

THE NEIGHBORHOOD ENTREPRENEUR LAW PROJECT

Our Mission:

The Neighborhood Entrepreneur Law Project (NELP) of the City Bar Justice Center was founded in 2003 to provide legal services to NYC-based micro-entrepreneurs of limited economic resources to help them start their small businesses on sound legal footing.

To date, NELP has assisted over 20,000 entrepreneurs and small businesses and has worked with volunteer attorneys from over 100 different law firms and corporate in-house legal departments to deliver legal services to individuals who see entrepreneurship as a means of creating economic stability for their households and their communities.



LEGAL ISSUES WE ADDRESS

NELP focuses on transactional legal issues relevant to small businesses. These include:

- Choosing and setting up the right business structure (sole proprietorship, partnership, corporation or LLC)
 - Protecting intellectual property rights through trademark and copyright
 - Drafting and reviewing business contracts
 - Helping clients understand their legal obligations as employers
 - Reviewing commercial leases and assisting in lease negotiations
- We do not provide assistance with non-profit entity formation, litigation, collection matters or disputes.



OUR SERVICES

We deliver our services in three ways:

Presentations

- Attorneys discuss topics of interest to entrepreneurs such as:
 - Business Structure
 - Commercial Leasing
 - Intellectual Property
 - Worker Classifications
 - Crowd Funding
- Presentations are open to all entrepreneurs, regardless of income.

Legal Clinics

- Entrepreneurs get on-the-spot legal advice during a 45-minute appointment with an attorney or team of attorneys about their business law issues.
- Clinics are open to all entrepreneurs, regardless of income


Direct Pro Bono Representation

- Entrepreneurs can get full legal representation for a particular issue, such as forming a limited liability company, through NELP. They are not charged any legal fees, but are responsible for any filing fees.
- Direct pro bono representation is only available to those NYC-based entrepreneurs who qualify for assistance in line with NELP's income guidelines.


Contact us for more information or for help:

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Cannabis Business Fundraising 101

Marco Materazzi
Emerge Law Group
November 2022



Today we will cover:

- ▶ **Matching your fundraising plan with your business plan**
- ▶ **Being responsive to investor priorities**
- ▶ **Investment structure basics –**
 - ▶ **Equity vs. Debt**
 - ▶ **Convertible Securities**
- ▶ **Securities law compliance**

Key Takeaways:



- ▶ **The business’s needs and plans should drive its choices for investment structure and investment instruments**
- ▶ **The Fundraising “ask” should be consistent with overall business strategy and narrative**
- ▶ **You need to be able to tell the “story” of your business, and the fundraising ask needs to fit within this story**

Debt vs Equity:

- ▶ **Debt financing = borrowing money from a lender with an obligation to repay the amount loaned plus interest on a set payment schedule. Investor is a creditor, not an owner.**
- ▶ **Equity financing = raising capital by selling ownership shares in the company to investors. Investor is an owner of the company, with a stake in the future earnings.**
- ▶ **An equity investor does not have the right to be repaid, and is last in line to receive money if the company fails.**
- ▶ **But an equity investor has the right to share in the upside of the business**

Varying investor priorities:

- ▶ **Set return on investment**
- ▶ **Right to be repaid in before equity owners**
- ▶ **Security.**
- ▶ **Percentage ownership in the company to share in future earnings and increased company value**
- ▶ **Active role in management**
- ▶ **Right to approve key management decisions**

Varying founder priorities:

- ▶ **Prevent ownership dilution**
- ▶ **Maintain control**
- ▶ **Protect cash flow**
- ▶ **Strategic partnerships**
- ▶ **Find ongoing source of capital**

Business Story 1

- ▶ **Small cultivation business needs \$200k outside investment for start-up expenses, to secure a lease, and to purchase equipment.**
- ▶ **Reasonable projections indicate the company being cash flow positive, with a cushion for emergencies, after this \$200K outlay. No intention to raise further investment funds.**

Business Story 2:

- ▶ **Manufacturing business needs \$200K immediately to secure location and licensing.**
- ▶ **Then, within 6-12 months, the business will need an additional \$1mn to complete the build out, purchase equipment, make hires, and get cash flow position.**
- ▶ **Founder is interested in re-investing profits to expand to additional locations and scale business to increase value**

Which investment plans make sense?

- ▶ **Borrow \$200K of debt financing at 10% interest; repayment over 2-3 years**
- ▶ **Sell an ownership stake in the company for \$200K**
- ▶ **Sell an ownership stake in the company for \$1mn**
- ▶ **Sell convertible note or SAFE for \$200K that will automatically convert into equity at the time of next equity sale**

Convertible Securities

- ▶ Traditionally (but not exclusively) used as a “bridge” to enable company to fund operations before larger equity fundraising
- ▶ Permits parties to delay valuation of the company, which is necessary for an equity offering
- ▶ Permits parties to delay negotiation of full set of investor rights (convertible note holders are typically passive investors, with minimal rights to control management)
- ▶ Accordingly, typically faster and cheaper to finalize than full equity financing
- ▶ Risk of early investment is rewarded with conversion discount and/or valuation cap.
- ▶ Valuation cap and conversion terms can be very dilutive for founders (which can be very expensive in the long run!)
- ▶ Convertible debt bears interest and has maturity date
 - ▶ Gives investors benefit of debt investment (e.g., repayment right; repayment priority)
 - ▶ Company has the obligation to repay (or, potentially, go bankrupt)



SAFEs

vs.

Convertible Notes

- ▶ **SAFE = Simple Agreement for Future Equity**
- ▶ **No interest rate or maturity date**
- ▶ **More standardized, therefore even cheaper and faster**
- ▶ **Created by institutional investors; rights slant towards investors (especially w/r/t founder dilution)**
- ▶ **TAX/Accounting treatment of SAFEs is murky (especially if used by LLC vs. corp)**

Common Equity vs. Preferred Equity

- ▶ **Founders have “common” equity.**
- ▶ **Investors often require equity with certain rights and preferences that are superior to common equity, including**
 - ▶ **Payment priority and minimum rate of return**
 - ▶ **Approval rights**
- ▶ **Gives investor some of the benefits of debt but with the upside of equity**



Working with regulatory ownership restrictions

- ▶ **E.g., Residency requirements; social equity programs**
- ▶ **Convertible securities can be a useful tool**



Securities Law Apply!

- ▶ **Securities offering must be registered with the federal and state securities regulators or be exempt from registration**
- ▶ **99.99% of start-up financings are done via exempt offerings**
- ▶ **Speak to an attorney before publicly soliciting investment (don't solicit investors via social media!)**
- ▶ **Disclosure and transparency with investors is key**