

# EQUITY CROWDFUNDING IN CHINA: CURRENT PRACTICE AND IMPORTANT LEGAL ISSUES

Jing Li\*

## Abstract

*By studying two leading Chinese equity crowdfunding portals, namely, Renrentou and Zhongtou8, this paper provides the very first empirical evidence on the practice and regulation of equity crowdfunding in China. In the case of Renrentou, I examine a hand-collected sample consisting of the investment documentation of the 53 crowdfunding projects that are successfully completed as of June 30, 2016 on the portal. It is found that the utmost task of the contractual terms in these agreements is to secure the investors' right of return. Control on the part of investors is rather minimal, and most of the time only encompasses the basic information and monitoring rights. Although investors are not first pooled to form a new entity before investing, it is still a prevalent practice for projects to commission a third party manager to manage the investment for the crowdfunders and exercise monitoring rights in the project entity on their behalf. In the Zhongtou8 case study, I go beyond the margins of investment contracts and explore the operation of the business with a both broader and deeper view. It is found that, the leading investors of crowdfunding projects are very often served by entities that are in some ways related to the founder of the portal. In addition, the portal is also identified to have financial interests in many projects besides that. While these practices do raise concerns about potential conflicts of interests, the regulatory solutions proposed by the Crowdfunding Measures are nevertheless overly cautious and effectually not enforceable. It is therefore argued that the regulator should rather focus on ensuring effective disclosure from the parties with better information, so that the investors can use it to make effective decisions. Furthermore, by setting down high entry thresholds for qualified investors, the Crowdfunding Measures fail to establish equity crowdfunding as a new financing alternative, but rather create a minimized version of the NEEQ private placement. As such, it would be meaningful for China to consider lowering the investor qualifications and allow crowds to participate, so that equity crowdfunding can grow into a true new alternative for entrepreneurs to avail in addition to existing fundraising channels.*

## INTRODUCTION

As a new alternative for entrepreneurs to raise capital for their new ideas and projects, crowdfunding has surely become a hot topic in the realm of entrepreneurial finance. Among different forms of crowdfunding, equity crowdfunding entails a set of unique legal issues. For the

most part, regulation in the area of issuing securities to the public is found to be the biggest barrier in the growth of crowdfunded equity to date.<sup>1</sup> To the extent that this business model is permitted, regulation typically imposes limits on who can invest in this form of equity, i.e., whether to limit it to sophisticated investors or rather allow participation of the general public, the number of investors allowed to invest, and the size of the company issuing the equity, etc.<sup>2</sup> Given the statutory limitations on the maximum number of shareholders in a private company, bringing in new small investors directly from the crowd can be problematic, as that may result in the limit being exceeded and the fundraiser thus being forced to forgo its private status, which is not necessarily desirable. In addition, it is also challenging to ensure that small crowd investors can still access the basic shareholder's rights, such as the rights of information and monitoring, despite their small ownership stakes. Arguably, rather than straightforward answers, the solutions to these issues would require certain degree of creative legal planning. In the presence of regulatory limitations, syndication emerges as an efficient way of conducting equity crowdfunding. By pooling crowd investors into a financial vehicle which then injects capital into the issuing company, syndication not only helps to bring this business model more in line with the requirements of securities laws, but also effectively reduces the information asymmetry problem,<sup>3</sup> as well as the transaction and negotiation costs for both the entrepreneur and investors.<sup>4</sup>

Notwithstanding its relatively new presence, crowdfunding industry in China is already sizable and maintains exponential growth.<sup>5</sup> In particular, China is the world's second largest regional market (after the US) for financial-return crowdfunding.<sup>6</sup> However, besides the

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\* Jing Li is an assistant professor of the Department of Business Law at Tilburg University, the Netherlands. This paper is accepted for presentation at the 9th Annual Conference of the Academy of Innovation and Entrepreneurship (University of Sydney, Sep. 2016).

<sup>1</sup> Yannis Pierrakis & Liam Collins, *Crowdfunding: A New Innovative Model of Providing Funding to Projects and Businesses* (May 2013) (unpublished manuscript), available at: <http://ssrn.com/abstract=2395226>, at 23.

<sup>2</sup> Eleanor Kirby & Shane Worner, *Crowdfunding: An Infant Industry Growing Fast* (Feb. 2014), IOSCO Staff Working Paper SWP3/2014, available at: <http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf>, at 30.

<sup>3</sup> Ajay Agrawal *et al.*, *Are Syndicates the Killer App of Equity Crowdfunding?* (Feb. 2015) (unpublished manuscript), available at: <http://ssrn.com/abstract=2569988>.

