide other updates or changes to the original Form C and information provided to Investors through the online platform. If these updates are 'material,' the Issuer must file a Form C/A and cancel and return any outstanding commitment from any investor who does not reconfirm his/her investment within five (5) business days of receipt of the notice.

An Issuer must file an annual report on Form C-AR and its financial statements on EDGAR (the "Electronic Data Gathering, Analysis, and Retrieval" which is the online SEC public database and filing system) and post the report on its website within one hundred twenty (120) days of the end of its fiscal year. This report must contain certain of the information provided in the initial Form C, including without limitation (1) identifying information regarding the Issuer, (2) identifying information regarding the Issuer's directors, officers and record holders of 20% or more of the Issuer's voting securities, (3) the Issuer's capitalization and ownership, (4) the Issuer's proposed business and business plan, (5) risks associated with the Crowdfunding Offering, (6) exempt offerings by the Issuer within the past three years, (7) transactions between the Issuer and its related parties, and (8) a description of the financial condition of the Issuer.[41] The Issuer must also provide either (1) its financial statements that have been reviewed or audited by an

[41] For a complete list, *see* 17 CFR § 227.202(a).

independent public accountant or (2) if the foregoing is unavailable, its financial statements, as certified by the Issuer's principal executive officer. An Issuer must file a Form C-AR/A with the SEC to disclose material changes to its prior Form C-AR as soon as practicable following discovery.

A Form C-AR must be filed annually by an Issuer until either the Issuer (1) has fewer than 300 record holders and has filed at least one Form C-AR since its last sale under the Crowdfunding Offering, (2) has fewer than $10,000,000 in total assets and has filed at least three Form C-ARs since its last sale under the Crowdfunding Offering, (3) becomes subject to the reporting requirements under Sections 13(a) or 15(d) of the Exchange Act, (4) repurchases all the securities previously sold in the Crowdfunding Offering, (5) liquidates or dissolves under applicable state law, at which time it must file a Form C-TR with the SEC within five business days announcing the same.

iii. Other Restrictions

In addition to the above eligibility and reporting requirements, a Crowdfunding Offering is subject to certain other restrictions relating to advertising, closing process, subsequent sales, registration exemptions, and anti-fraud provisions, discussed in brief below:

- Advertising[42] – An Issuer many not advertise its Crowdfunding Offering prior to launch. Following launch, an Issuer may advertise its Crowdfunding Offering only via a 'notice' that states only the existence and basic terms of the Crowdfunding Offering and Issuer and directs potential Investors to its Intermediary's online platform. An Issuer may communicate directly with potential and actual Investors on its Intermediary's online platform so long as it identifies itself as the Issuer. Others, including promoters, may also communicate directly with potential and actual Investors on the Intermediary's platform as long as they properly identify themselves and the Issuer takes 'reasonable steps' to ensure that they disclose any commission or compensation they may have been or be receiving in connection with the Crowdfunding Offering.
- Closing Process[43] – A Crowdfunding Offering must last and an Issuer must accept investment commitments for at least 21 days. A potential Investor may cancel and withdraw its investment commitment for any reason at any time before the 48 hours preceding the stated offering deadline for a Crowdfunding Offering. After that 21 day period, at or (if it provides five business days' prior notice) prior to the stated offering deadline, the Issuer may only close on the sale of offered securities and access committed capital if it receives (and maintains) investment commitments from potential Investors at least equal to the stated target offering amount.
- Resale Restrictions[44] – Securities purchased in a Crowdfunding Offering also may not be resold for one year, unless sold to the Issuer, an 'accredited investor' or a

[42] 17 CFR § 227.204. § 227.205; https://www.sec.gov/divisions/corpfin/guidance/reg-crowdfunding-interps.htm.

[43] 17 CRF § 227.304.

[44] 17 CRF § 227.501.

family member, family trust or in connection with a death or divorce of the Issuer, or in an offering registered with the SEC.

- Registration Exemptions[45] – In order for securities issued in a Crowdfunding Offering to remain exempt from the registration requirement of Section 12(g) of the Exchange Act,[46] the Issuer must timely file all required Form C-ARs, have $25,000,000 or less in total assets at the end of its most recent fiscal year and engage a SEC-registered transfer agent. If at any time the Issuer does, in fact, have more than $25,000,000 in assets, so long as it continues to file its Form C-ARs, it has two years to register its applicable class of securities.
- Anti-Fraud[47] – The purchase and sale of securities in Crowdfunding Offerings are subject to the same anti-fraud provisions and impose the same potential liabilities on Issuers (and Intermediaries) as other securities offerings.

B. Key Limitations

While Crowdfunding Offerings provide a new means to access capital, they are inherently limited (and limiting) by Regulation CF as described above and as discussed in greater detail in Section VIII below. For one, an Issuer engaged in a Crowdfunding Offering can raise only $1,070,000 in any twelve-month period, which may not provide sufficient funding for its current and anticipated needs. In addition, an Issuer who raises small amounts from multiple Investors may end up with an unwieldy capitalization table that could prove unattractive to future investors. The required use of an Intermediary in a Crowdfunding Offering will also impose a cost on an Issuer, whether in the form of a portion of the Offering proceeds or securities of the Issuer. Lastly, the offering and ongoing reporting processes of a Crowdfunding Offering itself may divert time and resources from other business of the Issuer.

V. ASSESSMENT OF THE MAJOR PORTALS[48]

Equity crowdfunding is the type of crowdfunding with which Title III of the JOBS Act is primarily concerned. With this type of investment, multiple investors pool money into a specific startup or developing business in exchange for equity ownership. As discussed in Section IV, the JOBS Act permits equity offerings over the Internet and allows non-accredited investors to participate through small investments. Such offerings must be made through registered broker-dealers or through portal intermediaries – online services that allow individual investment, and which must be registered with the SEC.

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[45] 17 CFR § 240.12g-6.

[46] Under Section 12(g), an Issuer must register its class of securities with the SEC if such class is held by more than either 2,000 record holders or 500 record holders who are not accredited investors and it has more than $10,000,000 in total assets.

[47] Section 4A(c).

[48] The portals discussed, and websites cited, in this Section V appear in no particular order and are not meant to be and do not represent an exhaustive list of options or available portals. This paper is not an endorsement of any of the portals discussed in this Section V and is not intended to address whether one or more than one portal can or should be considered or used.

The term “crowdfunding” conflates a variety of very different business models, primarily the reward/donation-based platforms discussed in Section III, Regulation CF portals that allow non-accredited investors to invest in securities offerings discussed in this Section V, and investment marketplaces such as AngelList. The term “equity crowdfunding” although used colloquially to refer to online capital raises through equity is a confusing and often misleading term. The ability to raise capital through equity offerings has moved online, but that does not mean a “crowd” is needed or targeted to raise funds for a company looking to raise funds over the Internet. Some companies seek, and some online platforms only permit, funding support that is focused on and targeted to a specific few identified or group of investors.

The following is a discussion of some of the most well-known portals for Regulation CF equity crowdfunding and a few platforms, namely OurCrowd and AngelList, that are well known for equity funding, but are restricted to accredited investors and therefore are not Regulation CF crowdfunding sites, as well as a few that are less well known but are more focused on restaurant/food related businesses. Each one is summarized and assessed in terms of its fees, application/listing process, experience relevant to restaurants, assistance with legal documentation, assistance with promotion, funds transfer, and any other value added other than simply being a portal to raise capital.

