



# RAISE MONEY THE RIGHT WAY

TIPS, STRATEGIES & STRUCTURES

Randall & Associates, PLLC

# RAISE MONEY THE RIGHT WAY

We create fundraising packages that comply with the law, are easy for potential investors to understand, and are more affordable than what the bigger corporate law firms charge.

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Randall & Associates, PLLC  
222 South Main Street, 5th Floor  
Salt Lake City, UT 84101  
[www.raaslaw.com](http://www.raaslaw.com)

(435) 612-0422

Offices located in Scottsdale, AZ & Salt Lake City, UT  
Free Consultations Available



# PROLOGUE

Entrepreneurs, fund managers, real estate investors, and small business owners often need to raise money in order to launch their next great enterprise. Most find that raising money can be difficult and the laws surrounding fundraising are complex. Raising money the wrong way can lead to unhappy investors or legal liability with the SEC and state securities regulators.

This three-part guide is written to provide tips, strategies, and common structures used to raise money using Regulation D of the Securities and Exchange Act. I hope that this helps you successfully raise money and avoid future legal headaches.

Sincerely,

A handwritten signature in black ink, appearing to read "A. Bradley Randall". The letters are stylized and cursive, with a prominent loop for the 'A' and a long, sweeping underline for the 'R'.

A. Bradley Randall  
Randall & Associates

## PART 1

# THE BASICS

*REGULATION D IS YOUR BEST FRIEND WHEN IT COMES TO RAISING MONEY.*

**U**nder federal and state law, any offer or sale of a security must either be registered with the SEC or meet and exemption. Memorize that sentence. Let's read it again. It is the foundation for everything in this guide. More than anything, there are three words in that sentence I want you to pay attention to.

The three most important words are: "**security**", "**registered**", and "**exemption**". If you want raising money to make more sense, be easier to explain to investors, and if you don't want to worry about breaking securities laws then that sentence is *THE* road map.

**W**hat is a SECURITY? Short answer, when you raise money from investors you are probably offering or selling a security and you need to comply with SEC and state securities rules. Keep reading for the long answer.

The sale of securities are governed by an extensive body of federal and state laws called securities law. These rules and regulations can be complex and expensive to follow.

**M**any business owners, fund managers and entrepreneurs have tried to raise money and avoid securities laws at the same time. So naturally, the definition of a security has evolved over the years. Maybe the clearest definition is, “a contract, transaction, or scheme whereby a person invests his (or her) money in a common enterprise and is led to expect profits from the efforts of the promoter or a third party<sup>1</sup>.” In other words, if you are asking another person to give you capital and that person is expecting some type of profit or gain in exchange for their investment then you are selling a security.

Selling or offering a security can take many forms. It includes selling the stock of your corporation or the membership units of your limited liability company. It could include raising money through a debt instrument like a convertible promissory note. It can also be raising money for your new start-up tech company, or pooling investors to go and buy a specific real estate property. It is not limited to formal hedge funds, VC funds, or private equity offerings.

**I**n any case, raising money is often synonymous with selling a security and therefore you must either be registered with the SEC or meet an exemption.

## *RAISING MONEY = SELLING SECURITIES <sup>2</sup>*

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<sup>1</sup> SEC v. W.J. Howey Co.

<sup>2</sup> Yes, there are exceptions. Generally speaking, anytime you are raising money, securities laws (both federal and state) should factor in to how you approach potential investors.

**W**hat does it mean that you must REGISTER with the SEC? If you are raising money (selling securities) **and don't meet any exemption**, then you must register with the SEC. Registering with the SEC is expensive, time consuming, and complex.

The registration requirements include providing descriptions of the company's properties and business activities, giving detailed information about the management of the company, and providing financial statements certified by independent accountants. Registering with the SEC is what is required to be publicly traded on registered exchanges like the NASDAQ or the New York Stock Exchange. It also requires monthly, quarterly and annual reporting that is intrusive and public.

**W**hen you register with the SEC, the registration statements, financial statements, and prospectuses become public shortly after filing with the SEC. The registration process is mostly filed on-line through the SEC's public database called EDGAR.

Companies like Walmart, Amazon, and CocaCola are examples of fully registered companies that sell securities. Private equity funds, hedge-funds, venture capitalist and start-up companies would find registration to be prohibitive and far too expensive. Fortunately, there's another way to sell securities (i.e. raise money), and to avoid registering with the SEC.