<sup>4</sup> Lars Hornuf & Armin Schwienbacher, *The Emergence of Crowdinvesting in Europe: With an In-Depth Analysis of the German Market* (Aug. 2015) (unpublished manuscript), available at: <http://ssrn.com/abstract=2481994>, pp. 14-15.

<sup>5</sup> Tao Zhang *et al.*, *China Crowdfunding Report*, CHINA IMPACT FUND OF DAO VENTURES, Oct. 2014, available at: [http://www.ied.cn/sites/default/files/CIF%20China%20Crowdfunding%20Report\\_Final.pdf](http://www.ied.cn/sites/default/files/CIF%20China%20Crowdfunding%20Report_Final.pdf), at 11.

<sup>6</sup> Kirby & Worner, *supra* note 2, pp. 14-15.

prevalent practice of syndicating crowd investors into a financial vehicle – typically a limited partnership – to hold equity in the issuer, not much is known about how exactly this industry has managed to maneuver itself through the current securities regulation framework to accomplish all this. What kind of people / entities are acting as the leading investor in the partnership? What is and should be the role of the crowdfunding platforms in terms of drawing in investors and bringing about the syndication? How does such practice of pooling investors reconcile with the 200-shareholder threshold<sup>7</sup> for a company to remain private? And how do investors exercise their economic and control rights *vis-a-vis* the entrepreneur in the issuing company or project entity? Last but not least, how do they exit from the investment? These questions are tremendously pertinent to the end of effective regulation of the industry, but largely remain unanswered due to the lack of data from the market participants.

Having seen such, this paper takes the very first steps into adding important empirical knowledge onto the current research about equity crowdfunding in China. This is done through two case studies. In the first one, I primarily focus on how can the many small crowdfunders properly exercise their investor rights in a non-public firm, where the fundraising campaigner presumably still wants to keep control. What kinds of shareholder / partner rights should be given to these small investors? Can they still expect to have certain amount of control in addition to the rights to know about business operations and expect economic returns? These questions arguably become even acuter when the investors are not syndicated into a separate entity in the first place. As such, I intentionally choose to analyze the investment contracts of the crowdfunding projects where investors are allowed to directly participate in the project entity, so that the pertinent issues can be exposed to their maximum extent. As the best exemplar of such direct investment model, Renrentou ([www.renrentou.com](http://www.renrentou.com)), a leading Chinese equity crowdfunding that has established a reputation in raising funds for all kinds of physical shops in the lines of consumer business,<sup>8</sup> emerges as a great object to be studied. Based on a hand-collected sample of the investment documentation of the 53 crowdfunding projects that are

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<sup>7</sup> Feishangshi gongzhong gongsi jiandu guanli banfa [Measures for the Supervision and Administration of Non-Listed Public Companies] (promulgated by the CSRC, Sep. 28, 2012) (effective as of Jan. 1, 2013), LAWINFOCHINA, available at: [www.lawinfochina.com](http://www.lawinfochina.com), art. 2 (implying that a non-listed company with more than 200 shareholders will be regulated in the realm of public companies).

<sup>8</sup> *Company Profile [Gongsi jianjie]*, RENRENTOU, [http://www.renrentou.com/article\\_37\\_1/](http://www.renrentou.com/article_37_1/). On this webpage, Renrentou claims itself as the oldest, largest and fastest growing equity crowdfunding portal specializing in raising funds for consumer business physical shops.

successfully completed as of June 30, 2016 on this portal, I find that the utmost task of the contractual terms of these equity crowdfunding agreements is to secure the economic right of the crowdfunders, i.e., the right to get return from the investment. Control is rather minimal on the part of investors, and most of the time it only concerns the basic information and monitoring rights, which are put in place apparently for the purposes of safeguarding the economic returns. Although investors are not first pooled to form a new entity before investing, it is still a prevalent practice for projects to commission a third party manager to manage the investment for the crowdfunders and exercise monitoring rights in the project entity on their behalf.

In the second case study, I go beyond the margins of investment contracts and explore the business with a both broader and deeper view. Who are actually the people acting as leading investors, and how are they related to the crowdfunding portal? Can there be any conflict of interests? What kinds of potential exit routes are around there, and what can the investors expect from them? Here, the questions are no longer answerable by examining crowdfunding investment agreements alone. Thanks to the recent effort of Zhongtou8 (<http://www.zhongtou8.cn/>), one of the country's leading equity crowdfunding platforms, to get quoted on China's National Equities Exchange and Quotation ("NEEQ", often more conveniently referred to as the New Third Board, [www.NEEQ.com.cn](http://www.NEEQ.com.cn)), its quotation application materials are available to the public. These documents offer a great opportunity to access important inside information about the industry. It is found that, at least to the extent of the Zhongtou8 case, the leading investors of crowdfunding projects are very often served by entities that are in some ways related to the founder of the portal. In addition, the portal is also identified to have financial interests in many projects besides that. When it comes to exit, NEEQ is the most popular potential venue, both in terms of what has been promised to investors and what has actually happened.