A. SeedInvest

SeedInvest describes itself as “a startup investing platform providing its members access to vetted investment opportunities…founded by a team of experienced investment professionals involved in the passage of the 2012 JOBS Act.”[49] For companies seeking to raise capital, SeedInvest claims it helps such companies:

- Simplify and speed up the fundraising process
- Access a network of accredited investors from around the world
- Host virtual fundraising sessions from one’s desk (i.e., over the Internet)
- Streamline investor pitches, execution of legal documents, and processing of investments.[50]

SeedInvest’s process involves at least two entities: (1) SI Securities, LLC ("SI Securities"), an affiliate of SeedInvest, a registered broker-dealer and member of FINRA/SIPC; and (2) North Capital Private Securities Corporation ("NCPS"), an unaffiliated entity, registered broker-dealer, and member of FINRA/SIPC. All private placement offerings under Regulation D, CF, and A on SeedInvest are conducted through SI Securities and/or NCPS. Regulation CF offerings occur through SI Portal, LLC, a SEC-registered funding portal.

SeedInvest, according to its website, seedinvest.com, has a dynamic community of over 224,000 investors. Its companies can raise not only from crowd investors, but also from SeedInvest’s network of tech angels, venture capital funds, and family offices.

[49] https://www.seedinvest.com/faqs.

[50] Ibid.

SeedInvest welcomes entrepreneurs looking for outside investment for the first time, as well as those raising a growth equity round. SeedInvest invests in pre-seed rounds as small as $500,000 (which may make it more accessible to many restaurateurs), through later stage growth rounds as large as $30 million.

According to SeedInvest, over 150 companies have been funded through it, and the typical amount of time to raise funds was 30 to 60 days, with an average raise of approximately $616,000.

i. Fees

For companies raising under $5 million (offerings pursuant to Regulation D and Regulation CF), the company pays no up-front costs to raise capital on SeedInvest. The company only pays if its raise on SeedInvest is successful; otherwise, SeedInvest will be responsible for the costs.

The following fees and reimbursable expenses are costs listed on SeedInvest's website, and may vary depending on offering type.

- 7.5% placement fee; charged on the total amount raised through SeedInvest in the round, paid only upon the successful completion of the company's offering.
- 5% warrant coverage or equity; based on the total amount raised on SeedInvest in the round.
- From $0 - $10,000 in due diligence, escrow, marketing and legal expense reimbursements.

SeedInvest charges investors a 2% non-refundable processing fee (up to $300) per investment. This fee will be refunded to the investor if the company does not reach its fundraising goal.

ii. Application/Listing Process

Companies featured on the "Vetted" section of the SeedInvest website have successfully completed the "vetting" process by SI Securities and/or NCPS, and are offering their securities under Regulation D or A. The offering must first be accepted ("vetted") by SeedInvest before it can be listed on the SeedInvest website. SeedInvest uses a third party service to verify the identities of the founding team members of each applicant company. Being vetted by SeedInvest also involves a complete due diligence process, including internal business due diligence and outsourced legal and confirmatory due diligence. The business due diligence process focuses on assessing the company's viability as an investment opportunity and the key risks associated with that opportunity. This may include reviewing (among other things) the company's historical financials, financial projections, and reference checks.

In the case of an offering under Regulation D or A, the findings of the foregoing review are presented to an internal investment committee comprised of senior executives of SI Securities or NCPS, which may approve, reject, or require additional information for the offering. Upon approval by the investment committee, an offering can be listed as "vetted" and can begin accepting investments online.

Both accredited investors and non-accredited investors may register to invest through SeedInvest, although some offering types are limited to only accredited investors.

The company seeking to raise capital determines the minimum and maximum amounts permitted for investment. The SeedInvest portal includes functionality allowing prospective investors to view the documents uploaded, to ask questions publicly and/or to exchange messages privately with the company.

If investors wish to invest anonymously in a company, SeedInvest provides website functionality allowing investors to do so.

In order to protect investors, companies may be required by SeedInvest to reach a minimum funding target to have a successful fundraise. Therefore, investments are not finalized until the company raises enough money to meet its funding target and completes all other closing conditions. If it fails to do so, then the money deposited by investors in an escrow account gets returned to the investors.

iii. Experience Relevant To Restaurants

SeedInvest claims that there is no typical company on SeedInvest, but that companies that have been successful thus far generally share the following characteristics:

- Technology and consumer facing businesses
- Startups raising between $100,000 - $50,000,000 (including offline)
- Companies looking to raise Seed Rounds, Series A Rounds, Bridge Rounds, and Growth Rounds
- Companies that already have funding terms and have attracted a lead investor

The typical restaurateur may not fit the above description, depending upon their level of experience and the size of their enterprise.

SeedInvest's website does not include a search function permitting the general public to search and see whether restaurants have been funded through SeedInvest. While SeedInvest provides several case studies on a dedicated page on its website, none of the case studies are in the restaurant or food industry. An overarching common theme of the companies described in the case studies is high-tech. While the lack of restaurant or food service examples on the portal may discourage a restaurateur, general searches on the internet do bring up food-service related companies offering investment through the SeedInvest platform.

SeedInvest does not generally provide assistance with the legal documentation required. A restaurateur seeking to use SeedInvest should consult its own legal counsel. At a minimum, key documents typically include an investor presentation, term sheet, and subscription agreement and/or note purchase agreement.

SeedInvest does have the law firm of Inventus Law (www.inventuslaw.com) perform an independent review of the transaction documents that a company uploads to its site, to check for red flags and conformance with stated terms.

B. AngelList

AngelList (https://angel.co) describes itself as a platform for startups to raise money online, recruit employees, and apply for funding. Older than most crowdfunding sites, it was started in January 2010. From reviewing their website, it is evident that AngelList is designed to serve many purposes for both investors and companies, such as connecting companies with incubators, providing professional networking connections (similar to LinkedIn but for investors), and more. Crowdfunding is by no means presented as the main purpose of the site. The investing portion of the web site may only be accessed by accredited investors. For companies seeking to be connected with investors, the basic categories of deal terms from which one is permitted to choose are equity; convertible debt; or SAFE (simple agreement for future equity) instruments – which is a form of agreement intended to be used as a superior alternative to a convertible note.[51]

i. Fees

We saw no evidence on the AngelList site of fees that the site charges to the company seeking to raise funds. Rather, the fees mentioned are to the investors, depending on the category of investment and investor. For investors, the site presents three choices for type of investment: (1) deal-by-deal investments done alongside proven and notable lead investors; (2) investing in the AngelList Access Fund (which is a diversified fund similar to an index fund); and (3) professional investors who are provided personal support and broad access to the investment opportunities on the site (this last option being “for family offices, institutions and active investors”). The fees that the site charges to the investor, and the minimum investment amounts, vary by type listed.

Of the categories presented, in our view, the category of investment and investor most likely to be relevant to crowdfunding for a restaurant is the “deal-by-deal investments” category. This is a category where an investor can invest alongside notable lead investors to access “deals.” The investor reviews each deal to build their own “portfolio,” and the minimum investment is $1,000. According to AngelList, the typical check size of these “private single-deal VC funds led by top angels” (a.k.a. “syndicates”) is $200,000 - $350,000 (on which the investor would be piggy-backing their smaller investment amount).

In terms of the flow of funds, once the investment documents are signed by the investors, AngelList collects the funds and wires them to the founders. AngelList claims that it can close deals in as quickly as 72 hours.[52]

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[51] With a “Simple Agreement for Future Equity” or SAFE investment instrument, an investor makes a cash investment in a company, but gets company stock or membership interests at a later date, in connection with the occurrence of a specific event (e.g., a business or product launch). A SAFE is not a debt instrument and is intended as an alternative to the convertible note often used by startups during the seed stage or as a short-term bridge between equity rounds.