## *AVOID SEC REGISTRATION & RAISE MONEY THROUGH AN EXEMPTION.*

**H**ow do you meet an EXEMPTION so you don't have to register with the SEC? The answer, exemptions like REGULATION D, REGULATION CF and others. For example, under Regulation D of the Securities Act, fundraisers can choose from a number of options which allow them to raise money without having to fully register the offering with the SEC.

Companies that comply with the requirements of Regulation D do not have to register their fundraising offering with the SEC, but they DO have to follow certain specific rules, depending on which exemption they choose to raise money under. These types of fundraising efforts are often called **REG D OFFERINGS** or **PRIVATE PLACEMENTS**. It should be noted that there are other exemptions outside of REG D, that allow you to raise money without registration. One example would be REG CF which allows crowd funding via an online portal. In any case, the most common exemptions used to raise money are identified below.

### *THE MOST COMMONLY USED EXEMPTIONS FOR FUND-RAISING ARE: REG D 506(b), 506(c), & REG CF.*

**T**here are many exemptions available to would-be fundraisers but the three exemptions listed above account for more than 99% of all private offerings in the last

decade. Many times, a new fund or start-up company will combine more than one of these exemptions to raise money. For example, a fund may raise money through a Regulation D 5016(c) offering and a Reg CF offering. Here's how each exemption works:

## RAISE MONEY UNDER REGULATION D 506(b):

- **CANNOT** generally solicit potential investors. Meaning you must have already established some kind of relationship. No facebook or good ads promoting your investment opportunity or fund.
  - Fundraiser cannot have been previously been identified as a "bad actor" by the SEC.
  - You can raise money an unlimited amount of money from an unlimited amount of accredited investors. Up to 35 sophisticated but non-accredited investors allowed.
  - Must provide adequate disclosures and inform investors of risks associates with the investment. Typically in the form of a Private Placement Memorandum and Subscription Agreement.
  - A FORM D required to be filed with SEC and equivalent state forms.
- 

## RAISE MONEY UNDER REGULATION D 506(c):

- You **CAN** generally solicit potential investors.
  - Fundraiser cannot have been previously identified as a “bad actor” by the SEC.
  - You can raise an unlimited amount of money from an unlimited amount of accredited investors only. You must take reasonable steps to verify that all investors are accredited.
  - Must provide adequate disclosures and inform investors of risks associated with the investment. Typically in the form of a Private Placement Memorandum and Subscription Agreement.
  - A FORM D required to be filed with SEC and equivalent state forms.
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## RAISE MONEY UNDER REGULATION CF (CROWD FUNDING):

- **CAN** generally solicit potential investors through an approved online portal, after FORM C is filed with the SEC.
- Fundraiser cannot have been previously identified as a “bad actor” by the SEC. Cannot be non-U.S. bank, “blank-check” or investment company.

- You can raise up to a total of \$1.07 million annually from investors. Each investor can invest depending on limitations based on annual income and net-worth.
  - Must provide adequate disclosures and inform investors of risks associated with the investment. Typically in the form of a Private Placement Memorandum and Subscription Agreement.
  - A FORM C is required to be filed with SEC and equivalent state forms as well as financial statements and progress reports annually.
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**R**aising money under one of these exemptions allows fundraisers to avoid the cost and head-ache of full SEC registration and provides a safe harbor from potential legal liability and penalties. Choosing the exemption that's best for you is fact specific and should be approached carefully and thoughtfully.

Once you've chosen the exemption under which you want to raise the money, then the key is using the correct set of documents to protect yourself and bring in the money.

**PICK AN EXEMPTION AND THEN FUNDRAISE.**



## PART 2

# THE “HOW TO”

## *YOUR DOCUMENTS & DISCLOSURES MATTER*

Once you’ve decided on which exemption you are going to rely on to raise money, then you must create the proper documents for that investment offering. The offering documents are the agreements and disclosures that are given to a potential investor prior to investing. They are typically combined into an offering package for the investor to review and sign.

The offering documents most often included in the offering package include:

- A disclosure document called a **Private Placement Memorandum** or (“PPM”). Not all investment offerings require a PPM, however they are often advised in order to disclose risk factors related to the investment and important fund information.
- Investment purchase documents in the form a **Subscription Agreement** and **Investor Questionnaire**. Remember that many of the exemptions require your investors to be “accredited”. These documents are where they affirm that they are accredited investors as well as purchase the securities in exchange for their investment.