Such findings are analyzed and reviewed in light of the *(Trail) Administrative Measures for Private Equity Crowdfunding (Draft for Comments)* ("Crowdfunding Measures"),<sup>9</sup> which, once officially promulgated, will become the cornerstone regulation for this brand new business in China. While the practices revealed by the Zhongtou8 case study admittedly raise concerns

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<sup>9</sup> Simu guquan zhongchou rongzi guanli banfa (shixing) (zhengqiu yijian gao) [(Trail) Administrative Measures for Private Equity Crowdfunding (Draft for Comments)] (promulgated by Securities Association of China, Dec. 18, 2014), available at: [http://www.sac.net.cn/tzgg/201412/t20141218\\_113326.html](http://www.sac.net.cn/tzgg/201412/t20141218_113326.html).



about potential conflicts of interests, the regulatory solutions proposed by the Crowdfunding Measures are nevertheless overly cautious and effectually not enforceable. It is argued that, rather than requiring a portal to completely refrain from raising funds for itself and its related parties, and from using its informational advantage to obtain investment opportunities and mislead investors, the regulator should set its top priority on ensuring effective disclosure from the parties with better information, so that the investors can use it to make effective decisions. Furthermore, because the most common and realistic exit destination for crowdfunded firms is NEEQ, which is only open to qualified investors, it is not contributing to limit crowdfunding investors also to the same camp. Otherwise, such co-called crowdfunding would be actually not very different than a NEEQ private placement, which is arguable even more effective in raising capital as it is based on a governmental platform. As such, it would be meaningful for China to consider lowering the entry thresholds for investors to participate in equity crowdfunding, which is the case of Europe<sup>10</sup> and also the US in the post-JOBS Act era.<sup>11</sup>

This paper is structured as follows. Section I reviews the relevant literature about crowdfunding. Section II sketches the key market players, describes the prevalent business models, and sheds light on the important legal issues in China's equity crowdfunding practice. Section III presents the Renrentou and Zhongtou8 case studies, and the findings thereof are discussed in view of the Crowdfunding Measures in Section IV. Section V concludes.

## **I. REVIEW OF LITERATURE ON CROWDFUNDING**

According to the research of the International Organization of Securities Commissions ("IOSCO"), "[c]rowdfunding is an umbrella term describing the use of small amounts of money, obtained from a large number of individuals or organizations, to fund a project, a business or personal loan, and other needs through an online web-based platform".<sup>12</sup> In particular, "[e]quity crowdfunding is a method of financing whereby an entrepreneur sells equity or equity like shares

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<sup>10</sup> Hornuf & Schwienbacher, *supra* note 4, at 5.

<sup>11</sup> SEC, *SEC Adopts Rules to Permit Crowdfunding Proposes Amendments to Existing Rules to Facilitate Intrastate and Regional Securities Offerings*, U.S. Securities and Exchange Commission press release 2015-249, Oct. 30, 2015, available at: <https://www.sec.gov/news/pressrelease/2015-249.html>. Note that, before these rules were adopted by the SEC to expand the investor base to general public, crowdfunding in the US were only limited to sophisticated investors, as defined by the US law. See Kirby & Worner, *supra* note 2.

<sup>12</sup> Kirby & Worner, *supra* note 2, at 8.

in a company to a group of (small) investors through an open call for funding on Internet-based platforms.<sup>13</sup> Relative to more traditional financing alternatives such as bank loan or one equity investor, building a community that supports the entrepreneur is a critical ingredient of crowdfunding, which is most often associated with community-based experiences that generate “community benefits” for participants.<sup>14</sup> In other words, crowdfunders are likely to be motivated to provide funding to a company to be connected with an entrepreneurial venture that shares their own values, vision or interests.<sup>15</sup> While angel investors already tend to invest in a wider range of sectors and geographies than venture capital, which normally concentrate on technology-based companies, the investment spectrum of equity crowdfunding can be even broader because the crowd might encompass quite heterogeneous investment motives.<sup>16</sup> Therefore, it can be argued that crowdfunding avails entrepreneurs and startups by mitigating their lack of conventional finance. Moreover, crowdfunding has the potential to act as an innovation and funding escalator, in that a successful campaign helps the startup to raise follow-on financing from various sources.<sup>17</sup> As such, crowdfunding arguably forms an important component of the early stage ecosystem, and thus has potential to open a new market of opportunity, growth, and could help thousands of startups with capital they need to get their business off the ground.<sup>18</sup>