[52] https://angel.co/syndicates/for-founders#how_it_works.

ii. Application/Listing Process

Going through the process of registering on the AngelList site is very mechanical. Unlike most other crowdfunding sites, the site is not designed with many photos, video, success stories and the like to get the reader excited about the opportunities presented. Rather, it is a series of forms asking for information to set up a profile and basic information about the business to be funded. The forms are generic for any business; there is nothing restaurant-specific about them.

The company seeking to be connected with investors is asked to specify the deal terms: currency; amount to be raised; the equity basis (whether equity; convertible debt; or SAFE (instruments); the pre-money valuation; any previous funding of the company; and any other deal terms. The company is also asked to list key metrics of "traction data"; key customers; key partners; technology; to provide a "deck" (presentation pitching the company); information about the product offered; past funding and investors; and the current company team (including attorneys and other service providers). When all of this information has been entered, one can decide to "publish" one's company profile, to be included in the search results presented to investors who browse the site.

The design of the AngelList site appears to be search-engine based, with a substantial amount of search functionality for the investor who is browsing opportunities. It also has functionality in regard to finding connections between individuals involved in a particular business who may be involved in other businesses listed on the site. In addition, it claims to draw lead angel investors who are well established and able to typically invest much larger sums than the typical amounts seen on most of the other crowdfunding sites discussed in this paper. Other than the sophisticated search functionality and the angel investors, however, the portal does not appear to have any major promotional assistance functions to help a business owner promote their business.

iii. Experience Relevant to Restaurants

AngelList does not appear to have any particular restaurant-specific experience or niche in the crowdfunding space. A search for restaurants on its site brings up various restaurant businesses, some of which are incomplete skeleton profiles of businesses rather than full-fledged crowdfunding projects or rounds.

C. Crowdfunder

Crowdfunder (www.crowdfunder.com) launched in Los Angeles in 2012 and promotes itself as an equity crowdfunding solution for "high-impact ventures." Crowdfunder's investment platform allows for accredited investors only and explicitly targets at entrepreneurs and startups with high growth potential. A review of the projects listed as of this writing reveals that most companies are tech startups, but the platform also accepts social enterprises, small/local businesses and film/entertainment offerings. Crowdfunder lists on its blog a number of figures relating to the company and its crowdfunding:

- $160,000,000 investment commitments on the platform

- 12,000 individual & institutional investors
- 36,000 companies
- Funded 100+ deals at an average deal size of $1.8M[53]

Crowdfunder offers a wide selection of Regulation D investment offerings, covering a range of industries and funding stages (from "pre-seed" through "Series C"). Details vary by investment, with companies listed on Crowdfunder offering equity, convertible notes, debt, simple agreements for future tokens (SAFTs), and revenue shares. Crowdfunder also offers a "VC Index Fund" for investors who want someone else to choose the investments. A key distinction from other platforms is that Crowdfunder isn't technically an online investment platform, as they do not handle any of the actual documentation or transaction details (like funds transfers or reporting) for a fundraiser. A fundraiser has to actually collect the funds raised from the investors offline themselves. Crowdfunder has a lot in common with AngelList, including a reliance on lead investors for deal curation and diligence, although AngelList seems to have more tools available for reporting and deal execution.

Crowdfunder operates under the keep-what-you-raise model of crowdfunding — the business keeps what it raises, regardless of whether or not it meets its stated funding goal. There is no cap on the amount of funds that can be raised through Crowdfunder's platform, but Crowdfunder recommends a minimum investment of $5,000 to $25,000 and a campaign period of 60-90 days, although it allows flexible deadlines.

i. Fees

Crowdfunder has a different fee structure compared to most equity platforms. While Crowdfunder doesn't charge a percentage fee off the amount raised by a campaigner like most crowdfunding sites, a business that wishes to fund through the site will have to pay a subscription fee of at least $299/month to use Crowdfunder's platform. This may be a significant barrier to entry that discourages businesses and entrepreneurs who lack resources. But in exchange for high monthly fees, Crowdfunder promises access to its network of elite accredited investors. Once a business has created its "Deal" for the site – which must include a term sheet, executive summary, and investor pitch deck, it must subscribe to a monthly package of services from Crowdfunder for fees ranging from $299 to $499 per month[54]. There are two available plans at the time of this writing described on their site, a "starter" plan at $299 per month that provides for a deal room set-up for sharing with one's existing network, a public profile (the deal becomes viewable and searchable), and deal alerts; a "premium" plan at $499 per month that includes the basic services plus deal analytics, ability to view publicly, search and connect with investors, and monthly personalized support from the Crowdfunder team.[55] A business can opt to pay $999 up front for three months of the premium plan.

Crowdfunder's fee structure reflects their stated target demographic of a subset of entrepreneurs confident enough in their eventual success at raising funds that the notion that the

[53] https://blog.crowdfunder.com/about-crowdfunder/.

[54] https://www.crowdfunder.com/choose-package.

[55] Ibid.

entrepreneur might lose money to Crowdfunder while their deal fails is not a deterrent. The company does not charge any fee to create a company profile and upload offering documents ahead of a fundraise. In addition to the monthly fees charged for use of their platform, Crowdfunder states: "We charge a one-time fee to make your Deal discoverable to our network of accredited investors."[56] A search of the website did not reveal the amount of, or how, this one-time fee is calculated.

ii. *Application/Listing Process*

Crowdfunder's application process is substantial. Setting up the required personal and Deal profiles is free, but in order to actually launch a deal on Crowdfunder, the business must complete various documents, including a: Term Sheet, Executive Summary, and Investor Pitch Deck. These documents are complex. In particular, Crowdfunder requires the business seeking funds to disclaim expressly receiving any legal advice from Crowdfunder, and recommends that when putting together a Term Sheet, the business "consult and work with an experienced attorney to create the right financial offering that makes sense both for the company, and for investors." Presumably, a business also needs the legal counsel to ensure that it is in compliance with applicable securities laws, since Crowdfunder does not take steps, beyond an initial self-verification questionnaire for accredited investor verification, to determine compliance with applicable securities laws. The business listing is responsible for ensuring that its offering meets exemption requirements or is in compliance with applicable securities laws and for properly documenting steps that it has taken, in the case of a private sale, to determine that its investors are accredited.

Crowdfunder has extensive entrepreneur and investor FAQ sections on its site and numerous support articles covering every aspect of the equity crowdfunding process (some of which are out of date). The platform also offers what it calls a "Knowledge Center." The Knowledge Center is free and consists of do-it-yourself tools like templates, webinars and Google Hangouts on topics such as "Crowd Expert Secrets to Crowdfunding Success" and "Equity Crowdfunding & the Future of Investing Online," which may be interesting, if of limited technical utility to businesses trying to raise funds. Crowdfunder does not assist with automating the fundraising tasks, but offers articles with fundraising information, such as an "Equity Crowdfunding Market Checklist."

Crowdfunder seeks entrepreneurs with a high degree of sophistication regarding business and startup financing and who are confident that they, as entrepreneurs, have substantial growth potential. The comparatively high monthly fees of the platform combined with the need for legal counsel given the complex nature of equity crowdfunding in addition to the fact that Crowdfunder does not assist with the collection of funds, limits the appeal of the platform for small startups or mom-and-pop ventures. There are less expensive and less complex, more straightforward crowdfunding options available for start-ups and small businesses that are not prepared or able to start on the level offered by Crowdfunder.

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[56] https://blog.crowdfunder.com/crowdfunding-faqs/crowdfunder-account-basics/.

