



Sustainable
Economies
Law Center



Grassroots Financing Guide for California Farmers

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ABOUT THIS GUIDE

This guide discusses options for obtaining funds for farm enterprises in California through methods other than bank and institutional loans. With growing consumer interest in local sources of food there are increasing opportunities for farmers to offer investment opportunities to their customers, friends, family, neighbors, and other community members. Receiving investment dollars from community members, instead of larger institutions, may also be more feasible for beginning farmers, since banks and other institutions generally only lend to well established businesses with steady revenue streams. While institutional lenders provide valuable financing opportunities for some farmers, these institutional loans are not always accessible. The information in this guide is intended to complement, instead of replace, the existing, more familiar options.

This guide will explain in detail the many state and federal laws that come into play when soliciting investments from individuals and organizations. These laws, known as securities laws, are primarily designed to protect investors from fraudulent or overly risky investments. Before asking anyone (other than a bank) for money for a farm enterprise, farmers should have a basic understanding of securities laws.

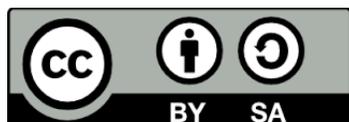
A word of caution! In addition to reading this guide, farmers are encouraged to **consult with an attorney who has expertise in securities law** to discuss how the law applies to a specific situation, since this guide will not cover specific legal details that may apply to every agricultural enterprise. Furthermore, **laws change**. Securities laws have changed significantly over the past decade. As we write this guide there is pending legislation at both the state and federal levels which could bring about more change in the near future. So before relying on any information in this guide please check for current laws and consult an attorney. This guide is intended to provide a general education on securities laws, helping farmers to better understand "grassroots financing" and "community capital." While this guide is not intended to be a substitute for legal advice from a knowledgeable attorney, we hope it better prepares farmers to be ready to meet with an attorney to discuss specific options.

Finally, **this guide covers select provisions of California and federal law only**. Any farmers or other business owner seeking to raise "community capital" in other states will need to learn about other state's securities laws.

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For revised editions and other legal resources see <http://theselc.org>.

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WHY GRASSROOTS FINANCE?

This guide provides a legal roadmap for farmers seeking funds from non-institutional sources, including individuals such as friends, family members, customers, and the broader community, which could include individuals as well as small businesses and organizations that care about the success of a particular farm enterprise. This fundraising approach is sometimes referred to as “community capital.” At the Sustainable Economies Law Center we often call this strategy “grassroots finance” because it harnesses the collective capacity of a community in support of a common goal, similar to grassroots organizing. Grassroots finance might be right for your farm enterprise if you want to (1) get lots of community members interested and involved in your farm, and (2) empower them to become investors who can support and benefit from your enterprise while helping shape the local economy.



Small businesses use grassroots financing strategies to fund a wide variety of business needs, including but not limited to working capital, start-up costs, and equipment lease or purchase.

There is a growing interest in these funding strategies for food and farm enterprises. We think one reason is that consumers increasingly strive to have a better understanding and sense of connection to their food and the people who produce it.

Becoming an investor in a local farm is one way to take their financial support for local food to the next level. Increasingly, consumers are concerned about ensuring that the next generation of farmers has the resources needed to produce high quality healthy food using farming and labor practices that are sustainable and responsible.

Grassroots finance can be particularly useful for many beginning farmers because banks and other institutions generally only lend to well established businesses with years of steady revenues, and these institutions often require that an owner with good credit history guarantee the loan personally. Although some farmers can use personal assets as collateral to qualify for bank or other institutional loans, many farmers, especially young farmers and farmers from low-income

communities, lack the personal assets, incomes, and credit scores to qualify for bank loans. These farmers may find it feasible to turn to their community for financial support.

Additionally, some farmers prefer to receive funding from individual members of their community because these individual investors are sometimes willing to make loans or other investments on terms that are more beneficial to the farmer than terms offered by institutional lenders. Sometimes individual investors are more flexible about repayment timelines, willing to accept lower interest rates, or willing to take on more risk. Further, involving community members as investors can be a tool for marketing a farm business. Community investors are likely to remain loyal customers and are likely to bring in new customers and new investors by spreading the word about their investment and why they are loyal fans of the farm enterprise.

Many beginning farm enterprises utilize a mix of funding sources to create and grow a farm business, including personal assets, money from friends and family, money from their community, and/or institutional grants and loans.

There are some institutions that provide loans that meet the needs of beginning farmers. One example is California FarmLink, a nonprofit organization that operates a revolving loan fund for beginning farmers, among other organizations included in the Resources section at the end of this guide.

We now turn to securities law basics, because farmers pursuing grassroots finance must be familiar with it to avoid liability. Carefully abiding by securities law will also help ensure that community investors are well informed about the risks and benefits of making an investment in your farm enterprise.

INTRODUCTION TO SECURITIES LAWS (FEDERAL AND STATE)

Securities laws are designed to protect investors from fraudulent or unduly risky investments. Despite their positive intentions, securities laws can sometimes be hard to navigate, especially for smaller businesses that don't have teams of lawyers working for them. Securities laws can be hard to approach because of their use of confusing jargon and because of the multiple layers of federal and state laws, which each have different general requirements for different types of securities offerings and nuanced exemptions and exceptions. This guide will seek to summarize key points for small farm enterprises as much as possible, but in some sections we'll delve into some of the nuances when it's important to do so. Don't be discouraged if it does not all make sense right away. It might be a good idea to study this guide over time. The resources, case studies, templates, and checklists at the end of this guide are there to help illustrate some of the legal concepts that will be discussed beginning on this page.

First we will discuss what is a security?

WHAT IS A SECURITY?

The definition of a security under both federal and California law is intentionally very broad. Almost any kind of investment is a security. All types of stock, shares, promissory notes (i.e. loans), or other evidence of indebtedness are securities, as are revenue sharing agreements and other certificates representing an investment. Even a handshake agreement over a small loan is likely to be considered a security. The key features of a "security" under federal law involve the investing of money in an enterprise where the investor expects profits solely from the efforts of others, and risks financial loss. It doesn't matter so much what the deal is called. If someone is contributing money to an enterprise, has little to no involvement in managing the enterprise, and expects a return on the investment, then the transaction is considered a sale of securities under federal law.¹

California has an additional layer of nuance in the definition of security with its *risk capital test*, which focuses on whether a person contributing funds is putting their money (or other assets) at risk. This nuance is important for farmers who plan to pre-sell products to raise funds, such as through a community-supported agriculture (CSA) program. The risk capital test was developed in

¹ SEC v. W.J. Howey, 328 US 294 (1946).

a California court case where prospective members of a country club purchased memberships in a country club before the country club was built as a means of financing the club's development. The contributors were not expecting to earn profits from their investment, but they did expect to enjoy access to the country club once it was built. The court ruled that because members were purchasing memberships at such an early stage in the development of the club, they were putting their financial contribution at risk, and thus their early purchases of memberships were securities under California law.²



Farmers and other enterprises who plan to pre-sell products must be aware that California might consider the pre-sale of vegetables not yet planted, (or planted and not yet harvested) the sale of a security. Much like the members of the country club, the members of a CSA are putting their dollars at risk and the food they expect to develop during the season might not grow and be harvested as expected. Therefore, farmers and other small businesses in California should consider securities law carefully before pre-selling

goods or services to raise funds, especially if the customers who pre-pay are at risk of never receiving the goods or services they paid for because the business or product is in an early stage of development. See pages 13-14 for a more in-depth discussion about CSA programs.

Another common example of the risk capital test at work is when a friend or family member makes a zero interest loan to an enterprise. Even if that friend or family member intends to make the loan very informally, maybe even without any repayment deadline or without a written contract, this can still be considered a sale of a security under the risk capital test if the loan is put to use in a farm enterprise or other risky endeavor in which the lender has little to no involvement. Fortunately under both California and Federal law such a transaction would most likely be exempt from onerous registration or permit requirements, however, general legal requirements to disclose information prior to making the investment (discussed in the next section) still apply.

² *Silver Hills Country Club v. Sobieski* 55 Cal.2d 811 (1961).

KEY CONCEPTS IN SECURITIES LAW

In the U.S., the federal government regulates advertising and sales of securities and all 50 states have securities laws in addition to the federal laws. So farmers raising money need to be aware of federal law, their own state's laws, and the law of any other state in which they plan to raise money. The default rule in state and federal securities law is this: before soliciting or advertising to investors, and before raising any investment money, a farm or other enterprise must either 1) be registered or permitted by securities regulators, or 2) be exempt from registration and permit requirements. Small fundraising campaigns are often exempt from both federal and state registration and permit requirements. Therefore, most of the securities law compliance strategies discussed in this guide will require either a simple filing or no action at the federal level. In California, the law may require some regulatory review process or the sale may be exempt from regulatory review.



One other key concept a farmer raising capital should know is that it is a crime to make any fraudulent or misleading statements, or to omit any material information, when advertising or negotiating a securities deal. So, prior to making any investment deals, or even soliciting potential investors, a farmer should work with an attorney to ensure that the business has prepared offering documents which include a prospectus that describes the business plan and terms of the offering, and a list of *risk factors*

involved in the business so that investors are aware of all the risks involved in making an investment in that farm business. Any information conveyed in the documents must be truthful, accurate, and complete. There are many other types of information that must be included in investment offering documents according to securities law. For a checklist see pages 25-28.

HOW DO SMALL FARMS COMPLY WITH SECURITIES LAW?

Most small businesses are able to avoid a lengthy and expensive registration process with the federal government (through the Securities and Exchange Commission (SEC)) by using one of many exemptions from the registration requirement that are available. Registration with the SEC can be very costly, and often entails ongoing reporting requirements which are burdensome for small businesses. In order to avoid these costs and burdens, most farm enterprises are advised to

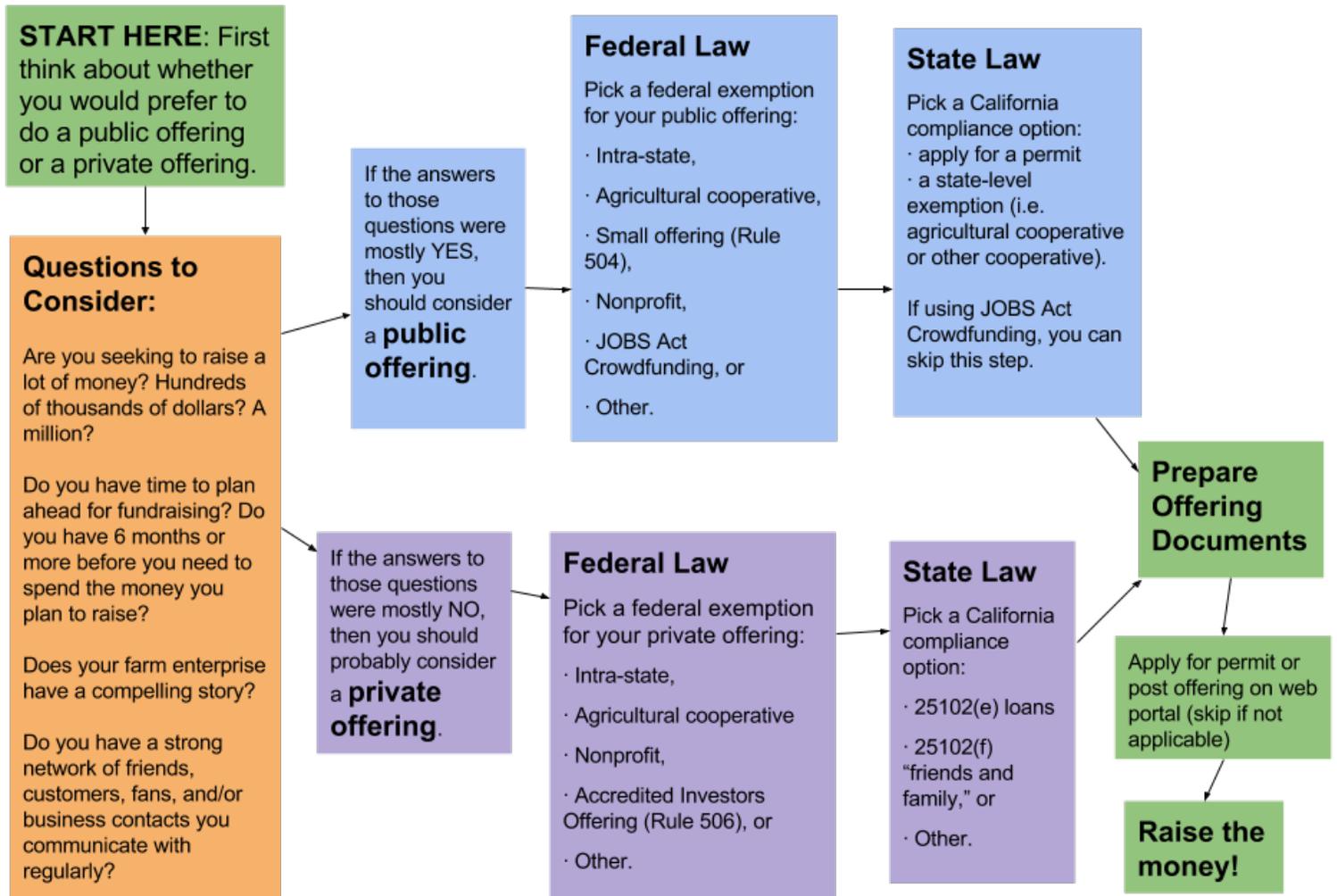
choose an exemption from the SEC registration process and comply with it. So that takes care of federal law compliance. For compliance with state securities laws, farmers in California must consider whether to obtain a permit to sell securities from the California Department of Business Oversight (DBO) or whether one of the exemptions from California permit requirements fits well with the ways the enterprise wants to raise money.