- The governing documents for the company or the fund. For example, if you are raising money for your new company which is an LLC, then the investor would be given a copy of the LLC's Operating Agreement. Or, if the investor is putting their money in your VC or Real Estate Fund, then they would receive a copy of the Limited Partnership Agreement (if the Fund was a limited partnership). **Governing Documents** could include Operating Agreements (LLC); By-Laws (Corporation); or Limited Partnership Agreements (Limited Partnership).
- Sometimes to attract investors a **pitch deck** is created. If a pitch deck is used, it is highly advisable for a securities attorney to review the information being shared with potential investors to make sure it complies with SEC rules and securities law.

## *A PROPERLY CRAFTED PPM SHOULD PROTECT YOU FROM INVESTOR CLAIMS OF NON-DISCLOSURE*

**A**s previously mentioned, a PPM is a securities disclosure document provided to potential investors. A PPM provides investors with material information about the investment or fund in order to allow the investor to make an educated and informed decision about making an investment. This document is critical in protecting you from liability in the future. A PPM should be custom to your specific investment or fund and includes industry and geographic specific disclosures.

A PPM is similar to a prospectus which is provided to investors in public offerings traded on public exchanges like the NYSE or NASDAQ. The PPM includes specific and detailed information about the terms of the investment, the structure of the fund or business, the background and experience of the managers, and the risks associated with the specific investment.

**S**ubscription Agreements are legal documents that provides investors with the legal right to purchase ownership in the company or fund. Via the subscription agreement, investors exchange their money for whatever they are investing in. As such, the subscription agreement is the contract between the investor and the fund or company which outlines the amount of the investment and the terms under which the investment is being made.

Often the subscription agreement will require the investor to attest that they meet certain eligibility standards, such as being an accredited investor as required by the SEC.

**G**overning Documents spell out the rules of the company or the fund that controls the investment. These documents are legally binding agreements and should be prepared by experienced legal counsel. Typical terms discussed in the governing documents include:

- How profits are allocated and then distributed to all partners.
- The fees and activities of the general partner or manager

- Designation of power of attorney, allowing managers to buy/sell fund securities, admit new investors, amend fund or company documents and vote.
- Withdrawal provisions, including lock-up periods, gates and distribution dates.

**F**inally, regulatory filings must be filed with the federal and state jurisdictions that are needed to satisfy certain securities laws and registration exemptions. Often these filings (for example, FORM D as required by a Reg D offering or a FORM C as required by a Reg CF offering) are sent to the SEC and state specific securities regulators.

Although each investment has a variety of custom and detailed requirements for complying with regulatory filings; typical regulatory filings would include:

- The SEC and state FORM D filings, which are required whenever there is a U.S. investor under REG D.
- Investor Advisor Registrations (depending on the type of investment, the amount of assets under management, and the state in which the fund managers are located).
- Registration with the Commodities Futures Trading Commission (CFTC). This is applicable to certain hedge funds that invest in commodities, futures, swaps, currencies, etc.



- The SEC and applicable state FORM CF filings, which are required for investments made under the relatively new crowd funding exemption REG CF.

ALWAYS PROVIDE INVESTORS WITH WELL DRAFTED OFFERING DOCUMENTS THAT MATCH THE EXEMPTION YOU CHOOSE.



## PART 3

# TIPS, TRICKS & FAQ

**T**ip number one; combine your OFFERING DOCUMENTS (PPM, Subscription Agreement, Organizational Documents and other required disclosures) into one “**INVESTOR PACKET**” so that the potential investor has all the required information in one place. Organizing the fund or investment documents this way increases the odds of getting investors and shows you are serious about raising money.

**A**nother important tip to remember is to keep it simple. An overly complex structure for your fund or business may cost you time and extra money. Make sure your documents are understandable and clear. Investors like to know exactly what they are getting in exchange for their money and for what exactly you are using the investment.

**O**ur clients often ask about filing the **FORM D** and the related state securities filings. The general rule is that you have 15 DAYS from the time you’ve taken on an investment to file the appropriate FORM D with the SEC. That means that your hedge fund, real estate fund or start-up should have all the proper documentation signed and file the FORM D no later than 15 days of receiving your first investment. Qualifying for an exemption is not enough if you don’t file on time.