D. OurCrowd

Founded in 2013 and headquartered in Israel (with offices in various cities on four continents), OurCrowd (www.ourcrowd.com) is an equity crowdfunding platform for investing in "global startups." It allows investors to participate in investment opportunities alongside venture capital funds and institutional co-investors, at the same terms. OurCrowd's team of investment professionals reviews thousands of companies each year, meets with selected management teams and, after an in-depth due diligence process, selects opportunities to share with the investor community.

One aspect of OurCrowd that is noteworthy is its international scope of operations. OurCrowd reports that it has funded companies in Israel, the U.S.A, India, Canada, the United Kingdom, New Zealand, and Australia, and expects to announce investments in additional geographical areas in the near future.

OurCrowd only allows accredited investors to join its platform, and notes that the legal definition of that term may differ from jurisdiction to jurisdiction. (For a discussion of accredited investors in the U.S., see Section II.). OurCrowd's website adds that other requirements may apply based on local laws. For example, OurCrowd notes on its website that accredited investors in the US are required by law to provide a current third-party accreditation letter from an accountant, lawyer or broker, before completing an investment. All OurCrowd offerings are equity offerings, and, as to the U.S., are made pursuant to Rule 506(c) of Regulation D under the Securities Act of 1933.

OurCrowd pitches itself to prospective investors as a contrast to venture capital funds, in terms of the fees it charges and its relatively low minimum investment threshold of $10,000 per company. It also notes that the investment can be limited to one company. This is contrasted to a $1 million minimum investment threshold, which is what OurCrowd claims is a typical minimum investment in a venture capital fund and often goes toward a portfolio of companies in the discretion of the venture capital fund manager, not the investor.

Capital raising rounds on the portal are typically 45-60 days in duration. Using the OurCrowd portal, an investor can browse and select startups that interest the investors and reserve an allocation through the "I'm interested" button on the website. This begins the commitment process whereby investors receive the relevant investment documents and wiring details. It can take several weeks for an investment to close even after all the funds are collected from investors. Only once the corporate diligence is complete and the funds are wired to the company is the investment closed.[57]

i. Fees

The expenses mentioned on OurCrowd's website are on the investor's side. An OurCrowd entity receives 20% carried interest on profits distributed to the limited partners (investors) in respect of exit proceeds up to five times the amount invested; proceeds in excess of five times the

[57] https://www.ourcrowd.com/startup-select.

amount invested are subject to carried interest at a rate of 25%.[58] In addition, an OurCrowd entity receives a total management fee of 8% on invested capital over the life of the investment, which is drawn down at 2% of invested capital per year for four years, and an administration fee reserve of 4% of invested capital per company for direct reimbursement of fund expenses over the eight year lifetime of the fund.[59]

ii. Application Process

To apply as a startup to be considered for funding by OurCrowd, a company must provide four categories of information. First, its basic details: name, industry (a drop-down menu in which the closest option to restaurants is "Other"), date founded, team size, company pitch in 600 characters or less, website, video link, "number of customers/users/downloads," and top three competitors. Second, its financial details: stage of funding being sought, size of current round, pre-money valuation of current round, monthly revenue, monthly burn rate, have you raised money before, and have you participated in any accelerator/incubator program. Third, contact information for the founder and the company, and the names of any "mentors." Fourth, the company is required to upload certain files: an investment memorandum or other supporting file; and an executive summary.

iii. Experience Relevant to Restaurants

OurCrowd does not have any readily discernible experience relevant to restaurants. Its website has a search function to browse the startups in which prospective investors may invest through OurCrowd. A search for "restaurant" yields no results. The sectors one may choose from to filter search results are heavily weighted toward the technology industry. They are: MedTech, Mobility, Enterprise Solutions, Internet of Things, Semiconductors, Consumer, OurCrowd Fund, GreenTech, WebTech, FinTech, and Cybersecurity. As of the time of this writing, searching all of the companies in the "Consumer" sector being funded through the portal yields approximately ten results, none of which are related to the food industry.

For a restaurateur, it appears that one possible major value addition of OurCrowd is the type of investors that it seeks to attract: solely accredited investors willing to invest at least $10,000 and who, at least in theory, are more sophisticated businesspeople than the population of investors at large.

E. Growth Fountain

Based in New York City and founded in 2013, Growth Fountain (www.growthfountain.com) is a crowdfunding platform for small businesses. It aims to simplify the process of running a fundraising campaign. Growth Fountain also seeks to provide a platform for investors "that makes it easy to discover, support and invest in a neighbor, local business, or the next big idea."

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[58] https://www.ourcrowd.com/investing/fees.

[59] Ibid.

GrowthFountain Capital, LLC is registered as a funding portal with the SEC and is a member of FINRA. It allows entrepreneurs to raise capital from $10,000 to $1 million per 12-month period per capital raising campaign ($1 million being approximately the maximum allowed under Regulation CF). If the company does not reach its minimum fundraising target, all investor committed capital must be returned. The company seeking to raise capital is able to set a minimum and maximum amount it is willing to receive.

Besides equity, Growth Fountain also offers revenue sharing crowdfunding solutions under Regulation CF. A company can choose between the following types of securities to issue on Growth Fountain:

1. Revenue Share Agreement. If a company chooses to offer a Revenue Share Agreement, the company would make annual payments to its investors from a repayment pool equal to 5% of its revenue until two times (2x) the amount invested is paid back. No distributions would be required until the company's second full fiscal year and the company would also be allowed one year of forbearance if needed. These obligations would be unsecured and contain no pre-payment penalty. Growth Fountain states that this security may be a good choice for:

    - Companies that generate or expect to generate cash (the company's operating earnings will have to be more than 5% of its revenue for this to make sense);
    - Limited liability companies (LLCs) that are looking for ways to raise funds without the need to issue form K-1s to their members; and
    - Companies that want to maintain a clean capital structure in anticipation of a future venture capital fundraising round.

2. Common Equity. Selling common equity shares/interests in the company, which may be good for growth companies that are consuming cash. This allows the company to make its investors true "owners" so that the investors can participate in the upside of the business without any cap on the amounts that can be repaid.

3. Common Equity and Revenue Share Agreement. This is a hybrid of #1 and #2 above. It enables a company to offer both securities with one offering: a revenue share for smaller investors and equity for larger investors. The company will choose the toggle amount (for example, investments under $2,000 will receive the Revenue Share Agreement, and investments of $2,000 or more will receive Common Equity).

iv. Fees

Significantly, it is free for an entrepreneur to set up an account and thereby receive access to all areas of the Growth Fountain site, including the various tutorials and other educational information and guidance.

For companies that are looking to raise money through Growth Fountain, the portal charges a registration fee of $500 purportedly to help mitigate some of the fixed costs that it incurs related to performing background checks, reviewing campaigns and filing documents. If a company is able to successfully meet their minimum fundraising goal, Growth Fountain charges a success fee representing 6% of the total amount raised in the offering, along with the pass through of any variable costs attributable to the offering.

For investors that participate in an offering, Growth Fountain charges a minimal participation fee of $10 to defray costs. This fee may be waived in certain circumstances.

v. Application Process

Growth Fountain does not vet applications by companies to be listed on its site. Rather, Growth Fountain just screens for fraud.

As with the other crowdfunding portals, Growth Fountain requests various information in order to launch a fundraising campaign on its portal. However, unlike most of the other portals, Growth Fountain offers to walk the entrepreneur through the process step by step, and to set up a phone call with the entrepreneur to do so.