To formulate a plan to comply with securities law, farmers can go through this decision tree: First review the common exemptions from federal registration discussed on pages 14-17 of this guide, and pick an appropriate federal exemption. Then review the common state exemptions (pages 21-22, 29-30) and the other channels for conducting a public offering (pages 22-28) in California. Given the available options, farmers can decide whether to pursue a public offering or a private offering of securities (distinguished in the next section) to raise funds for their farm. Note that most exemptions from registration cannot be used in concert, meaning that the farm generally can use only one federal and one state exemption at a time. And subsequent offerings typically should be separated in time, meaning they should not overlap with a current offering and it's often advisable to separate multiple offerings by 6 months to ensure that they will not be seen as one offering.

Regardless of whether a farmer decides to obtain a permit from the California DBO or falls within a state level exemption, the next step is to prepare securities offering documents that provide information to prospective investors. These documents give potential investors all the information they need to determine how much risk is involved, and to make an informed decision on whether to invest in the farm enterprise. Failure to disclose any of this important information could result in litigation and liability, so hiring an attorney to help prepare the offering documents is advisable. The cost of hiring an attorney can vary greatly, depending on the attorney's level of experience and credentials, and depending on how much work the farmer is willing to do and how much they plan to rely on the attorney to complete.

Note that securities laws generally do not apply to asking for donations and they sometimes do not apply to advance payment for products, however, the following section on CSA subscriptions and the later section of this guide on Donation-Based Crowdfunding Campaigns (pages 11-13) discuss when and how securities laws apply to such situations.

FLOWCHART ON NAVIGATING SECURITIES COMPLIANCE OPTIONS



Important Note: This flowchart simplifies the process of picking a securities law compliance plan to help convey complex concepts of securities law in simple terms for educational purposes. It does not cover all possible options. It should not replace the advice of a lawyer who is knowledgeable about securities law. It should not replace your own research and good judgment.

DISTINGUISHING BETWEEN PUBLIC OFFERINGS AND PRIVATE OFFERINGS

The distinction between a *public* and a *private* offering is important because different rules apply and it affects how a farmer can advertise an investment opportunity to potential investors. Farmers who want to advertise an investment opportunity on their website for example, would need to comply with the laws for a public offering, because the investment would be offered to the general public if it's advertised on a website that anyone can view. By contrast, farmers who want to present their investment opportunity to only close personal contacts would likely be making a private offering, and need only comply with the rules governing a private offering, which are typically less burdensome. Numerous California court cases have discussed the distinction between public and private securities offerings. There is no bright line distinguishing between the two types of offerings, but here is a list of factors the courts have used to determine whether a securities offering is public or private:

- (1) The number of offerees (potential investors who receive the offer to invest);
- (2) The relationship of the offerees to each other;
- (3) The relationship between the issuer (i.e. the business offering the investment) and the offerees;
- (4) The size of the offering;
- (5) The way the information about the offering is conveyed; and
- (6) The character of the security offered.³

Generally speaking, securities offerings with a small number of offerees, a small number of investors, and a small amount of money exchanged is likely to be viewed as private. The manner in which the securities offering is communicated is also very important. Advertisements made to strangers, or to the public at large, are likely public offerings. Offerings made one-on-one or to small groups of people acquainted with the farmer are more likely to be viewed as private.

³ *People v. Humphreys*, 4 Cal. App. 3d 693 (1970).

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| Characteristics of Private Offerings | Characteristics of Public Offerings |
|---|--|
| <p>Issuer typically has some relationship with investors either directly or through mutual contacts or through mutual involvement in an organization</p> | <p>Issuer typically accepts investment dollars from friends and strangers alike</p> |
| <p>Information about the offering is conveyed through one-on-one meetings, messages, phone calls (or in small groups)</p> | <p>Information about the offering is widely advertised, such as through mass emails/mailings, social media, newspaper/radio/TV advertisements, holding large events, making announcements at social/business gatherings, etc. Solicitations may also occur in one-on-one communications.</p> |
| <p>A small number of investors participate in the deal: as few as one to at most a few dozen (the exact number may be more limited by the exemption used)</p> | <p>A large number of investors participate: dozens or hundreds of individuals could be involved</p> |
| <p>A small number of investors are solicited (can be limited by law to a specific number)</p> | <p>Any number of investors are solicited</p> |

DISTINGUISHING BETWEEN INVESTMENT CROWDFUNDING AND DONATION CROWDFUNDING

Many popular websites such as Kickstarter, Indiegogo, and Barnraiser, among others, now exist to help businesses, organizations, and individuals solicit donations from personal networks and the public. Sometimes there are rewards or gifts offered to entice supporters to donate, however, these gifts are typically of little value compared to the monetary contribution made. Donation crowdfunding is legally very distinct from investment crowdfunding. Investment crowdfunding involves investors who expect to receive money back on their investment (typically with some interest or dividend) or something of more value in the future, in return for their investment today. Some of the pros and cons of donation crowdfunding are discussed briefly below. Donation crowdfunding is only briefly discussed in this guide because securities laws generally do not apply to donation crowdfunding campaigns.

WHEN TO USE DONATION-BASED CROWDFUNDING

Donation crowdfunding campaigns are typically associated with nonprofit or public serving organizations and projects. However, they are also increasingly utilized by individuals and small businesses, especially businesses that have a broad fan base and a social mission. Asking for donations is not regulated by securities laws, as long as the fundraising campaign is truly asking for donations (or offering rewards of limited or nominal value), not selling securities. Some businesses use popular crowdfunding sites to "pre-sell" products as a way to help finance production of those products. Beware of the *risk-capital test* (see pages 5-6) before conducting any fundraising campaign where people contributing money expect something of value in return, and where there is some risk that the contributor will not receive the product.

Many crowdfunding websites have useful features, such as graphics that let supporters see how much money has been raised toward a specific goal. Many of these sites require a deadline for raising the money to help create a sense of urgency. These websites also facilitate credit card payments and offer other convenient features. Kickstarter and Indiegogo are among the most well-known of these websites. Barnraiser was developed specifically for food and farm enterprises and offers some technical assistance in setting up food and agriculture related campaigns. All of these popular donation crowdfunding sites have web pages that offer lots of helpful tips on how to organize a successful campaign. The high level summary is this: running a successful donation-based campaign requires leveraging your personal networks, crafting a compelling pitch, and focused time and energy devoted to the campaign. The web platform on its own will not raise the money for you, but it can be a useful tool for raising money.

Donation crowdfunding campaigns are often utilized by early-stage and smaller enterprises and organizations. Although there are numerous stories of amazingly successful donation crowdfunding campaigns that have raised hundreds of thousands of dollars, remember that these don't necessarily reflect the typical campaign. Donation crowdfunding is typically most feasible for funding needs in the range of \$5,000 to \$50,000. Getting up to a figure like \$50,000 takes considerable time, effort, and leveraging of personal relationships. Donation crowdfunding may be a good option for a very early stage farm enterprise that is unlikely to be generating sufficient revenues that can reliably pay off investors in the near term future. However, because donation fundraising typically yields less money than a well crafted investment crowdfunding campaign, donation crowdfunding is most appropriate for smaller funding needs. Additionally, people are generally willing to donate money to a "cause" and some are less willing to donate money to an

ordinary business, so farm enterprises are likely to be successful with donation appeals if the farm revolves around a compelling public service mission. If this is not the case, donation crowdfunding may not be a good use of a beginning farmers' time and effort.

For those farmers pursuing donation crowdfunding, remember to factor into your budget the cost of any goods or services you promise to provide to your donors during the campaign - these are costs that can add up to significant amounts on top of the time and effort put into raising the money.

Because donation-based crowdfunding typically does not fall under the scope of securities law and because fundraising by asking for donations is of limited viability for farm enterprises, the remainder of this guide will focus on investment offerings that fall under the scope of securities law.

CSA SUBSCRIPTIONS

Because California courts use the risk capital test (see pages 5-6), it is possible that a court could consider a CSA (Community Supported Agriculture) membership as a security. This is particularly true where CSA subscribers make a large payment at the beginning of a season and participate in the risks of the farm by receiving a larger or smaller amount of agricultural products depending on the success of the crop. Because the CSA subscribers capital is at risk during the growing season, it's possible that a court could decide that the subscription is a security. Since the courts have not yet addressed this specific question, there is no legal clarity on when a CSA subscription becomes a security. However, applying other court rulings by analogy we can infer that CSA programs where the customer makes large up-front, non-refundable payment for a product or service that is not yet produced are possibly subject to securities regulation. Until there is more legal clarity, farmers should use caution and consult an attorney before creating a CSA program where customers put substantial capital at risk in the farm enterprise. In situations where customers pre-pay for the entire growing season it may be safest to assume that the CSA membership is a security, and comply with securities laws.

Many CSAs in California likely do not trigger securities law because customers do not make major payments far in advance, rather, members are billed by the week or month, they get a relatively

predictable amount of produce for their money, and they can opt-out anytime. In these situations the CSA is unlikely to be considered a sale of a security.

| Securities law is more likely to apply to your CSA if... | Securities law is less likely to apply to your CSA if... |
|---|---|
| Customers share in the risk of the farm business and get more or less product depending on the success of the harvest | Customers get a relatively stable and predictable amount and quality of product, regardless of how well the business is doing |
| Customers make a big advance payment before the season starts | Customers pay in monthly or weekly installments, and can easily opt-out whenever they change their mind about participation |

COMPLYING WITH FEDERAL LAW

HELPFUL EXEMPTIONS

Under federal securities law, there are many exemptions from the SEC’s registration requirements. The following summarizes exemptions that are commonly used by small, place-based enterprises and by agricultural enterprises. The following does not provide a full list of all exemptions available.