**H**ow do you file a FORM D? Form D filings must be made using the SEC's EDGAR (electronic data gathering, analysis and retrieval) system. To get access to EDGAR, a fund must complete a FORM ID to get a filer identification number (called a "Central Index Key" or "CIK") and access codes. This process is completed using the EDGAR Filer Management system and requires Form ID to be signed by an authorized signatory of the issuer. Once the application process is complete, approval can take up to 48 hours.

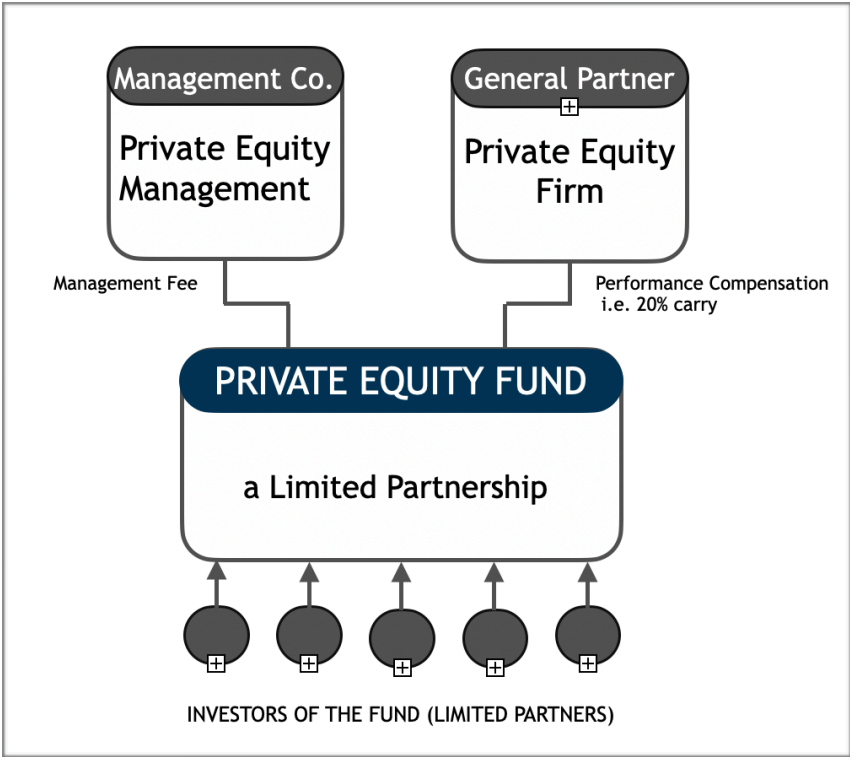
Therefore, it is important not to wait until the last minute. Once the initial Form D is submitted, the filer has to submit an annual amendment on or before the first anniversary date, if the offering is continuous. Certain private funds, such as private equity, generally do not submit an annual amendment if fundraising has been completed and no new commitments are being accepted.

**A** common question we're asked by our clients is whether or not they are allowed to pay a third-party for finding investors. The SEC allows funds and start-ups to pay certain individuals or companies finders fees or commissions for helping raise capital. In order to pay these finder fees or commissions, these individuals must be licensed and registered with FINRA, among other things. Paying commissions or finder fees to a non-licensed, non-registered individual or company is not allowed.

**W**hat are the common structures for raising money? The best structure for raising money is the structure that fits your investment. The structure for a hedge fund or