An entrepreneur will need to provide financial statements, prepared in accordance with GAAP, covering the two most recent years or since inception. If raising $107,000 or less, the financials must be certified by the company's CEO. If raising $107,001-$1,000,000, the financials must be reviewed by an independent public accountant. However, Growth Fountain states that no audited financials are required for a first time Regulation Crowdfunding (Regulation CF) raise.[60]

In addition, a restaurateur will need to provide Growth Fountain with a campaign description and disclosure. This includes a description of any outstanding securities and any rights associated with those securities; a description of any historical results, financial milestones and challenges; a business plan and proposed use of funds; disclosure of material risk factors; and, team biographies (officers, directors and owners of at least 20% of the company).

Furthermore, an entrepreneur will need to generate media and public relations campaign materials, including a list of the company's supporters and potential investors; a slide deck; a video describing the restaurant and team; campaign photos; and a plan for public relations support and a social media presence.

Growth Fountain provides tools to help an entrepreneur generate a compliant Form C (which is a form required to be publicly filed when using Regulation CF). Specifically, Growth Fountain assists companies in populating and filing their Form C, including helping the company evaluate potential disqualifying events in connection with completing the Form C. Growth Fountain notes, however, that it is not a legal advisor and does not purport to provide legal advice. It recommends in all cases that a company discuss the offerings and investments with their own legal counsel.

In addition, Growth Fountain advertises that it can file documents with regulatory authorities on behalf of the entrepreneur. Finally, Growth Fountain states on its website that the

[60] https://growthfountain.com/pg/entrepreneur-questions#collapseSixEntrerpreneurQuestions.

entrepreneur may use Growth Fountain's template investment contracts and subscription agreements without needing to create their own forms for these documents.

Growth Fountain's website offers a variety of educational material, calculators, and useful guidance to entrepreneurs such as articles on the following topics: "Wonder How Much You Need to Raise?" and "Want to Know What Your Business Is Worth?" It also explains, in layman's terms, the basic legal requirements and restrictions involved in crowdfunding (such as a 21-day waiting period under applicable rules). The information provided is generally presented in very accessible, easy to understand terms and does not assume significant prior knowledge about crowdfunding, the JOBS Act, or securities regulation. In addition, Growth Fountain provides the entrepreneur with dashboards to monitor campaign progress, helps track the crowdfunding steps to ensure that nothing gets missed, and website functionality to communicate with investors.

vi. Experience Relevant to Restaurants

At the time of this writing, a total of four investment opportunities are listed on Growth Fountain's portal, of which only one is food related: Kansas City Breweries in Kansas City, MO. However, in the recent past, the platform included at least four other food-related investment opportunities: (1) American Draft craft beer hall in Chattanooga, TN; (2) Kobeyaki fast casual restaurants in the New York area; (3) Liberty Acres Farm in Bangor, PA (led by a team of restaurateurs and chefs); and (4) Rustik Tavern in Brooklyn, New York. All four of these food related companies were using the revenue share approach to crowdfunding on Growth Fountain, rather than the equity approach.

To provide more detail on one of the past restaurant offerings: Rustik Tavern's revenue share offering in late 2017 was for a restaurant and bar near the Brooklyn Navy Yard. The restaurant and bar, now open, is owned by Rustik 77, LLC, and was looking to open its second location. The security offered by Rustik through Growth Fountain was a Revenue Share Agreement, by which the company would share 5% of its revenue annually with investors; no distributions would be required until the second full calendar year and the company would be allowed one year of forbearance as needed; distributions would be capped at two times the invested amount; and, in the event of default, investors would become general unsecured creditors (senior to equity). The campaign ended in late 2017. But when the campaign was still active, with only 15 days left, it had a target fundraise of $150,000 - $500,000 and a minimum investment of $100, but only $2,250 had been committed.

A more recent example is the campaign for the restaurant Kobeyaki (a casual-style Japanese chain that had existing locations in New York City and Jersey City, New Jersey) conducted on Growth Fountain to raise capital for the construction of a new Kobeyaki location in Newport, New Jersey and the related pre-opening and operating costs. The company would share 5% of its revenue annually with investors, up to a cap of two times the investment amount, and subject to certain other restrictions. The campaign had a minimum investment of $100, a target minimum raise amount of $100,000, and a target maximum raise amount of $300,000. As of

February 5, 2018, there was one day left in the campaign, and $56,000 had been committed toward the restaurant's goal.[61]

VI. MULTIPLE INVESTORS AND STATE LIQUOR AUTHORITY DISCLOSURE ISSUES

As discussed above, crowdfunding is becoming an increasingly popular way for business owners to gain the financial backing they need to turn their concepts into realities. Unfortunately for the hospitality industry, the regulations imposed by the New York State Liquor Authority ("NYSLA"), as codified in the Alcoholic Beverage Control Law ("ABC"), unintentionally limit the effectiveness and usefulness of crowdfunding. The recent approval by the SEC of new equity crowdfunding regulations, does not, unfortunately, relieve an owner from any ABC statutory regulations or requirements pertaining to its business. One such regulation is Section 111 of the ABC, which prohibits a licensed establishment, or principal thereof, from making its license available to a person who has not been approved by the NYSLA. Certain individuals are statutorily disqualified from holding a liquor license, including those persons who: (a) are under the age of 21; (b) are not a U.S. citizen or alien admitted to the U.S. for permanent lawful residence; (c) have been convicted of any felony, or promoting or permitting prostitution, or the sale of liquor without an alcoholic beverage license;[62] (d) are police officers or police officials; (e) have had an alcoholic beverage license revoked; or (f) presently hold a wholesale license. As a result of these limitations, there should be a clear process to eliminate these disqualified individuals from the target investment pool prior to launching a crowdfunding campaign.

Once funding has been procured, an applicant, typically a company, is required to disclose the names, ages, citizenship and permanent home addresses for each and every one of its directors, officers and shareholders (or in the case of an LLC, its managing member(s) and members) as part of the application process. However, if a company has more than 10 members or shareholders, then only those members or shareholders owning 10% or more of any class of stock or membership interest must be disclosed. This exception is unfortunately limited because applicants must still disclose all persons who "directly or indirectly have an economic interest in the applicant's business by way of investment, loan or other financial arrangement." In other words, any person who has given money to the applicant must be disclosed regardless of their ownership percentage.

For illustration purposes, assume that Tom is gifted a 5% membership interest in XYZ, LLC and that this LLC has 20 members. Under this scenario, assuming that Tom is not statutorily disqualified from holding a license, and further assuming that he is neither an officer nor managing member of the company, there is no requirement that his interest be disclosed. Likewise, in those limited circumstances where equity is not involved (such as in donation or reward-based offering

[61] https://growthfountain.com/pg/entrepreneur-questions (campaign is no longer available on the site).

[62] Unless the investor has been issued a Certificate of Relief from Disabilities. Under Correction Law §700 a person is eligible to receive a Certificate of Relief from Disabilities if they have not been convicted of more than one felony, provided that the conviction cannot have stemmed from a violation of Public Health Law §2806(5) or Vehicle and Traffic Law (VTL) §1193(2)(b). Where obtained, a Certificate of Relief from Disabilities overrides an automatic disqualification for any license, permit, or employment.

campaigns, both of which are discussed in Section III),[63] crowdfunding can be a useful tool in raising small amounts of capital regardless of whether an alcoholic beverage license is sought. The flaw in this example is that people rarely are given a membership interest in an LLC for no consideration. Instead, a more realistic example would be to assume that Tom acquired his membership interest by investing in the company or through some other financial transaction. Now, despite the fact that Tom owns less than 10% of the company, his interest must be disclosed because of his personal investment. It is this caveat – the equity investment – that complicates crowdfunding since it necessitates the disclosure of each participant, regardless of the size of his or her investment.