Intrastate Offerings Exemptions: Businesses that operate nearly or entirely within one state, and that sell securities entirely within that state, can use the intrastate offering exemption to avoid registering with the SEC. The SEC provides some guidelines in its Rule 147 and the newer Rule 147A as to what qualifies as an intrastate offering. The two rules have many similarities, but Rule 147A is newer and designed to facilitate intrastate offerings that may use some online advertising,

so this section will focus on Rule 147A. Under Rule 147A, a securities offering will be exempt from SEC registration if all of the following criteria are met:⁴

- The principal place of business of the issuer is within that state, or if the business is not part of an incorporated entity, then the person's principal residence is located in that state; and
- 80% of the gross revenues of the business come from within the state, or 80% of the business' assets are within that state, or 80% of the proceeds from the sales of securities during the offering are intended for use within that state, or a majority of the employees of the business are within that state; and
- Offers to sell securities can be advertised openly in a way that may reach residents of multiple states as long as any actual sales of securities are only made to residents of that state, and as long as the issuer makes efforts to affirm the investor is a resident of that state, beyond taking the investor's own declaration;⁵ and
- Resale of the securities is restricted for at least 6 months, and the certificate or other document evidencing the security states: "Sales will be made only to residents of the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]. Offers and sales of these securities are made under an exemption from registration and have not been registered under the Securities Act of 1933. For a period of six months from the date of the sale by the issuer of the securities, any resale of the securities (or the underlying securities in the case of convertible securities) shall be made only to persons resident within the state or territory of [identify the name of the state or territory in which the issuer was resident at the time of the sale of the securities by the issuer]."⁶

Note that these guidelines are a suggested "safe harbor," meaning that if you comply with them you are deemed to be in compliance with exemption requirements, but they are not necessarily the only way to comply with the intrastate offering exemption.⁷

⁴ SEC Rule 147A (17 CFR §230.147A).

⁵ 17 CFR §230.147A(b) and 17 CFR §230.147A(d)

⁶ 17 CFR §230.147A(f)(iii)(3)

⁷ Section 3(a)(11) of the Securities Act of 1933 and SEC Rule 147A (17 CFR §230.147A).

Agricultural Cooperative Exemption: Agricultural cooperatives which are exempt from taxation under Internal Revenue Code Section 521 are also exempt from registering with the SEC for the sales of any securities.⁸ To qualify for this exemption, the agricultural cooperative must "operate on a cooperative basis" which entails allocation of profits in proportion to a member's "patronage" or contribution to the cooperative. In the case of an agricultural cooperative, this normally means allocating profits to farmer-members in proportion to the value of the agricultural products produced by that farmer and sold by the cooperative. For more discussion on agricultural cooperatives in California, see page 29.

Nonprofit Organization Exemption: Organizations that are exclusively for charitable purposes or set up not for the benefit of private individuals are exempt from registering with the SEC.⁹

Small Business Offering Exemption: Rule 504 allows businesses to raise up to \$5 million in any 12 month period provided that they file the simple Form D with the SEC within 15 days of their first transaction in reliance on the exemption.¹⁰ Form D (also known as Notice of Exemption Offering of Securities) must be filed on the SEC's website (<https://www.sec.gov>) and there is no filing fee. Form D is considered a "notice filing" and does not require approval by SEC regulators. It only requires a complete and accurate form be filed. This Rule does, however, require approval by *state level* regulators by requiring a state-level permit or registration to sell securities, or in the absence of a state-level permit this Rule can be used to sell securities to accredited investors only in conjunction with a state-level exemption. In summary, this is an appropriate federal exemption to use in concert with a permit obtained from the California DBO, discussed on page 22-28.

The process of registering a securities offering with the SEC is not described in this guide, because for small businesses including farms, it is almost always more practical to use an exemption from SEC registration.

Accredited Investors Exemptions: Accredited investors are wealthy individuals or organizations described in the next section. There are two similar exemptions that may interest farmers seeking investments primarily from affluent investors. When using this exemption, the simple Form D must

⁸ Section 3(a)(5)(B)(i) of the Securities Act of 1933.

⁹ § 3(a)(4) of the Securities Act of 1933.

¹⁰ 17 CFR § 230.503, § 230.504.

be filed with the SEC within 15 days of the first transaction.¹¹ The two accredited investor exemptions cannot be used simultaneously, so a farm enterprise must choose one:

- Under Rule 506(b) securities offerings are exempt from SEC registration if they are made privately (meaning no general advertising is allowed) and investment deals are made with any number of accredited investors plus up to 35 non-accredited investors.¹² Each of the non-accredited investors must have “knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment.”
- The other option is under Rule 506(c).¹³ Under this rule, businesses can advertise an investment opportunity publicly without registration with the SEC as long as investments are only accepted from accredited investors. There is no limit on the number of accredited investors under this Rule, but each one’s status as an accredited investor must be verified by documentation such as W-2s, tax returns, bank statements, etc. Accepting investments from non-accredited investors is not allowed at all when using Rule 506(c), not even if the investors has knowledge and experience in business and finance.

ACCREDITED VERSUS NON-ACCREDITED INVESTORS

Securities law assumes that certain wealthy individuals and institutions need less protection from fraud and risky investments either because they are more likely to know how to manage their money, or better able, due to their substantial wealth, to withstand the financial loss from a bad investment. For these reasons, securities laws pose fewer legal barriers to selling securities to accredited investors.

An accredited investor is any one of the following:¹⁴

- An individual with greater than \$200,000 in annual income
- A married couple with greater than \$300,000 in annual income¹⁵

¹¹ 17 CFR § 230.503

¹² § 4(a)(2) of the Securities Act of 1933; 17 CFR § 230.506(b).

¹³ § 4(a)(2) of the Securities Act of 1933; 17 CFR § 230.506©.

¹⁴ 17 CFR §230.501(a).

¹⁵ Note: to meet these income requirements, the investor should have earned greater than \$200,000 of \$300,000 in the two most recent past years and has an expectation of reaching the same level of income in the current year.

- An individual or married couple whose net worth exceeds \$1 million, excluding their primary residence and home furnishings
- A 501(c)(3) nonprofit organization or a trust (that was not set up for the purposes of purchasing the securities in question) with more than \$5 million in net worth
- Banks, and numerous other financial institutions
- Any entity in which all of the equity owners are accredited investors

SEC Reporting Requirements Can Be Triggered When Assets Exceed \$10M or Number of Investors Exceeds 500 or 2,000

Although not relevant to most beginning farm enterprises, you should be aware that reporting to the SEC may be triggered when an enterprise has assets above \$10 million and has 2,000 or more investors or 500 or more non-accredited investors at once.¹⁶ These additional reporting requirements can be triggered regardless of whether the enterprise is otherwise exempt from SEC registration. And while there are some exemptions to these reporting requirements, including for nonprofits and certain cooperatives,¹⁷ this guide will not further discuss these reporting requirements. If your farm business is approaching these thresholds, you must plan a compliance strategy.

DIRECT PUBLIC OFFERING: INVESTMENT CROWDFUNDING UNDER THE JOBS ACT

Newly implemented federal legislation is making it easier for startups and small businesses to raise money through public offerings of securities conducted online. The highly anticipated Crowdfunding Title of the JOBS Act is designed to facilitate internet-based campaigns where an enterprise raises small amounts of money from many individual investors (often called “investment crowdfunding”). This law creates an exemption from the securities permit requirement for investment crowdfunding campaigns that comply with the following restrictions and requirements:

- Up to \$1,070,000 total can be raised in any 12 month period

¹⁶ Securities and Exchange Act of 1934 as amended §12(g)(1)

¹⁷ Securities and Exchange Act of 1934 as amended §12(g)(2)

- Investors whose annual income or net worth is below \$107,000, can invest the greater of (1) \$2,200 or (2) 5% of the lesser of the investor's annual income or net worth.
- Investors whose annual income and net worth are equal to or greater than \$107,000, can invest 10% of the lesser of the investor's annual income or net worth.¹⁸
- Businesses raising money must have their financial statements reviewed by an independent accountant if raising more than \$107,000, or audited by an independent accountant if raising more than \$535,000.¹⁹
- Securities offerings must be made exclusively through a regulated web platform²⁰

Pros and Cons of Investment Crowdfunding under the JOBS Act

Because this new law, sometimes called "Regulation Crowdfunding," requires the use of a regulated web platform for conducting transactions, there are now numerous web platforms that can help businesses raising money navigate the steps involved, and many of these platforms offer templates for offering documents. However, such guidance should not replace the advice of an knowledgeable securities attorney, especially for developing components of offering documents such as ensuring that all risks are adequately disclosed. Many of the regulated web portals under this new law provide a well designed web platform to display offering information in an attractive way and facilitate online payment processing, which is convenient for investors. Another big advantage compared to offerings by state-level permits is that Crowdfunding under the JOBS Act does not require waiting for regulator approval, so once a business has all of its offering documents posted on an appropriate web platform, the sales of securities can begin.

Another advantage of using the Crowdfunding Title exemption is that it applies all across the U.S., and it preempts state law. So when organizing a campaign under this Title, a business can accept investments from *any* resident of *any* U.S. State, without having to comply with each state's securities laws. This ability to accept investments across state lines is not available under many other exemptions. Further, choosing one of the federal exemptions described previously in this guide is not necessary because the Crowdfunding Title is an exemption from SEC registration.

However, there are some notable limitations and drawbacks to the new Crowdfunding Title. Because a business must use a regulated web platform to conduct campaigns, the business

¹⁸ SEC Regulation Crowdfunding 100(a) (17 CFR § 227.100(a)).

¹⁹ US JOBS Act of 2012, Title III, § 302, 4A (b)(1)(D).

²⁰ See generally the US JOBS Act of 2012, Title III, §§ 302 and 304.

raising money must budget for fees paid to the web platform, which are typically 4% of the funds raised or more.

Another drawback is that **advertisement of the securities is restricted to communications made through the regulated web platforms**. Communication outside the web platform (such as in personal conversations, emails, or other means) is strictly limited to the following: a statement that the issuer (the business) is conducting an offering, the basic terms of the offering, factual information about the legal identity and business location of the issuer, (limited to the issuer's name, address, phone number, website, e-mail address of a representative and a brief description of the business).²¹ No other advertising or discussions of the securities offering are allowed outside the regulated web platform under the Crowdfunding Title of the JOBS Act.

While many crowdfunding web platforms emphasize how their platform can help an enterprise effectively reach potential investors, the sleek design and convenience of a web platform will not replace the tremendous amount of personalized outreach it takes to run a successful investment crowdfunding campaign on the internet. The web platform will not advertise and generate enthusiasm about the campaign. Even very internet savvy individuals behind crowdfunding campaigns have many personal conversations with their supporters about their campaign, in addition to posting compelling content to the online platform. Because the Crowdfunding Title does not allow the type of personalized solicitation that is often associated with successful fundraising campaigns, farmers should carefully consider whether their farm enterprise can compel enough investors to contribute without more personalized meetings, events, and other forms of more personal outreach to potential investors.

²¹ SEC Regulation Crowdfunding 204 (available at 17 CFR § 227.204).

COMPLYING WITH CALIFORNIA LAW

“FRIENDS AND FAMILY OFFERINGS” AND “PRIVATE OFFERINGS” UNDER CALIFORNIA LAW

Once a suitable federal exemption has been identified, a *private* offering can sometimes be exempt from California regulatory permits as well, but there are requirements and limitations. In a private offering there is no general advertising of the investment opportunity and the number of investors who are solicited is relatively small. Here are two commonly used California exemptions for private offerings where no general advertising is allowed:

- **Small Loan Offering Exemption:** California Corporations Code (CCC) Section 25102(e) allows a business to solicit loans (no other types of securities) from individuals without filing with state regulators, so long as the offering is sufficiently private in nature. California Regulations suggest (not mandate) the following for ensuring the offering is sufficiently private:
 - the securities offering is not made to more than 25 people
 - the security is not actually sold to more than 10 people.²²
- **"Friends and Family" Exemption:** California Corporations Code Section 25102(f) allows a business to offer any type of securities to any number of accredited investors and up to 35 non-accredited investors, so long as the securities offering is a private offering, the business files Form 25102(f) with the DBO within 15 days of its first securities transaction, and each of the prospective investors are at least one of the following:
 - an accredited investor (discussed on pages 17-18), or
 - a person who has considerable business or investment experience (or who is advised by someone who has such experience and is not a party to the transaction), or
 - a person with a pre-existing personal or business relationship with any of the partners, directors, or managers of the business, such that the person understands the character and business acumen of the issuer.