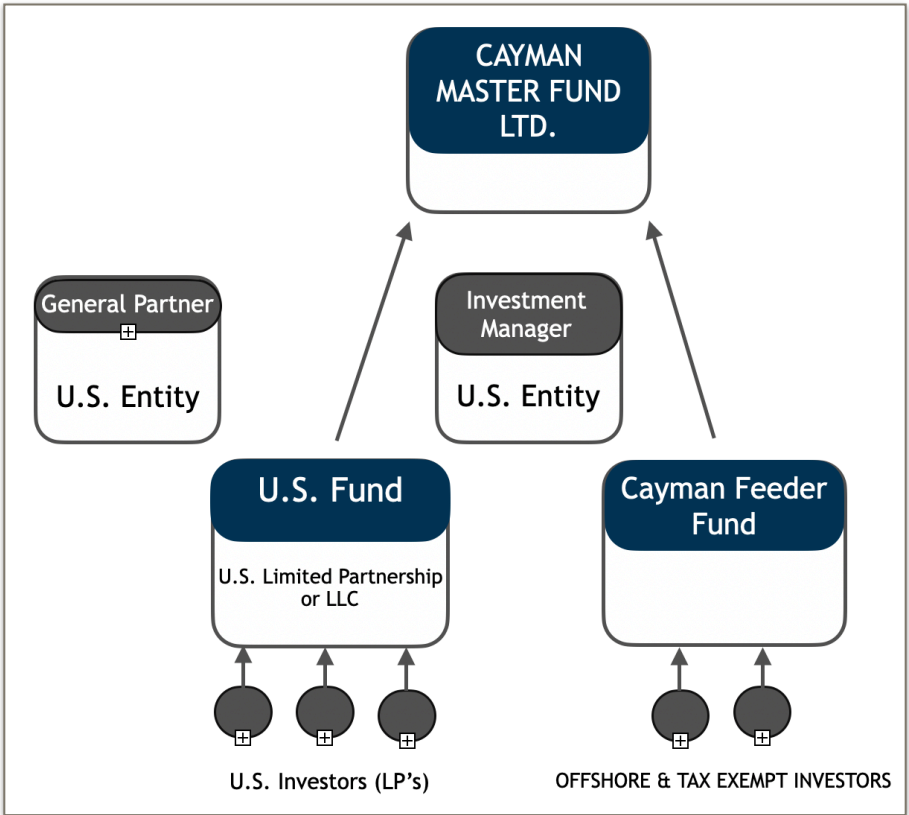
private equity fund can look quite different than the structure to raise money for a start-up tech company. Below are a few common structures used by successful funds and start-up companies:

The most common Private Fund structure is shown below. This is used for **Private Equity Funds, Hedge Funds and Real Estate Funds**. The actual “fund” is a limited



partnership with the fund manager being the general partner and the investors being the limited partners.

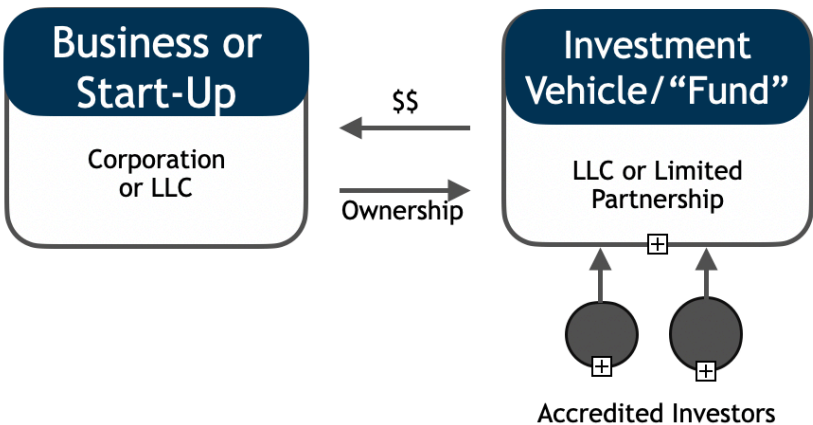
A structure for a private fund changes if you are also raising money from Non-U.S. investors. If **Non-U.S. investors** are also contributing capital to your fund then the following structure (or a similar one) should be used, the most commonly used are called the master-feeder and the side-by-side structure.



# A PROPER FEEDER-FUND STRUCTURE BLOCKS NON-U.S. & TAX EXEMPT U.S. INVESTORS FROM DIRECT U.S. TAX LIABILITY.

The example structure used above is implemented by using the Cayman Islands as the foreign jurisdiction for the master fund but other jurisdictions like, the British Virgin Islands (BVI) is a common landing spot for multi-national funds. Anytime structures like these are being considered it is highly recommended to consult with an experienced securities attorney.

**F**or start-ups or operating businesses wanting to bring in investors a common structure is to create a special purpose vehicle or single entity for the investment. A structure similar to the one shown below is common.



**A**lthough there are always variations and different structures used to raise money, we've tried to give you an idea of the most common.

In any event, this guide has hopefully helped you realize that **(i)** any time your a raising money you should be aware of federal and state securities law, **(ii)** before taking investors money, always identify which exemption/rule you are raising money under, and **(iii)** be sure to provide the proper documents to your investors and complete the correct filings with the SEC and state.



# ABOUT THE AUTHOR



A. Bradley Randall is the managing partner of Randall & Associates with offices located in Salt Lake City, UT and Scottsdale, AZ. Mr. Randall's practice is solely focused on securities law and the representation of private equity funds, hedge funds, start-up's and venture capitalists.

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