There are many appealing considerations when it comes to equity crowdfunding, particularly since many would-be restaurateurs do not have ample 'connections' to generate the investment needed to open and operate their business or because they may be unwilling to grant any single person, or group of individuals, a significant ownership stake or voice in their business. Crowdfunding addresses these concerns by widely publicizing investment opportunities to a vast group of individuals, each of whom are given a chance to invest on a much smaller scale, and on terms generally considered more favorable for the company than your standard venture capital deal. One obvious downside, however, becomes the requirement of having to disclose hundreds of investors to the NYSLA.

So, how does an applicant disclose its investors? While the process is not overly complex, it is far from simple. The NYSLA requires that each investor complete a personal questionnaire detailing the following: name; date of birth; social security number; address; phone number; email address; citizenship; height; weight; hair color; eye color; sex; marital status; spouse name and social security number; position in the company; percentage ownership; five-year residential history; five-year employment history; whether they will take an active part in the business; liquor license history and affiliations (New York State and beyond) to identify any interlocking interests;[64] criminal history;[65] and any applicable statutory disqualification. Additionally, each investor must provide proof of citizenship or alien status, a copy of their driver's license or passport, and a headshot photograph, submit to fingerprinting,[66] and provide bank statements

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[63] Notably there is a gray area concerning rewards-based online crowdfunding as it relates to the NYSLA policy of requiring the disclosure of funds relied upon by an applicant entity.

[64] Businesses engaged in the manufacturing, wholesale or retail sale of alcoholic beverages are highly regulated at both state and federal levels. Of particular concern are regulations governing 'interlocking interests', more commonly referred to as "tied house" prohibitions. Tied house essentially refers to a three-tier manufacturing, distribution and retail sale licensing structure whereby manufacturers are to be kept separate from wholesalers, and wholesalers are to be kept separate from retailers. Applicants (and their principals) are required to disclose any interest, whether direct or indirect, in any premises licensed by the NYSLA and/or any business that manufactures, transports or sells alcoholic beverages at wholesale. This part is broadly construed to include any interest, in any such business, anywhere in the world

[65] If a criminal conviction is disclosed, a Certificate of Disposition must be obtained by the disclosing investor and filed with their personal questionnaire (to ensure that a statutory disqualification does not apply), along with an affidavit from the investor explaining the details of his or her conviction.

[66] Fingerprinting must be completed within 3 weeks from the date of the application receipt provided by the NYSLA, or an application may be disapproved. Investors who are New York residents are fingerprinted at an IdentoGO (by Morpho Trust USA Solutions) location. Out-of-State Investors are provided with fingerprint cards by

(typically 3 months) or other financial documentation showing the source of their investment. If the investment source is a personal bank account, then any deposit over $10,000 needs to be explained. A common scenario involves an individual who invests a sum of money (e.g., $15,000) and upon review of their bank records it is discovered that the source of his or her investment was a gift or transfer from a family member. In that situation the family member who gifted the funds would also need to complete a personal questionnaire and produce their bank records to show the source of the transferred funds.

Further complicating matters, if an investment source is a joint bank account (e.g., husband and wife), the non-investing spouse must also complete a personal questionnaire. As you might imagine, with potentially hundreds of investors, the disclosure process can become onerous. The logistics of reviewing all of the required documents for each investor, as well as spouses, family members, etc., to ensure accuracy, compliance and an absence of tied house violations, can be cumbersome, particularly when you routinely have to communicate with each person to address identified deficiencies, ensure receipt of signed questionnaires, and confirm that everyone has been timely fingerprinted.

Personal questionnaires and accompanying applicant statements must then be signed by the investors and originals must be filed with the NYSLA as part of the company's application. Once the application has been filed with the NYSLA, it will be reviewed and, where applicable, a deficiency letter will be issued to outline any aspect of the application that necessitates further documentation, support or clarity. Barring an extension, responses to a deficiency letter are required within 10 days from the date of the deficiency letter, meaning that an applicant may be required to address several investor deficiencies within a limited period of time. Language barriers, time zones, schedules (work, family, vacation) and other availability concerns pose real problems affecting an applicant's ability to respond in a timely manner.

Assuming that an applicant is able to organize all its crowdfunding investors and coordinate the required filings, there remains a very real potential that one or more investors will, unwittingly, invest in more than one licensed business among the three tiers (e.g., bar and vineyard) in violation of tied-house restrictions. In such a scenario, regardless of the investor's ultimate ownership (even if it were a nominal one), both businesses would be at risk of losing their license, or, if the businesses were still in the application stage, their application likely would be denied.[67] At the present time, there are no online crowdfunding platforms that have a mechanism to identify and eliminate potential investors who hold an interlocking interest and ultimately the licensee bears the responsibility to insure that all crowd-sourced shareholders have properly disclosed their interests.

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the applicant which can then be taken to their local police station, after which they are submitted to IdentoGO for filing with the NYSLA. The fee charged by IdentoGO, as of the date of this writing, is $99 per person.

[67] In Rihga International U.S.A., Inc. v. New York State Liquor Authority, the New York Court of Appeals upheld a tied house ruling from the New York State Liquor Authority when brewers indirectly owned less than 10% of a hotel alcohol beverage license, holding that "even *de minimis* ownership is a disqualifying interest under tied house laws." 620 N.Y.S.2d 784 (1994). Given the Rihga holding, applicants mulling the use of equity crowdfunding should include a requirement that all potential investors agree to submit requalification documentation at the close of the offering as a form of certification that no tied house violations exist.

Even after the issuance of a license there are continuing disclosure obligations. The NYSLA requires license holders to apply for permission to make any corporate change involving: (1) any change of officers or directors, shareholders, members, etc.; (2) any change in ownership where there are fewer than 10 stockholders or LLC members; or (3) any change involving 10 percent or more of the ownership or any change which would increase a shareholder or LLC member's ownership to 10 percent or more in companies where there are 10 or more stockholders or LLC members. Further, tied house restrictions are ongoing. Therefore, a licensed entity must be vigilant in educating its shareholders of the restrictions surrounding interlocking interests so that no after-the-fact investment is made in a business that might trigger a violation at some future point in time.

The new SEC rules on crowdfunding provide an intriguing opportunity for hospitality businesses to procure the illusive funding which is so often needed during their various stages of development and operation. This opportunity, while exciting, is not without risk, complexity or challenges, and attorneys counseling hospitality clients looking to source funding through an equity crowdfunding campaign should become knowledgeable of state and federal regulations which might otherwise complicate a simple capital raise.

VII. MULTIPLE INVESTORS and COMMERCIAL REAL ESTATE LEASE ISSUES

The concept of investing using an Internet crowdfunding model is a fairly recent development and commercial leases often are behind the curve. A restaurant or hospitality business owner planning to raise capital through an online equity crowdfunding platform would be prudent to pay close attention to restrictions that are often contained in the assignment provision of its commercial lease agreement. Generally, clauses governing a tenant's right to assign or sublet are some of the most detailed, complex and extensively negotiated provisions of a commercial lease, partly due to the fact that a tenant's covenant that it will not assign its lease cannot be implied. Landlords who want to maintain control over the identity of their commercial tenant, are therefore expected to include within the lease explicit language restricting those types of transfers which cannot be performed without first obtaining the landlord's written consent. Additionally, because New York courts disfavor assignment prohibitions, viewing them as a restraint on alienation, clauses intended to restrict lease transfers must be clear and precise in order to pass judicial scrutiny.