What does it mean to have a “pre-existing personal or business relationship” for purposes of the 25102(f) exemption? There is no clear answer, but courts have ruled that the requirements of 25102(f) are satisfied if the prospective purchaser has a solid enough relationship so that they

²² 10 CCR § 260.102.2.

have a good sense of the character and business acumen of the business proprietor. Therefore, meeting someone at a networking event once or twice likely does not satisfy the relationship requirement, but a longstanding close working relationship with a colleague likely would satisfy the requirement.

Remember that the two exemptions discussed in this section are exemptions for private offerings only, so no general advertising is allowed (see pages 10-11 for more on the distinction between private and public offerings).

Taking investments from close friends and family members is a common way for small businesses to get started and to grow. For farmers who have friends and family who can afford to take a risk on an early stage business, this often proves to be one of the easiest to access sources of capital. The obvious downside is that this strategy can strain personal relationships when the farm is not as successful as expected. Beginning farmers may not want to ask friends and family for investment until they gain sufficient experience and proven agricultural and business skills.

DIRECT PUBLIC OFFERINGS: GETTING A PERMIT FROM THE CALIFORNIA DEPARTMENT OF BUSINESS OVERSIGHT

A farm business can advertise to the public in California, and accept investments from both accredited and non-accredited investors, if it either (1) obtains a permit to make a Direct Public Offering (DPO) from the California Department of Business Oversight (DBO) or (2) it is exempt from permit requirements, as in the case of California agricultural cooperatives described below.

The DBO's permit process involves submitting an application with detailed information about (1) the business, (2) the terms of the proposed investment, and (3) the plans for raising money, among other documents. Farmers should expect to spend many hours preparing the application materials, something that is true of most securities offerings, and especially those that will be subject to regulator scrutiny. Small businesses that pursue these securities permits typically hire an attorney to help with drafting and assembling the application materials, and especially to help make sure that the business is disclosing all risks and material information that should be

disclosed in those materials, to shield business owners from liability. After submitting the application, it may take weeks or months for the DBO to review it. Sometimes the DBO has questions about the submitted material and the farmer will need to respond to those questions in writing, then wait for further communication from the DBO, which could entail more questions or receiving a permit. Wait times vary greatly for the DBO regulators to review applications. The regulators review the materials to make sure the information is clearly presented, not misleading, and all risks associated with the investment are disclosed.

Here is an overview of materials that a farmer would submit to apply to the DBO for a permit to make a Direct Public Offering in California:

- A description of the business including developments during the past three years;
- A description about how the funds raised will be used, including a budget;
- A plan for selling the securities;
- Information about recent business transactions involving any officers, directors, partners, etc.
- Information about relevant prior sales of securities so prospective investors know if there are shareholders or noteholders from a previous securities offering who are still owed any payments;
- A copy of the security itself (i.e. a copy of a loan agreement to be made with investors, or any stock plan and shareholder agreement);
- A copy of the partnership agreement, articles and bylaws, or operating agreement if the business is a partnership, an incorporated entity or an LLC;
- Financial statements; and
- A copy of any advertising materials to be used to sell the securities.

For a complete checklist of materials to include in an application for a permit, see pages 25-28.

When is a Direct Public Offering Strategic?

Because this type of securities offering requires a carefully organized application and waiting time for regulators to review and approve the application, this strategy is best for situations where the farm enterprise is planning ahead for significant growth or major expenses such as the purchase of land or equipment. This strategy is generally utilized for larger fundraising campaigns that require reaching potential investors outside a business owner's immediate personal network. Many small businesses that go through this process seek to raise hundreds of thousands of dollars, sometimes even a million dollars or more. These campaigns are typically successful when there is a polished business plan and a well-organized marketing campaign for raising the money

once a permit is obtained. Businesses that have used this strategy successfully include those that are working on realizing a novel business model that has wide appeal in a large community, such as opening a new retail store or restaurant. Others that have had major successes with this strategy are well established businesses with a large and loyal customer base. Such campaigns often entail many forms of outreach to prospective investors, including events, one-on-one meetings with prospective investors, well developed email marketing, flyers, and other advertising methods, that all use a very compelling message about the business and its need for funds. That message must appeal to a broad community of people. Typically it takes a dedicated team to carry out all aspects of the campaign.

In summary, this financing strategy takes thoughtful planning and implementation over the course of many months or years.

Decades ago, Annie's Homegrown (makers of popular organic boxed mac and cheese products and snack foods) and Ben and Jerry's Ice Cream financed their growth using DPOs. Both are now large national brands. An example of a farm business that has successfully done a DPO in California is discussed on page 41.

CALIFORNIA DPO APPLICATION MATERIALS CHECKLIST

These materials are required application materials when applying for a permit from the Department of Business Oversight to do a Direct Public Offering in California. If your offering is exempt from permit requirements in California, this checklist can still be helpful for preparing offering documents.

Documents that Need to Be Created Prior to Application Submission:

- Facing page provided in 10 CCR § 260.110 - lists basic facts and contact information.
- Check for application fee which is \$200 plus one-fifth of 1 percent of the aggregate value of the securities sought to be sold in this state, up to a maximum fee of \$2,500 (CCC § 25608(e)).
- The maximum amount of securities proposed to be offered in California (CCC § 25160).
- Specimen of the security (i.e., a sample loan contract or stock certificate) (10 CCR § 260.113).
- Description of any prior “friends and family” or other private offerings completed previously (10 CCR § 260.113).
- A copy of any advertisement, prospectus, or other materials to be used in connection with the offer or sale of the securities - this should include flyers, website content, sample social media posts, and as much other advertising material as you have available at time of application (10 CCR § 260.113).
- A description of the consideration to be received by applicant in exchange for the securities if other than cash (10 CCR § 260.113).
- A list containing the names of all directors, officers, trustees, general partners, general managers, principal executives, etc. who will be charged with the business activities and with respect to each of those individuals:
 - The current post office address (can use corporate/business office address);
 - Age; and
 - Current occupation and principal occupation during the last five years (10 CCR § 260.113).
- Description of the business done and intended to be done by the business, and the general development of such business during the past three years. Indicate any other names under which the business or any of its subsidiaries have conducted business during the past three years (10 CCR § 260.112).

- ❑ Description of the principal purposes for which the net proceeds of the securities offering are intended to be used and an approximate budget. (10 CCR § 260.112)
- ❑ List of all risk factors involved in the business that an investor should know about to make an informed decision (see sample Risk Factors on p __).
- ❑ A plan of distribution of securities (i.e., how the investment opportunity will be advertised) (10 CCR § 260.112).
- ❑ Description of any material transactions or agreements during the 3-year period immediately preceding the filing of the application between (i) the applicant or any of its affiliated companies, and (ii) any of the promoters, directors, officers, principal employees, principal security holders, underwriters or agents, or any company directly or indirectly controlled by any such persons. (10 CCR § 260.112)
- ❑ Statement in tabular form: the title and amount of all outstanding securities and whether any of such securities are publicly traded. (10 CCR § 260.112)
- ❑ Statement of the compensation paid to every director, officer, and principal holder of securities whose payment in the last year exceeded \$60,000 (for any and all services), and the aggregate remuneration paid to all officers, directors and principal holders of securities as a group. (10 CCR § 260.112)
- ❑ If selling stock: Statement in tabular form the voting securities of the issuer owned of record or beneficially by each person who owns of record or is known by the applicant to own beneficially more than 10 percent of the outstanding securities of any class of voting securities. The statement should reflect the respective amounts and percentages owned either beneficially or of record by each person and such statement should also include information as to the amounts held by, and the terms of, any voting trust or similar agreement with respect to more than 10 percent of the outstanding securities of any class voting securities of the issuer. (10 CCR § 260.112)
- ❑ If offering debt securities (i.e., asking for loans, not selling stock): A copy of the trust indenture or other instrument pursuant to which the debt securities are to be issued. (10 CCR § 260.112)
- ❑ A calculation based upon earnings history during the past three years demonstrating the ability of applicant to meet the proposed dividends, interest and signing fund requirements on all senior securities outstanding and proposed to be outstanding.
 - ❑ In cases where the ability to meet those requirements depends upon future earnings, include calculations of such future earning capacity together with supporting evidence to demonstrate reasonable certainty such future earnings. (10 CCR § 260.112)
- ❑ The Consent to Service of Process (CCC § 25165 and 10 CCR § 260.113)

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- A Customer Authorization of Disclosure of Financial Records Form (Form No. QR 500.259). (10 CCR § 260.113)
- Application shall be reviewed and signed by an authorized officer (or power of attorney). (10 CCR § 260.110.2)

Documents that Should Already Exist, to be Included with the Application:

- Articles and Bylaws of Corporation (or analogous documents). (10 CCR § 260.113)
- A copy of any contract made or to be made by the issuer affecting any of the rights, preferences, privileges or transferability of the securities. (10 CCR § 260.113)
- Financial statements of the issuer and any other business involved in this transaction as required by CCR Title 10 § 260.613 which generally:
 - require a balance sheet as of a date within 90 days prior to the date of the application and statements of income and statements of cash flows for each of the three fiscal years preceding the date of the balance sheet and for the period, if any, between the close of the last fiscal year and the date of the balance sheet.
 - must be organized per generally accepted accounting principles.
 - may need to be audited or reviewed by a CPA firm, or simply certified by an officer or principal of the business depending on the circumstances (DBO has some discretion).

Notes on Submitting Your Application:

- Application materials should be submitted on single sided paper. (10 CCR § 260.110.1)
- If any material information changes after the application is submitted, then the application will need to be amended. (CCC § 25160)
- It is unlawful for any person willfully to make any untrue statement of a material fact in any application, notice, or report or willfully to omit any material fact when submitting applications to the DBO and when discussing the offering with any potential purchasers. (CCC § 25166)
- Application must disclose any adverse order, judgment, or decree entered in connection with the offering by any securities regulatory agencies or any court. (CCC § 25160)

Additional Requirements May Apply To the Following:

- Applications submitted in conjunction with the Small Company Offerings exemption via SEC Rule 504. (see CCC § 25113(b)(2))

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- ❑ Businesses with stock options, stock bonuses, or warrants must disclose detailed information about such options. (see 10 CCR § 260.112)
- ❑ Real estate programs whose primary purpose is “the investment in, operation of, or receipt of gain from an interest in real property.” (See Title 10 CCR § 260.140.110 et seq)
- ❑ If anyone other than officers, directors, or management or the business, or licensed broker-dealers, are to be employed in connection with the sale of securities in California, there are additional rules detailed in Sections 260.112, 260.141.30 and 260.141.31 of Title 10 of the California Code of Regulations.

DIRECT PUBLIC OFFERING: CALIFORNIA AGRICULTURAL COOPERATIVE EXEMPTION

Under federal law and in California, agricultural cooperatives are broadly exempt from securities registration requirements. California law exempts "any security" issued by a corporation organized under California's agricultural cooperative law.²³ See pages 36-37 for details on the purposes and structure of agricultural cooperatives exempt from securities permits under California law.



For many reasons, farmers may find it advantageous to organize an enterprise as a California Nonprofit Cooperative Association, or to join an existing such enterprise, which is typically organized as a group of farmers who pool resources to access distribution infrastructure, equipment, or to hire professionals to brand and market their products so that the farmers can focus on running their own farm business.

Under the securities exemption for agricultural cooperatives in California law, securities may be offered to the public in California, not just members of the cooperative, without a permit from the DBO. As with other exemptions, farmers-members of agricultural cooperatives should be aware of the general requirements to disclose all material facts and risks to prospective investors. It's still typically a good idea to work with an attorney on securities offering documents before beginning a securities offering, even if the offering is exempt from permit requirements. The checklist of offering materials to assemble for an application for a permit from the DBO on the preceding pages is a useful checklist even for agricultural cooperatives exempt from the permit requirements. Just a few materials on the checklist such as the check for the permit application fee and the generic cover pages are not applicable for an exempt offering. Farmer-members using this exemption would typically want to present essentially the same information and disclosure materials directly to members of the public who might invest as they would to state regulators.

²³ California Corporations Code § 25100(m).

DIRECT PUBLIC OFFERING: CALIFORNIA GENERAL COOPERATIVE EXEMPTION

Other types of cooperatives, such as worker cooperatives and consumer cooperatives, can also sell securities in California without a permit, but only up to \$1,000 per person and the security must be a membership or a share in the cooperative, such as a “community investor” share, as described on pages 37-38.

CONSIDERATIONS ON USING DPOS TO PURCHASE LAND

In California, there are additional rules for DPOs conducted for “real estate programs” where the investment is in real estate as a form of investment, but not where there is real estate purchased or leased for purposes of a business to be operated out of that real estate. In most cases a farm enterprise may use some or most of its DPO funds for real estate purchases or improvements without triggering the need to comply with the additional real estate rules. However, an enterprise seeking to raise funds for the purchase of farmland or other real estate as a means of investment by itself, without a business plan for an actual farm enterprise may be considered a “real estate program” and need to comply with the special real estate rules. The real estate rules begin at 10 CCR §260.140.110. When in doubt, this is a matter to discuss with an attorney.

CALIFORNIA DPO BY PERMIT VERSUS JOBS ACT (TITLE III) REGULATION CROWDFUNDING

| | California DPO by Permit | JOBS Act Title III Crowdfunding via Web Portal |
|-------------------------------------|---|--|
| Maximum amount you can raise | Depends on federal exemption used - there may be no limit or it may be \$5 million. | \$1,070,000 |

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| | California DPO by Permit | JOBS Act Title III Crowdfunding via Web Portal |
|---|--|--|
| Maximum per investor | Regulators often impose a limit of \$2,500 per investor, except for investors who have either a) greater than \$50,000 annual income and greater than \$75,000 net worth OR b) greater than \$150,000 net worth. | <ul style="list-style-type: none"> For investors whose annual income or net worth is less than \$107,000, the cap is the greater of (1) \$2,200 or (2) 5% of the lesser of the investor's annual income or net worth. For investors whose annual income and net worth are equal to or greater than \$107,000, the cap is 10% of the lesser of the investor's annual income or net worth. |
| Offering period | 12 months | The maximum offering amount and investment amounts are all based on the preceding 12-month period, but shorter timeframes may be imposed by the web portals |
| Open to non-accredited investors? | Yes | Yes |
| Fees | California Department of Business Oversight charges a fee of \$200 + 1/5 of 1% of value (\$2,500 max) | Web portals charge fees. Fees vary by platform; approximately 4% to 10% of funds raised. |
| Can you discuss directly with investors? | Yes | All communication about the offering must be done through a regulated web portal, except for statements to the effect of "Our organization is raising funds. See _____ [URL or platform name] for more information." |
| Escrow or impound account requirements | At the discretion of regulators - depends largely on whether there is a minimum amount of money that must be raised to successfully meet the goals described in the offering. | Raises through Regulation Crowdfunding require the use of an escrow account, money raised during the campaign will be returned to investors if the target raise is not reached. Web portals provide this service. |

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| | California DPO by Permit | JOBS Act Title III Crowdfunding via Web Portal |
|---|---|--|
| Audited or reviewed financials required? | At the discretion of regulators - usually not. | <ul style="list-style-type: none"> • Raising less than \$107,000 -financial statements • Raising more than \$107,000-but less than \$535,000-financial statements reviewed by an independent account • Raising more than \$535,000-reviewed financials if first time under Reg. Crowdfunding; audited financials if previously sold under Reg. Crowdfunding |
| Timeline once offering materials are created | California Department of Business Oversight can take weeks or months to respond to an application. Once they respond, they may respond with questions or they may respond by issuing a permit. | Offering materials may need to be approved by the web platform used, but this should typically happen very quickly. |
| Accepting payments | You must accept checks from investors or set up an online payment processing system, which may take additional fees. | Payment processing typically included in web portal fees. |
| Any Restrictions on Resale? | At the discretion of the regulators. There may be resale restrictions in the federal exemption used. | Yes. Generally securities sold in a Regulation Crowdfunding transaction can <u>not</u> be sold for one year, except under certain situations. |
| Any Additional Required Filings with CA Regulators and/or SEC? | <ul style="list-style-type: none"> • CA-Semi annual reports are required for 18 months after the permit is effective • SEC-Depends on what federal securities law exemption you rely on. For example, if you use the nonprofit exemption then there won't be. But other exemptions, such as a Rule 504 exemption, requires a Form D | Yes. Some portals generate and file some of these forms. <ul style="list-style-type: none"> • Form C • Form C-U (updates on progress) • Annual Report, Form C-AR |

TIPS ON APPROACHING POTENTIAL INVESTORS

Most of us do not think about our friends, family, colleagues, customers, neighbors, and other people in the community as investors, but many of them are, or would like to be investors. It may seem scary to approach these people for money, but many of them might feel honored to be invited to participate in your farm as an investor! Here are some tips we've learned from small farm and food enterprise owners and their community investors:

- Personal connections are key in raising community capital. Set up farm tours, dinner parties, or other events where investors can become familiar with the business and with the individuals behind it.
- Set up one-on-one meetings over coffee or lunch or beer, or set up personalized tours of the farm with individuals who are likely to invest a substantial amount. Let them know in advance that you intend to discuss a possible investment deal during the meeting to avoid catching anyone off guard.
- When inviting someone to a meeting or to consider investing, if you are unsure of their level of interest, it's perfectly OK to let them know that upfront and to make it clear that it's OK to decline the invitation. There is no need to use pushy salesmen tactics.
- It often takes multiple points of contact to bring someone on as an investor – many investors will require several nudges to make the final decision to invest. This is not typically a decision made on impulse. Make time to follow-up with all prospective investors after any meeting, or other form of communication.
- Increasingly, investors are looking for alternatives to global stock markets, and some are joining local investment clubs such as Slow Money networks, Local Investing Opportunity Networks, and other similar groups. Find out if any such groups exist in your region and get in contact. Different groups have different criteria for what it takes to be invited to “pitch” or make any sort of presentation at a gathering. You may need to attend multiple meetings in order to be eligible to present your investment opportunity to the group, and in order to develop relationships with members of the group. Some of these groups have some meetings for investors only, so learn about how your local group works and then get involved.
- Remember that Slow Money and other forms of grassroots finance are not fast money: raising money from individuals through personal networks, community groups, and online networks takes time so be prepared to be in fundraising mode for many months or even over a year.

- Many small food and farm enterprises raise money over multiple rounds of investment during multiple stages of development. Don't be discouraged if your ultimate fundraising goal seems out of reach at the beginning. Figure out how you can get going on a smaller scale with less capital, and work from there.
- As you develop your business plan, experience, and track record, your business becomes more attractive to prospective investors.
- Think about your own journey to the work you do, or would like to do, on your farm and what motivates you to do it. Practice your storytelling skills, and work on developing a strong story about your personal journey as a farmer. Most local economy investors will be compelled to make an investment based on your story and personal connections more than legal documents (although clear and well organized legal documents can help avoid problems down the road!).
- Prior to determining your securities law compliance plan, you should not solicit investments from individuals (especially if you might apply or are in the process of applying for a permit to sell securities). However, at any point in time you can work to get the word out about your farm or your future plans for a farm, and develop a larger network of supporters. In advance of any offering, it will help to grow your mailing list or social media following as early as possible. Attend community events. You can always work to develop name recognition, trust, and a network of supporters.
- Be patient and be persistent!

CORPORATIONS AND LLCs

WHY FORM A CORPORATION OR LLC?

It's not necessary to form a Corporation or LLC to engage in fundraising, but many attorneys advise it. People form business entities, such as corporations and LLCs, for several reasons. Some do it to limit their legal liability—that is, to limit the ability of outsiders to sue them personally for actions that the business may take. In many circumstances, forming a corporation or LLC will shield individuals from personal liability if the separate business entity is properly maintained and managed. This includes holding meetings as described in the entity's governing documents and maintaining separate books and bank accounts for the business entity. Another primary reason people form corporations or other business entities is to facilitate getting investments (or in the

case of nonprofit corporations, to facilitate getting grants). Corporations were originally created to facilitate structuring investment deals and shared ownership in an enterprise to enable the establishment of enterprises so large that one, or even a few individuals, would not be able to finance it alone. Corporate law provides legal structures that help to establish investor rights, profit allocation, and decision-making processes when multiple investors are involved in a business.

CORPORATIONS VS. LLCs

Limited Liability Companies (LLCs): A limited liability company is a flexible form of enterprise that blends elements of partnership and corporate structures. LLCs are popular for small businesses because, similar to a corporation, LLC owners (called members) have limited personal liability for the debts and actions of the LLC. Resembling a partnership, however, LLCs by default have pass-through taxation (meaning the LLC's profits and losses are passed through to its owner/members who incur most of the LLC's tax burdens.) And like partnerships, LLCs do not need to adhere to corporate formalities such as electing a board of directors, appointing officers, holding regular board meetings, and keeping formal minutes of board decisions. LLCs can, however, elect to be taxed as corporations. So the key distinguishing feature of an LLC is that it need not have a board of directors or follow corporate formalities. Similar to Corporations, LLCs are formed by creating organizing documents and filing them with the state. In the context of an LLC these documents are called articles of organization and operating agreement.

Corporations: To form a corporation, one must file articles of incorporation with the state, create bylaws, hold elections for a board of directors and hold annual meetings for shareholders which follow the meeting notice requirements prescribed in corporate law. Directors of corporations have certain fiduciary duties that require them to manage the corporation in the best interests of shareholders (or in the interest of the organization and furthering its purposes, if a nonprofit corporation where there are no shareholders). A corporation is viewed as a separate legal entity, distinct from its owners, who are called shareholders. Because it is a separate entity, a corporation is able to incur its own debts and liabilities and the owners (the shareholders) are, with some exceptions, shielded from personal liability for the acts, debts and other liabilities of the corporation. By default, corporations are taxed separately from their shareholders, resulting in taxation that is known as the "Corporate Double Tax" whereby profits made by the corporation are taxed at the corporate level, and then dividends paid to shareholders are additionally taxed. However, certain corporations with few shareholders may be eligible for pass-through taxation. In addition to general corporations, California law has numerous special types of corporations, some of which are described below.

California Nonprofit Cooperative Association Corporations (“NCACs”) (commonly known as “agricultural cooperatives” or “producer cooperatives”)

Three or more people, a majority of whom are residents of California, may form this type of cooperative for any of the following purposes:

- (a) The production, marketing, or selling of the products of its members.
- (b) The harvesting, preserving, drying, processing, canning, packing, grading, storing, handling, shipping, or utilization of any product of its members, or the manufacturing or making of the byproducts of any product of its members.
- (c) The manufacturing, selling, or supplying to its members of machinery, equipment or supplies.
- (d) The financing of the activities which are specified by the purposes listed above.
- (e) Any combination of the purposes listed above.²⁴

This type of cooperative can be set up to sell products that can include horticultural viticultural, aquacultural, forestry, dairy, livestock, poultry, bee, or farm products.²⁵ It must primarily use its resources to reduce operations costs for its members and otherwise engage in furnishing services or facilities to its members.²⁶ These cooperatives may only admit as members, or issue common stock (i.e. voting stock) to people who are 1) engaged in the production of a product which is to be handled by or through the association, or 2) that use or employ any service or facility offered by the association (including people leasing land from the association).²⁷ It can otherwise have non-member investors.