Most landlords employ an evaluation process to vet prospective hospitality tenants, and this process includes rigorous screening of each prospective tenant's financials, credit and rental history, experience, food and beverage concept, as well as other intangibles such as business acumen, management style, and industry reputation. Landlords are justifiably cautious when it comes to selecting who will occupy their space and, therefore draft commercial leases to expressly prohibit, or limit, a tenant's ability to assign its lease to an unknown third-party without the landlord's blessing. The most common transfer restrictions are those that address direct assignments (i.e., the transfer of a lease from one tenant to another). Less common, but no less impactful, are transfer restrictions which regulate indirect assignments. In this Section, we limit our discussion to indirect assignments resulting from the sale and issuance of stock or membership interests and the admission of new shareholders or members into a corporation or LLC[68] which, is already bound by a commercial lease. It is in this scenario that equity granted through a crowdfunding campaign proves to be the most problematic.

The lack of sufficient capital is a major reason why many restaurants fail. All too often inexperienced restauranteurs underestimate the capital requirements of their intended business, while others start without an actionable game plan outlining how additional capital will be secured when necessary. A recurrent byproduct of this head-in-the-sand approach is the failure properly to review and negotiate critical lease terms such as the circumstances under which a future change in the tenant entity's stockholdings or membership structure will require the landlord's approval.

Many landlords believe that a change in corporate holdings, or control of a commercial tenant, should be regulated as though it were an assignment. If not regulated, a tenant could effectively achieve the parallel of a lease assignment (and skirt the limitations thereof) through a successful reorganization that shifts the governing authority of a tenant, and by extension the premises, to an unvetted third-party. Notably, in the context of commercial leasing, a stockholder in a tenant entity has an absolute right to sell his or her interest to a third-party and a corporate tenant has the absolute right to issue additional shares in the corporation to existing or new stockholders in the absence of lease language explicitly requiring landlord's consent to any proposed change of control or stockholding. As such, most commercial leases contain some form of limitation over a tenant's ability to alter its corporate structure or stockholdings or membership structure.

Similar to the manner in which direct assignments are handled, indirect assignments often require the landlord's prior written consent to any corporate reorganization or amalgamation with another entity, often irrespective of affiliation. While it is common to see indirect assignment restrictions contained in a hospitality lease, the wording of such restrictions can vary appreciably. Many commercial leases contain over simplified language intended to limit, but not necessarily define, changes of control occurring with respect to the tenant entity itself, while others contain exhaustive language defining 'control', and describing in exacting detail what constitutes a 'change of control.'[69] Still others require that any change in stock holdings or membership interests, regardless of its corresponding ownership percentage or whether it comes with any voting rights, be pre-approved by the landlord.

Astute tenants aim to preserve their assignment rights, both to ensure that necessary capital raises and reorganizations can be undertaken, but also as a general exit strategy should the tenant elect to sell its business or business assets. A well-crafted and equitable indirect assignment

[68] Limited liability companies and partnerships are similarly treated although the language used to restrict transfers within and among such entities is different. It is therefore recommended that careful consideration to the language settled upon where limited liability companies, general and limited partnerships, and other forms of joint ventures, are concerned.

[69] While negotiating indirect transfer provisions, parties should cooperatively define terms such as "control", "change of control" and "change in effective voting control", as necessary, to clarify the parties' intention and to ensure that certain future stock transfers are not unnecessarily deemed to be an assignment of the lease requiring landlord's prior written consent.

provision will balance the parties' competing interests, but the norm, at least in New York City, is that most indirect assignment provisions favor the landlord. A typical transfer restriction might read:

> For the purposes of this Article, a transfer of 51 percent or more of the beneficial interest in Tenant, at one time or in a series of transactions, and whether of the issued and outstanding capital stock, partnership interest, or otherwise, shall be deemed to be an assignment of this Lease.

A less favorable (albeit common) transfer restriction, might read:

> If Tenant is a corporation or limited liability company, any dissolution, merger, consolidation or reorganization of Tenant, or any sale, assignment transfer, pledge, encumbrance or other disposition of any of the corporate stock or membership interest of Tenant, or, if Tenant is a partnership, any sale, assignment, transfer, pledge, encumbrance or other disposition of any interest in such partnership, shall constitute an assignment of this Lease. With respect to any assignment of this Lease to an assignee, Tenant, all of Tenant's principals at the time of the assignment and any guarantor(s) of Tenant's obligations hereunder shall remain jointly and severally liable (as primary obligor) with the assignee, and with any and all subsequent assignees, for the performance of Tenant's obligations under this Lease during the balance of the Term, and, without limiting the generality of the foregoing, they shall remain fully and directly responsible and liable, jointly and severally, to Landlord for all acts and omissions on the part of any assignee subsequent to Tenant for a breach or violation of any of the obligations of this Lease.

The latter provision is obviously far more restrictive since all transfers, regardless of scope and size, are deemed to be an assignment of the lease, while the former provision at least exempts those transactions in which less than 51 percent of the ownership interests of the tenant entity changes hands. Arguably, the first provision should be viewed as more tenant friendly, but that does not necessarily mean it is equitable.

The actuality of how many small hospitality businesses operate is frequently ignored in the tenant negotiation of a commercial lease. As previously mentioned, it is not uncommon for a lease to inadvertently omit a provision defining "control" leaving the parties to argue that their respective interpretation should be incorporated into the lease. Within the hospitality industry, many closely-held corporations are exclusively managed and controlled by a minority class of shareholders, and others, by a board of directors and appointed officers. The degree of control vested in any particular stockholder, class of stockholders, board member or officer, is dictated by state regulation and through the by-laws of each corporation, and where applicable, the stockholders agreement. It is common to see control defined as the ownership of the majority of a corporation's stock, but it is equally common to see it defined by the right to cast a majority of the votes of a tenant's entity, or a right exclusively vested in the board of directors, authorizing it alone, to control and manage a tenant entity and its day-to-day business affairs, notwithstanding the majority ownership of all issued and outstanding shares. Stated simply, when it comes to the governance and operation of a corporation (or an LLC or partnership for that matter), control and majority ownership are not always synonymous.[70] Consequently, boilerplate provisions designed to restrict indirect transfers often have the unintentional effect of limiting a company's ability to secure additional capital or strategically reorganize, should the need or desire arise. This is where crowdfunding becomes difficult.

In many ways similar to a public corporation, a small, closely held company engaged in a crowdfunding campaign is, relatively speaking, unable to regulate the persons who might acquire an equity interest in their business. While a landlord may agree not to unreasonably withhold its consent to the admission of new shareholders or the transfer of shares among existing shareholders, the mere act of seeking the landlord's approval of potentially hundreds of small, crowd-sourced investors is impractical, especially given that most lease agreements require the tenant to either pay the landlord a fee to review the proposed transfer, or at-minimum, cover the landlord's expenses which are connected to their review of the proposed assignment.

Furthermore, depending on the sophistication of the landlord and the equity being granted, irrespective of voting rights, most tenants should expect some level of required disclosure for each new shareholder, meaning that the logistics of obtaining necessary material for a landlord's consideration, could be a daunting task in and of itself, particularly if certified financials are being requested.

While it is unlikely that most landlords would stand in the way of a corporate reorganization where only a small percentage of equity is issued to a pool of crowd-sourced investors, the likelihood for complication nonetheless exists and becomes exponentially greater as the equity offering increases.