In addition to the general provisions that must be included in articles of incorporation, a NCAC’s articles must expressly identify the corporation as a Nonprofit Cooperative Association Corporation.

Advantages of Nonprofit Cooperative Association Corporations: An NCAC can sell securities to its members and to the general public in California without first qualifying for a permit from the

²⁴ California Food and Agricultural Code § 54061.

²⁵ California Food and Agricultural Code § 54004.

²⁶ California Food and Agricultural Code § 54179.

²⁷ California Food and Agricultural Code § 54231.

Department of Business Oversight. This could result in very significant cost and time savings for farm enterprises that would like to advertise to and raise money from the general public. Additionally, they may qualify for advantageous tax treatment under Internal Revenue Code Section 521.

California Worker Cooperative Corporations

One significant difference between a cooperative corporation and a general corporation is that cooperatives have one vote per member. This contrasts with general corporations where voting rights are generally proportional to the amount of money a shareholder has invested in the company. Another significant difference is the way that a cooperative distributes its net income. While a general corporation distributes profits to the shareholders on the basis of the number of shares held, in a cooperative, surplus income is distributed to members on the basis of the value or quantity of each member's patronage, or contribution. In a consumer cooperative, for example, a member who has made a greater number of purchases will receive a larger patronage dividend. And in a worker cooperative, a member's patronage dividend is proportional to the labor provided by that member (which can be calculated in a number of different ways, such as proportional to salaries, wages, or number of hours worked, among other factors).

Worker Cooperatives in California may be formed under the Cooperative Corporation law found in the Corporations Code beginning at Section 12200. Cooperatives under this law are characterized by the hallmark one member; one vote structure. This law does, however, allow for multiple classes of memberships and voting powers may be different for each class of membership.

Advantages of Worker Cooperative Corporations: Worker cooperatives are increasingly recognized as a business structure designed for worker empowerment. With growing awareness of farm labor issues, worker cooperatives in the food and agriculture industries stand out as promising models. Further, in California, worker cooperatives may publicly sell memberships or limited voting shares to "community investors" up to \$1,000 per person without a securities permit.

Legal and Tax Guides on Cooperatives

Income Tax Treatment of Cooperatives, 2013 Edition from USDA Rural Development - Business and Cooperative Services. Cooperative Information Report 44, Part 1. Available at <https://www.rd.usda.gov/files/cir44-1.pdf>.

Sustainable Economies Law Center's Cooperative Law "library" available at <http://www.co-oplaw.org>.

Nonprofit Public Benefit Corporations

There are many types of nonprofit organizations in California, and the Public Benefit Corporation is just one type. Farm enterprises should only form as nonprofit organization when the goal of the enterprise is not to provide profits to one or a few individuals, but rather, to serve the broader community or the general public. Farm enterprises hoping to secure tax-exempt status under Internal Revenue Code Section 501(c)(3) or other provisions should consult with an attorney with expertise in nonprofit organizations since there are limited business activities that may be conducted by tax-exempt organizations. While there are some tax-exemptions specifically designed for certain agricultural enterprises, farm enterprises are generally not well suited for nonprofit structures, unless the farm is established for education and training purposes, or under other special circumstances. There are numerous examples of urban farms and community gardens formed as various types of nonprofit organizations that rely on volunteers, grants, and/or donations. These organizations typically have charitable or education-oriented missions and activities.

Advantages of Nonprofit Corporations: Nonprofits with 501(c)(3) tax-exempt status are eligible for foundation grants. Those and other types of nonprofits are exempt from income tax.

CASE STUDIES OF FARMERS USING GRASSROOTS FINANCE

Capay Valley Farm Shop, FarmOrders B2B / Food Hub, Esparto, CA

Capay Valley Farm Shop ("Farm Shop") began in 2007 when farm families and community members who cared about the local agricultural economy came together to fund a specialty foods

market near the Capay Valley that would source products directly from their local farms. The business plan evolved into a multi-farm CSA where produce boxes were delivered to customers throughout Northern California. In 2012, the Farm Shop began offering "FarmOrders" for institutional buyers such as online retailers, tech companies, universities, and other institutions with large cafeteria orders to fill. Eventually, in 2016, the CSA ended as the success of the "FarmOrders" continued. Capay Valley Farm Shop today focuses on the "FarmOrders" which involve helping its farmer suppliers with packaging, transportation, and storage facilities.

Over the course of its business development, the Farm Shop has used several different creative financing strategies, many of which relied heavily on relationships with friends and customers.

One phase of fundraising involved a Kiva Zip campaign which raised \$5,000 by collecting tiny loans from 100 different people around the world. These tiny loans, as is typical of Kiva Zip loans, are zero interest loans. Thomas Nelson, a co-founder of the Farm Shop, pointed out some advantages and disadvantages to Kiva Zip campaigns: "It's obviously great to get zero interest loans and it feels very encouraging to get financial support from so many different individuals, however, there is still a cost to this financing strategy because it typically requires time intensive outreach to lots of individuals, so the amount of effort per dollar received is quite high."

The Farm Shop applied for a USDA local food promotion grant which they received in 2014 to lease a refrigerated truck, purchase a walk-in freezer, and conduct food safety training. This was a very useful form of funding, since it was a grant, not a loan or other investment that needed to be repaid. Nelson noted, however, that the application process for this grant was very time consuming: it took two people and a combined 40 hours to apply. In addition, after the grant funds were received, extensive bi-annual progress reports had to be prepared and submitted to USDA.

The business also received two institutional loans to buy trucks: one from a customer food distribution company, Good Eggs, and one from the nonprofit revolving loan fund, RSF Social Finance. Loan funds such as RSF typically have stricter criteria than individual investors, so this loan was only possible after the business was in a more mature stage and seeking growth capital.

Finally, the Farm Shop was one of the early recipients of investment from members of Slow Money Northern California. Nelson worked with a group of Slow Money investors to discuss the business plans and possible terms of an investment deal. Next there was a period of time for "due diligence" when investors learn about the business and assessed the risks and merits of the

investment deal, before deciding whether to invest. That process yielded a group of five individuals who made equity investments in the Farm Shop totaling \$80,000. These funds were used to move to a larger facility. Slow Money members made equity investments in the business but were only eligible for dividends when the business was able to pay dividends. The process from the initial contact with Slow Money Northern California to the day investors wrote checks took close to a year. Nelson said he is grateful that Slow Money members see their investments as long term investments, and accommodate the capital needs of a growing business by agreeing to invest on flexible terms. He also said it was great to build relationships with these investors, even though it took a considerable amount of time.

Another important benefit of working with Slow Money members was the alignment of values among all parties involved. Nelson thought that this alignment of values was critical in every decision made by his business to accept money from investors, both institutions and individuals. The Farm Shop is dedicated to working with farmers, ranchers, and food producers within 20 miles of their food hub in Esparto. Most of their fresh fruit and vegetable farms are certified organic and their ranchers raise animals with ample access to pasture, among other good environmental stewardship practices. Investors in the Farm Shop are generally similarly passionate about local and sustainable agriculture, which facilitates mutually beneficial investment deals.

Some additional words of wisdom about financing for beginning and growing farm enterprises from Thomas Nelson:

- Limit the amount of money that you borrow up front. Be conservative with your projections. It's good to boot strap up front to avoid involving friends and family in excessive risk.
- As you develop confidence in your business, it will be easier to instill confidence in your investors.
- Don't be shy about being creative about financing. It's not just friends and family who want you to succeed, but also your customers.
- Be cautious about borrowing money for new equipment. Make sure you can afford the debt service.
- As you gain experience, maintain a business plan. Business plans always evolve, but keeping a business plan updated is a great way to clarify your thinking about where you are going with your business, and it helps communicate with potential investors.

Farm Fresh To You, Multi-Farm CSA, Capay Valley, CA

Farm Fresh To You (FFTY), also based in the Capay Valley in Yolo County, has a unique fundraising story. It is the only agricultural enterprise in California in recent memory to raise funds by a Direct Public Offering after obtaining a permit from the California Department of Business Oversight (described on p--).

FFTY operates multiple organic farm sites around California totaling 1,000 acres of farmland and distributes produce around California to CSA customers as well as institutions. The enterprises owns a 20,000 sq. foot warehouse in Sacramento, leases distribution warehouses in San Francisco, Los Angeles, San Diego, and elsewhere.

FFTY first received a permit to conduct a public offering of securities in California in 2012 and has renewed its permit numerous times since then. With each renewal, the business has raised hundreds of thousands of dollars for working capital for its numerous farm sites, warehouses, and distribution equipment. It is owned and operated by three brothers who grew up on a farm in the Capay Valley. Their farms use organic farming practices. Their multi-farm CSA delivery box gives customers many choices from a large variety of fresh produce.

During the course of its multiple Direct to Public Offerings, FFTY has doubled its number of customers up to 80,000. The company advertised its DPO as a "Green Loan" offering members the opportunity to "Invest in your food system" and to receive interest payments in the form of cash or in the form of produce deliveries. Brochures used to advertise the loan opportunity have described it as an "alternative investment to industrial finance." Minimum investments per investor are typically \$2,000 and maximum investments are \$50,000. Investors must make a minimum 15 month commitment and received a variable interest rate ranging from 1.5% above the LIBOR rate²⁸ to 3% above the LIBOR rate, depending on whether they choose to receive interest payments in produce or cash.

Farm Fresh To You is an example of one of the larger enterprises in the food and agricultural sector that has used grassroots finance. By leveraging consumer enthusiasm for local and organic food, it was able to raise nearly \$2 million in patient capital over several years to grow its farm enterprise.

²⁸ LIBOR stands for London Interbank Offered Rate and represents an internationally recognized minimum interest rate used by banks, and the rate fluctuates based on economic conditions.

New Hope Farms, Worker-Owned Cooperative Farm, Pinole, CA

New Hope Farms was established in 2014 on five acres of hilly grazing land owned by the East Bay Municipal Utilities District. The farm is owned as a cooperative of three founding members, with a few more worker-members on course to join the cooperative as new worker-owners. New Hope is one of a handful of worker-owned cooperative farms in California. While cooperatives are quite numerous in the agricultural industry, most agricultural cooperatives are producer-owned cooperatives. In a producer-owned cooperative, a group of independently owned and operated farm businesses come together as a cooperative to distribute their combined agricultural goods. The decision-makers in producer-owned cooperatives are typically a group of farm owners (or producers of other goods) who may employ many workers who have little say in the management of the cooperative. In contrast, the decision-makers in a worker-owned cooperative such as New Hope Farms, are the worker-owner farmers who work the land, and share in the risks and profits of the farm business.



New Hope Farms began fundraising with a Kiva Zip campaign that raised \$10,000 in zero interest loans. The campaign results exceeded their expectations after a wealthy individual who is passionate about sustainable agriculture, tweeted about the campaign and offered to match any small contributions made by others.

Next in terms of fundraising strategy was engaging with the Slow Money / Local Investing Opportunity Network in the South Bay where they built relationships with investors interested in local food and farming enterprises. Over the course of a year they got to know each other and agreed with several investors upon terms for loans to the farm cooperative totaling \$25,000. The funds raised through Kiva Zip and Slow Money investors was used for irrigation, fencing, rent, tractors and other tools. Only minimal compensation has been paid to worker-owners to date, as this is still a very young farm enterprise.

One founding member, Hank Herrera, emphasized that this fundraising strategy was very slow, but it has been working quite well due to the flexibility and generosity of the investors. And he notes

that developing relationships with individual investors, who are passionate about local and sustainable agriculture, has been very enjoyable.

New Hope Farms is hoping to conduct a Direct Public Offering someday, to raise additional capital for on-farm infrastructure and for infrastructure for a distribution network to get more food to more customers. New Hope's mission is to provide fresh, healthy, and affordable food for vulnerable communities. Its worker-owners envision developing the business into a larger network of cooperatively-owned farms and grocery stores serving East Bay communities that currently lack access to affordable, healthy, local food.