VIII. LIMITATIONS OF JOBS ACT

Despite the time and attention paid to the implementation of crowdfunding under Title III of the JOBS Act, crowdfunding has nevertheless failed to reach its full potential and be widely adopted. Possible reasons behind crowdfunding's current limitations:

A. Low Issuer Threshold

First and foremost, the $1,070,000 Issuer threshold is too low to make a Crowdfunding Offering worthwhile for many potential Issuers. The cost and expense of opening a new venue can easily exceed this threshold, especially in New York City, and an Issuer may not wish or be able to conduct multiple offerings to meet its capital needs. Therefore, when confronted with the regulatory burden, costs and other issues associated with a Crowdfunding Offering a potential

[70] Consideration should also be given to whether the indirect assignment restriction is intended to limit specific control of the tenant entity, or whether the restriction is to be more broadly interpreted so as to encompass transfers occurring within the tenant entity's parent or affiliated entities, which may ultimately impact the effective control of the tenant entity.

Issuer, especially one who requires funding close to or in excess of the threshold, may instead choose to pursue a more traditional form of capital raise such as those described in Section II above.

i. Investors

The Investment Cap, as described in Section IV above, imposed on each Investor may similarly make an investment via a Crowdfunding Offering unattractive to certain Investors. At most, in any twelve-month period, Investors whose annual income or net worth is less than \$107,000 can invest only \$5,350 and Investors whose annual income and net worth is greater than or equal to \$107,000 can invest \$107,000. These relatively low limits may dissuade potential Investors from taking the time to consider such an investment. On the Issuer side, assuming a \$1,070,000 equity raise, the existence of the Investment Cap may result in the addition of anywhere from ten to 200 additional shareholders on an Issuer's capitalization table. The addition of so many additional names to a capitalization table may prove unattractive to the more typical or institutional investors while increasing costs to the underlying Issuer. Lastly, despite Regulation CF's disclosure requirements, the potential lack of sophistication of new Investors may increase the risk of shareholder, securities and related litigation, nuisance, or otherwise.

ii. Financial Statements

Regulation CFs' requirement that certain Issuers provide financial statements audited or reviewed by an independent public accountant with their Form C and Form C-AR filings imposes a potentially impractical and certainly expensive burden on what may be relatively early stage Issuers. An Issuer may not wish to divert capital and attention from growing its business to auditing meager financial statements that would not otherwise be audited. In addition, an Issuer may only meet this requirement by submitting an audit report with an unqualified opinion – in other words, the report cannot contain an adverse or qualified opinion (including, for example a going concern qualification) or a disclaimer of opinion. Given the realities of restaurant operations, an unqualified opinion, and thus compliance with Regulation CF, may be difficult to obtain. Lastly, given that the initial financials must be filed with the Form C, payment to the auditors will likely be due prior to, and may not be contingent upon, receipt of Offering proceeds.

B. Requirements for State Liquor Licenses

As discussed more fully in Section V, the regulations of state liquor licensing authorities unintentionally impose ownership and reporting requirements for obtaining and maintaining a liquor license that may limit the appeal and usefulness of Regulation CF for Issuers. For example, NYSLA regulations prohibit a licensed restaurant or bar or principal thereof from making its liquor license available to a person who has not been approved by the NYSLA which includes persons who are statutorily disqualified from holding such a license (e.g., persons who are under the age of 21, non-US citizens, police officers, or convicted felons). Additionally, NYSLA license application and maintenance regulations require certain disclosures, including personal identifying, background, spousal, and financial information, about the owners, directors and officers of the license applicant or owner. The nature and part of the appeal of crowdfunding under Regulation CF is the ability to reach and raise funds from hundreds of potential investors.

However, the appeal, practicality, and utility of this capital raise method is diminished if the Issuer potentially has to vet or provide disclosures for hundreds of investors for purposes of obtaining or maintaining its liquor license to comply with NYSLA requirements or similar regulatory requirements in other states. Not only could such a process prove daunting and expensive, but the Issuer may have little time to cure any deficiencies by identifying and eliminating investors who will prevent compliance. Obtaining and holding a liquor license is vital to the success of most restaurateurs and foregoing or delaying obtaining such a license is often not a viable option.

C. Lease Transfer Restrictions

As discussed in Section VII, Commercial landlords typically want to control the transfer of a lease by a tenant to an un-vetted third-party, and accordingly, treat and regulate a change in the ownership or control of a commercial tenant such as a restaurant or bar as an indirect assignment of the tenant's lease. Most commercial leases reflect this in provisions that require the prior consent of the landlord to any transfer or assignment of a lease and some form of restriction on a commercial tenant's ability to change its ownership or control structure in order to limit the ability of the tenant to make unauthorized transfers or effectuate an indirect assignment of the lease. A crowdfunding capital raise under Regulation CF involving multiple investors may result in a change of ownership or control that triggers an indirect assignment under the terms of the Issuer's commercial lease. Consequently, the Issuer will need to obtain the approval of the landlord for multiple and potentially hundreds of crowd-sourced investors to comply with the terms of its lease. This is impractical and potentially time consuming as well as expensive if the landlord requires a fee to review and approve the terms of the transfer; and the landlord may have considerable leeway to withhold or deny consent.

iii. Offering Costs

In addition to the costs and expenses to the Issuer associated with its financial statements, an Issuer must also compensate its attorneys involved in the Offering process and the Intermediary portal on whose online platform it conducts the Crowdfunding Offering. As with its auditors, an Issuer's attorneys may require payment for services rendered in contemplation of, but prior to, the consummation of the Offering and regardless of the success of the Offering. This potential cost may prevent Issuers from undertaking Offerings or, if they do, from seeking thorough legal counsel. With respect to Intermediaries, while compensation to Intermediaries can vary from platform to platform (see Section IV for an in-depth discussion of certain online platforms), an Issuer can expect to pay approximately seven percent (7%) of the gross proceeds raised in a Crowdfunding Offering to an Intermediary, whether in cash or securities. Payment of this compensation will reduce proceeds available for use by the Issuer or impose costs of issuance on the Issuer, depending on the type of security; however, at least it can be tied to the outcome of the Offering.

iv. Compliance Requirements

Even after the closing of the Offering, the time and expense imposed by ongoing reporting requirements of Regulation CF may dissuade an Issuer from relying on Regulation CF in the first place. An Issuer must post updates and one or more Form C-Us regarding the Crowdfunding

Offering, and must file at least one Form C-AR after it completes its last sale under a Crowdfunding Offering, each filing of which inevitably requires the time and attention of Issuer personnel that could otherwise be directed towards growing the Issuer's business. In addition, due to Form C-AR requirements, the Issuer may choose to provide financial statements that have been reviewed or audited by an independent public account, which could impose additional costs on the business.

v. Privacy Concerns

An Issuer may be hesitant to undertake a Crowdfunding Offering due to the high level of public disclosure required on both an initial and ongoing basis. While these disclosures may insulate an Issuer against Investor claims, they also give away potentially valuable information about an Issuer's business and prospects to its competitors. On balance, an Issuer may find that the cost of such disclosure may outweigh the benefit of raising limited capital.

vi. Testing the Waters

Lastly, given all of the above drawbacks, the fact that an Issuer cannot 'test the waters', i.e., gauge interest among potential Investors due to restrictions on advertising, such as is permitted in certain other types of securities offerings, prior to retaining legal counsel, obtaining appropriate financial statements, filing a Form C and formally undertaking a Crowdfunding Offering, may make crowdfunding too risky a proposition for many. An Issuer may understandably not be willing to commit the time and money to a Crowdfunding Offering if they cannot get a sense of whether potential Investors will be interested in the specifics of the deal. As a result, an Issuer may look to other types of securities offerings or more traditional forms of capital raises.

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July 2018