Additional words of wisdom for beginning farmers from Hank Herrera include these:

- There is wisdom in starting small - starting with even as little as a quarter of an acre may be a smart strategy.
- There is wisdom in getting the right training (a farm apprenticeship for example). The person taking over the production role at New Hope spent two years in a farm apprenticeship, and is now teaching the others about key aspects of farming.
- A beginning farmer needs to think carefully through their business plan.
- Read Elizabeth Henderson and Robyn Van En's book on CSAs *Sharing the Harvest: A Citizen's Guide to Community Supported Agriculture*.

HYPOTHETICAL EXAMPLES OF FARM ENTERPRISES COMPLYING WITH SECURITIES LAW

These are examples of hypothetical farm enterprises using various combinations of state and federal securities law compliance steps to successfully raise funds. For brevity and simplicity, they do not reflect all the nuances of real life scenarios. These examples are provided to help explain the applications of various combinations of federal and state securities law compliance options.

Beginning Farmer Annie

Annie is a beginning farmer leasing land for growing fruits and vegetables, which she sells in her town's farmers' market. She could use some capital to purchase seeds and starts for next year's plantings. Annie decides to ask a few friends, family members, and customers to each loan her \$1,000 to \$3,000, for a total of \$15,000.

How can this be exempt from Federal registration?

Either of the intrastate exemptions (see pages 14-15) would likely apply if Annie's farm business is based in California and she does not cross any state lines to reach the farmers' market or other customers. Depending on her prospective investors, Rule 506(b) might be another option.

How can this comply with California securities law?

If Annie has a pretty substantial prior relationship with all the friends, family, and customers she solicited for money, or if they are accredited investors, or if they have substantial business or investing experience, then Annie's soliciting is exempt from permit requirements under California's friends and family exemption in Corporations Code Section 25102(f) (see pages 21-22), which still requires filing a simple notice form with the California DBO. Note that a typical business owner's relationship with a casual customer probably doesn't meet the prior personal relationship standards to use the prior relationship prong of the "friends and family" exemption in 25102(f) but some customers might meet it. If the customers solicited were accredited investors or if they have sufficient business or investing experience then this would enable use of that section. Another exemption she could use, since she was asking for loans, not selling stock, would be California Corporations Code Section 25102(e) (see pages 21-22), which does not require a notice filing. Using either of these exemptions would require that Annie avoid any "advertising" meaning Annie

would have to privately ask a small number of friends, family, or customers to discuss investment. To lawfully use these exemptions, Annie could not put up a sign advertising an investment opportunity at her farm stand or farmers' market booth, or send out email blasts to her many customers, or otherwise solicit large numbers of people.

Salinas Valley Organic Farm Worker Cooperative

Juan, Natalia, and Gerardo have all been developing their skills as organic farmers and business owners through ALBA's Farm Incubator and Kitchen Table Advisors. A few years ago they came together as farm worker-owners to form a worker-owned cooperative corporation to advance their dream of owning a farm business together. Thanks to a loan from California FarmLink they have been leasing land and growing strawberries and vegetables on it. They are interested in increasing production and capacity to sell to some restaurants and small grocery markets with more regularity. Their friend Cynthia would also like to join the cooperative as a worker-owner, but cash flow on the farm hasn't been strong enough to hire another worker yet. They estimate that they will need \$100,000 for a little working capital as they expand operations.

The worker-owners work with their lawyer to make sure that their corporate documents allow for the inclusion of "community investors" with very limited voting rights in their corporation, and together they craft an offering memorandum describing their goals for bringing on an additional worker-owner, increasing strawberry and vegetable production, and growing their customer base. Then they start to sell "community investor shares" to their customers at the farmers' market. They also learn about a local investing club that meets regularly a few towns away from them, so they start attending those meetings and get invited to present about their farm and their community investor shares offering. During the course of the campaign they hold farm tours and farm dinners for prospective investors who are all California residents. They bring on 100 new investors at \$1,000 each, for a total of \$100,000. The investors know they won't get any dividends for the first few years, but they will get other perks, like fresh strawberries and an invitation to the annual members' party on the farm. These investors are able and willing to be patient with their investment, and they enjoy the benefits of being connected to this growing farm worker-owned cooperative even if the return on investment will be modest and they will have to wait a few years before receiving any monetary returns.

How can this be exempt from Federal registration?

The intra-state exemptions (see pages 14-15) would likely apply.

How can this comply with California securities law?

California has a new exemption from permits for sales of shares or memberships in cooperative corporations up to \$1,000 per individual, so no permit is required for this securities offering in California (see pages 30, 37-38). Remember that this exemption applies for sales of memberships or shares, not loans, and in order to sell shares or memberships in a cooperative (or in any corporation) the corporation's articles must authorize the sale of such shares or memberships. So a review of the corporation's articles and bylaws should be done before using this exemption, and amendments may be required prior to proceeding.

Salinas Valley Organic Farm Worker Cooperative Scales Up

A few years have gone by since the Salinas Valley Organic Farm Cooperative (see above) successfully raised \$100,000. Community investors are starting to get paid modest annual dividends. More customers want to become community investors. Some even ask if they can invest more than \$1,000. Additionally, some restaurants that buy produce from the cooperative also want to buy pasture raised eggs, which can only happen with considerable increase in production and additional investment.

Juan, Natalia, Gerardo, and their new worker-owned Cynthia work with their attorney to apply for a permit from the California DBO to sell community investor shares that start at a minimum buy-in of \$1,000 per person, and can go up to \$20,000 per person. They carefully follow their lawyer's advice and refrain from advertising or selling any more community investor shares until they have received their permit from the DBO. Once they get their permit they begin selling these "community investor shares" and they raise \$300,000.

How can this be exempt from Federal registration?

Again, the intra-state exemption (see pages 14-15) would likely apply assuming that the farm business is based in California and the sales of agricultural products for the most part do not cross state lines, and all the investors are California residents. Another option would be to use SEC Rule 504 (see pages 16-17) and file a Form D with the SEC, since the cooperative is also applying for a permit from California's Department of Business Oversight, it meets the parameters of Rule 504.

How can this be exempt from California Securities Registration/Permits?

The community investor shares sold under this scenario are not exempt, but they have been properly permitted by the California Department of Business Oversight (see pages 22-28). Note that a California worker cooperative is different from a California Nonprofit Cooperative Association (i.e. producer cooperative) and therefore, the more broad securities permit exemption does not apply here.

New Agricultural Cooperative for Poultry Producers

A group of a few dozen poultry producers in Northern California get together to create their own slaughter and packing facility for their products, because the existing facilities are too far away and don't accommodate smaller producers very well. They estimate they will need about \$3 million to create their facility. Many of the farmers in the group are willing to invest small sums in the creation of the facility and want to be involved in overseeing operations at the facility to ensure it meets their needs. However, the combined capital of the group members is nowhere near \$3 million. They consult a lawyer and form a California Nonprofit Cooperative Association, commonly known as an agricultural cooperative or a producer cooperative, which also qualified for federal tax treatment as an agricultural cooperative. Each poultry farmer purchases a \$5,000 share in the cooperative and has one vote in electing the board of directors. Their attorney helps them craft an offering memorandum to sell nonvoting shares to the general public and the members start advertising to their customers and the general public through signs at farm stands, email marketing, and engaging the press about their campaign to build a poultry facility.

How can this be exempt from Federal registration?

Agricultural cooperatives organized as a California Nonprofit Cooperative Association are typically exempt from registering with the SEC under the agricultural cooperative exemption (see pages 29, 36-38). Other possible exemptions would be the intra-state exemptions (see pages 14-15) but the agricultural cooperative exemption is the most straightforward exemption to apply here.

How can this be exempt from California Securities Registration/Permits?

Agricultural cooperatives organized as California Nonprofit Cooperative Associations are also exempt from permit requirements in California (see pages 29, 36-38).

BANK OF COMMON "RISK FACTORS" IN AGRICULTURE

IMPORTANT NOTE: Your securities offering materials should provide a thorough warning of all of the risks you can think of that are involved in your business and that could affect your ability to pay back investors. The risk factors below are likely to apply to farm enterprises generally, however, your farm enterprise will most likely have unique risks that you must think about and include in securities offering documents. It's generally advisable to work with an attorney on this part of the offering document.

Risks Inherent to Farming: Farm enterprises are vulnerable to many risks related to changing climate and weather which can cause unexpected droughts, crop failures, and other losses. Further, a natural disaster such as an earthquake, fire, flood, or severe storm could cause great interruption to business activities, resulting in less revenue than anticipated.

Food Safety and Other Regulatory Risks: This business is dependent on numerous regulatory permits related to agriculture, food safety, environmental health, land use, and other matters. Laws regulating these matters may change, thus affecting the business in many unpredictable ways. Permits that are necessary to our operation as a farm business may be revoked at any time if a foodborne illness is traced to our farm. The business may be held liable for food safety incidents found to be caused by the farm.

Competition: The market for local food and agricultural products is highly competitive and could become even more competitive. This farm enterprise competes with other similar businesses that provide similar products in the same region and competitors may have greater access to capital, marketing and sales opportunities, and other business development resources. There can be no assurances that this business will be able to compete successfully, and competitive pressures may affect ability to earn profits.

No Crop Insurance: This farm enterprise does not carry crop insurance.

Control of the Business: Control of the business lies solely with _____. Investors must rely upon the business judgment and skills of these owners and any managers they appoint.

Tax Risks: Each prospective investor should seek his or her own tax advice concerning the tax consequences of an investment in this business.

Revisions to Use of Proceeds: Due to the uncertainty and complexity of agricultural enterprises, this business may need to change plans and may need to change the use of proceeds of this offering. If funds raised during this offering are insufficient, the business could experience financial problems including, but not limited to lack of access to sufficient capital on favorable terms and lack of ability to fully execute the business plan. The failure of management to make business decisions regarding the use of funds could have material adverse effects on the business and its ability to repay investors.

Restrictions on Transfer of Securities: There is no secondary market in which these securities may be sold. Therefore, prospective investors should consider this investment as a long term investment.

Key Personnel: This farm enterprise is heavily reliant upon the leadership and skills of a few key personnel such as _____. If the business were to lose any of these key leaders for any reason, the business may suffer.

GLOSSARY

Accredited Investor - An investor who has a minimum net worth or income sufficient to be eligible to be offered securities with less regulatory oversight compared to other investors. See pages 17-18.

California Department of Business Oversight (DBO) - The Department within the California Business, Consumer Services Agency, and Housing Agency that regulates the financial industry and enforces California's securities laws, among other laws.

Capital - Wealth in the form of money or other assets. As used in this guide it will refer specifically to money or assets that are available for investment in a business endeavor.

Community Supported Agriculture (CSA) - A method of enlisting customers to support a farm enterprise, often employed by small-scale organic farms, whereby customers commit to buying from the farm regularly, or paying in advance for products from the farm in order to help finance the farm or help it maintain predictable revenue. See page 13 for discussion on when securities laws apply to CSAs.

Cooperative - A democratically structured business or organization made up of members who might be consumers of the cooperative, producers of goods marketed by the cooperative, or workers who labor for the cooperative. Cooperatives are most often characterized by the principle of one member-one vote, and are often known for additional principles, such as member economic participation and concern for community, among others. Typically, in a cooperative the governance decisions are made entirely by members or by a board elected by the members; however, some "new generation" cooperatives include multiple classes or groups of members, and some have investors with very minimal powers. There are many different types of cooperatives, including:

Agricultural Cooperative - An agricultural cooperative is most often structured as a producer cooperative, although there are other types of cooperatives in the agricultural industry.

Producer Cooperative - A cooperative whose members produce a good or service for the cooperative. Most producer cooperatives in the U.S. are in the agricultural industry, therefore, the terms "agricultural cooperative" and "producer cooperative" are often used as synonyms although the two terms have distinctions.

Worker Cooperative - A cooperative in which the members are workers who labor for the cooperative.

Corporation - A company authorized to act as a single entity by law, typically formed by filing Articles of Incorporation with a state agency. Corporations are formed to carry out many different types of business, charitable, social, and other purposes.

Crowdfunding - The act of raising monetary contributions from a large number of people, typically each individual contributing a small amount, toward an enterprise, organization, project, or endeavor.

Investment Crowdfunding - Crowdfunding by raising money from investors.

Donation Crowdfunding - Crowdfunding by raising money from donors.

Debt - Money that is owed or due. This term is often compared/contrasted with *equity* in terms of capital raising.

Direct Public Offering - The process of offering and selling securities directly to the public without selling through a stock broker, stock market, or other such middlemen.

Equity - The value of shares of stock of a corporation or other applicable enterprise that one owns. This term is often contrasted with *debt* as a structure of a security.

Investor - A person who puts money into a financial scheme involving equity or debt, typically one involving some risk, and expecting a return.

Issuer - A person or business selling securities. In other words, the term use in securities laws to refer to a person or business raising money by selling securities.

Limited Liability Company (LLC) - A company authorized to act as a single entity by law. Often compared/contrasted to a corporation, LLCs were created in part to act as a less rigidly structured business entity to provide a more flexible alternative to the corporation.

Loan - A sum of money (or other thing of value) that is borrowed, and must be repaid. While that money is borrowed it is called *debt*.

Note - A document representing debt.

Prospectus - A document that describes a securities offering.

Risk Factors - A list describing all of the risks involved in a particular securities offering. Its purpose is to inform prospective investors.

Risk Capital Test - A legal doctrine created by a California case known as *Silver Hills Country Club v. Sobieski*, that established a criteria for determining whether a capital-raising scheme meets the definition of a security, wherein the court concluded that whether investors are putting money at risk can be a factor in determining whether a transaction should be considered a security (even when those investors do not expect a profit from their investment).

Security - A loan, note, evidence of indebtedness, stock, share, or other document or instrument representing an investment. See p -- for a much more detailed discussion of the definition of a security.

Securities Offering - An act of making an offer to sell securities.

Shares - See stock.

Stock (Shares of Stock) - A paper, written record, or other agreement representing an ownership interest in a corporation. Sometimes stock owners have voting rights in the corporation and sometimes they only have rights to monetary gain in the event that the corporation meets certain profit goals.

Partnership - A business enterprise organized by two or more individuals ("partners"), as used in this guide, an unincorporated business entity.

Private Offering - A securities offering made to targeted individuals or entities without general advertising. See page --

Public Offering - A securities offering made to the general public, typically involving advertising of the offering, such as through newspaper/radio/TV/social media promotions, holding events, mass email/mail announcements, flyers, and/or word of mouth.

Securities and Exchange Commission (SEC) - The federal agency that enforces and implements securities laws.

SAMPLE LOAN AND ISSUES TO CONSIDER

The decision on whether to structure securities as shares of stock in an enterprise or as loans is an important financial decision for a farm enterprise. Some business owners and investors alike may prefer shares because shares of stock facilitate payment to investors dependent on how lucrative the business is from year to year so investors really share in the risks and rewards of the business. Sometimes shareholders are also entitled to a vote in the board elections of the corporation (but not always). Sometimes investors and small business owners alike prefer loans (also known as “notes” “promissory notes,” or “debt securities”) because loans typically have a more predictable, agreed upon payment plan, although these agreements can still involve risk for the investor. Typically investors who sign onto a loan contract do not get any decision-making powers in the business. Because simple loans are common among beginning farm enterprises and non-professional investors, we’ve provided a sample loan contract on the next page. The sample is very simple. Be aware that this simple fill-in-the blank template may work in some situations, but in some cases a farmer or investors may wish to develop something more tailored to their unique situation.

Because profitability can be unpredictable during the early stages of a food or farm enterprise, investors may prefer a note that promises a very modest return on their investment, except in the case where the farm business earns profits above a certain level, in which case the investor will get an additional bonus payment. This makes investors feel confident that they, too, will be rewarded for taking a risk, in the event that the enterprise turns out to be very profitable. In these situations, a loan contract can have additional provisions describing a certain threshold of profits beyond which the farm enterprise owes investors a percentage of profits or revenues above the fixed interest rate. The loan template provided here does not provide these provisions because the exact wording would need to be tailored to the situation.

If farmers and investors decide they want a contract that includes a share of profits under certain circumstances, then they should consider the following when drafting a contract:

- What triggers the additional payment? Is it a certain amount of annual profit achieved during the term of the loan? Or does a certain amount of total profit within some other window of time trigger additional payment?
- How will the amount of the additional payment be calculated? Is it a percentage of profit? A percentage of revenue? Or some calculation?
- How will “profit” or “revenue” be defined? Will there be limits on expenses that the business can incur that could affect calculation of profit?
- When will the additional payment be due?
- What types of financial statements will be provided to investors?
- Will financial statements need to be reviewed or audited by an accountant?

PROMISSORY NOTE

_____ ("Farmer") is a farm enterprise.

_____ ("Investor") intends to loan money to Farmer.

Farmer and Investor wish to clarify the terms of the repayment of the loan described in this Promissory Note ("Note"), as follows:

1. Promise to Pay: Farmer, for value received, hereby promises to pay to Investor, at the address listed above Investor's signature at the end of this Note, or a substitute address if provided by the Investor, a sum of:
 - a. \$_____ (the "Principal"), due ___ years from the signing of this agreement, plus
 - b. ____% annual interest, without compounding, due within ____ days of each term year.
2. Prepayment: This Note may be prepaid, at any time, in whole or in part, without premium or penalty, as long as any Principal prepayment is accompanied by a payment of interest accrued to the date of prepayment on the amount prepaid. Any such prepayments, to the extent applied to the principal, shall reduce the outstanding principal amount of this Note for all purposes. All prepayments shall be applied first to accrued but unpaid interest and thereafter to the principal.
3. No Early Redemption: No early redemption to Investor will be permitted.
4. Notices: Investor shall notify Farmer in writing at the following address of any changes in address or other notices regarding this Note.

5. Debt Offering: Investor understands this Note represents a loan to Farmer. Investor is not purchasing any part of the farm enterprise. The only return on investment is the interest, and Investor shall have no ability to participate in the management of the farm.
6. No Intention to Resell or Transfer this Note: Investor represents and warrants that he/she/it is accepting this Note for his/her/its own account and not for the purpose of re-selling the Note to someone else. Investor may not assign,

pledge, or otherwise transfer this Note without Farmer's written consent. Subject to foregoing, this Note shall be binding upon and inure to the benefit of the parties' successors and assigns.

7. Amendments: No provision of this Note may be amended or modified unless in writing signed by both Farmer and Investor.
8. Investor Understands the Risks: Investor represents that he/she/it has been informed about the risks associated with this investment, and understands that this is an unsecured, subordinated promissory note.
9. Governing Law: This Note shall be governed by and construed in accordance with the laws of the State of California.
10. Other Terms: This Note shall be subordinated to all indebtedness of Farmer to banks, commercial finance lenders, insurance companies, leasing and equipment financing institutions, or other institutions regularly engaged in the business of lending money. This Note is unsecured and not convertible into any other securities of Borrower.

By signing below, Farmer and Investor agree to the above terms and conditions of this Note.

[investor name]

[investor address]

_____ Date: _____
[signature of investor]

[Name of Farmer or farm enterprise]

_____ Date: _____
[signature of Farmer]

ADDITIONAL RESOURCES

LOCAL INVESTING CLUBS/NETWORKS IN CALIFORNIA

The following is a list of community groups that regularly convene to discuss local investing opportunities. Organizations like these continually form, evolve, and sometimes dissolve. Farmers are encouraged to do their own research on these groups. These groups generally do not have a collective pool or funds to invest, but rather, these groups tend to bring together individual investors and small business owners. These groups are typically volunteer-run or very minimally staffed, and investors who join these groups are typically not professional investors, so farmers should approach these networks with patience. Farmers seeking funds from individual investors are sometimes invited to make presentations about their farm enterprise at network meetings. Some of these groups are particularly focused on directing investment into local and sustainable food and agriculture. Others are interested in a broader range of investments that support their local economy. For tips on approaching investors, see pages 33-34.

Slow Money Northern California

<http://slowmoneynorcal.org/>

Slow Money / Local Investing Opportunity Network South Bay

<http://www.slowmoneysouthbay.org/>

Slow Money San Luis Obispo

<http://slowmoneyslo.org/>

Slow Money Southern California

<http://slowmoneysocal.org/>

North Coast Local Investing Opportunity Network

<http://fundhumboldt.com/local-investing-opportunity-network/>

Lake County Local Investing Opportunity Network / Thrive Lake County

<http://www.thrivelakecounty.org/lion.html>

ORGANIZATIONS THAT PROVIDE FUNDING TO FARMERS IN CALIFORNIA

California FarmLink is a nonprofit Community Development Financial Institution that links farmers and ranchers to land and financing. It provides flexible loans, business management training, and other technical assistance to beginning farmers, especially limited-resource, immigrant, and other underserved farmers.

<http://www.californiafarmlink.org/>

Northern California Community Loan Fund is a 30 year old nonprofit that provides loans to local and regional businesses and nonprofits, and increasingly makes loans to food and farm enterprises.

<https://www.ncclf.org/>

RSF Social Finance is a nonprofit that provides loans to businesses and nonprofits with social missions, including sustainable food and agriculture enterprises.

<http://rsfsocialfinance.org/>

EDFC is a nonprofit Community Development Financial Institution that operates a loan fund for local economic development in Lake and Mendocino Counties.

<http://edfc.org/>

Farmer Veteran Coalition is a nonprofit that provides business resources, grants, and fellowships to returning veterans who are beginning farmers.

<http://www.farmvetco.org/>

California Department of Food and Agriculture (CDFA) periodically has grants available for farms to implement practices related to healthy soils, climate-friendly agriculture, and other environmentally-friendly practices, as well as local food marketing.

<https://www.cdfa.ca.gov/>

US Department of Agriculture (USDA) provides grants and loans for a wide array of projects and business needs, among other resources, including many resources designed for beginning farmers.

<https://www.usda.gov/topics/farming/grants-and-loans>

ORGANIZATIONS THAT PROVIDE INFORMATION, ADVICE, AND TECHNICAL ASSISTANCE TO FARMERS IN CALIFORNIA

Kitchen Table Advisors is a nonprofit that provides practical business advising and connections to sustainable small farms.

<http://www.kitchentableadvisors.org/>

ALBA is a nonprofit that provides training to beginning farmers in managing their own organic farms. The organization's Organic Farm Incubator in the Salinas Valley provides 1/2 acre to 5 acre plots at subsidized rates along with equipment and technical assistance for new farmers to gain hands-on experience managing their own farms.

<http://www.albafarmers.org/>

U.C. Cooperative Extension and U.C. Agricultural and Natural Resources (funders of this guide) are part of the University of California and intended to make information from the university available to farmers across California. UCCE and UCANR provide trainings and workshops, online information, and other resources to educate farmers. Contact your local Cooperative Extension office in your county for more information and resources.

<http://ucanr.edu/>

<http://ucanr.edu/Farming/>

California Center for Cooperative Development is a nonprofit that provides education and resources for cooperative development, including agricultural cooperative formation and management.

<http://cccd.coop/>

Sustainable Economies Law Center (creator of this guide) is a nonprofit that provides legal research, education, advice, and advocacy for just and sustainable economies. The Law Center provides legal advice to creative businesses and organizations, including food and farm enterprises, cooperatives, community groups, and more. The Law Center has many legal guides available on various food and farm law topics.

<http://www.theselc.org>

http://www.theselc.org/food_resources

<http://www.co-oplaw.org>