Above being said, there are a number of issues about equity crowdfunding that may raise concerns. Unlike conventional equity investment made into early stage firms, which uses tailored contracts to align the interests of the investor with those of the entrepreneur, equity crowdfunding typically only relies on standardized contracts that are provided by the funding portal.<sup>19</sup> For a small crowdfunder with neither the bargaining power nor the necessary

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<sup>13</sup> Gerrit K.C. Ahlers *et al.*, *Signaling in Equity Crowdfunding* (Oct. 2012) (unpublished manuscript), available at: <http://ssrn.com/abstract=2161587>, at 8.

<sup>14</sup> Paul Belleflamme *et al.*, *Crowdfunding: Tapping the Right Crowd*, 29 JOURNAL OF BUSINESS VENTURING 585, 588 (2014).

<sup>15</sup> Karen E. Wilson & Marco Testoni, *Improving the Role of Equity Crowdfunding in Europe’s Capital Markets*, 9 Bruegel Policy Contribution 1, 5 (2014), available at: <http://ssrn.com/abstract=2502280>.

<sup>16</sup> *Id.*

<sup>17</sup> European Commission, *Unleashing the potential of crowdfunding in the European Union* European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions COM (2014) 172, available at: [http://ec.europa.eu/internal\\_market/finances/docs/crowdfunding/140327-communication\\_en.pdf](http://ec.europa.eu/internal_market/finances/docs/crowdfunding/140327-communication_en.pdf), at 2.

<sup>18</sup> Thomas A. Martin, *The Jobs Act of 2012: Balancing Fundamental Securities Law Principles with the Demands of the Crowd* (Apr. 2012) (unpublished manuscript), available at: <http://ssrn.com/abstract=2040953>, at 32.

<sup>19</sup> Wilson & Testoni, *supra* note 15, at 8. This point is supported by the findings from the Renrentou case study in Section 3.1, *infra*.

professional expertise, it is rather difficult to negotiate over such boilerplate contracts to protect his/her key investment rights, such as those over participation in later rounds of financing, anti-dilution, liquidation preferences, and exit strategies. This, combined with the lack of adequate pre-investment screening and due diligence, and the weak post-investment support and monitoring, can make the risk associated with equity crowdfunding significantly higher than the risk usually borne by business angels and venture capital.<sup>20</sup>

While it is understandable that crowdfunders are largely passive because of the small amount of capital they invest, and such passivity can significantly affect his/her relevant rights as a shareholder of the startup firm, it is still not feasible to simply go all out and let the investor be active. This is because doing so would be too costly for a small firm to manage a crowd of investor that want to participate, especially when considering that the venture has limited ability to select its crowdinvestors.<sup>21</sup> Another serious problem about equity crowdfunding is the lack of secondary market for this type of investment.<sup>22</sup> Typically, feasible exit alternatives for an equity investor in a private firm include selling its stake to investors from further rounds or to a third party acquirer who acquires the firm, or waiting till a public market is available after the firm goes IPO. Although it is no news that the value of equity in a private firm is hard to value thus is highly illiquid, a small crowdfunding investor has much lower tolerance for and the ability of protecting oneself against such illiquidity risk, as opposed to a professional investor such as business angel or venture capitalist. As such, a crowdfunder is prone to dilution resulted from further equity issuances; while the chance of the firm achieving a public float is notoriously low for everyone. This raises concerns about the need for special investor protection for crowdfunders, who are more likely to overreact in times of stressed market conditions or difficult personal circumstances.<sup>23</sup>

Information asymmetry, though a problem ubiquitous in entrepreneurial financing setting in general, can get worse when it comes to crowdfunding, where funders are remote and have limited opportunity to perform due diligence in person with the entrepreneur that raises the

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<sup>20</sup> *Id.*, at 9.

<sup>21</sup> *Id.*

<sup>22</sup> Kirby & Worner, *supra* note 2, at 20.

<sup>23</sup> *Id.*, pp. 36-37.

fund.<sup>24</sup> Moreover, because crowdfunders are largely small and inexperienced investors, they can and do tend to make decisions based on personal biases and persuasive narrative, rather than on financial experience, and such tendency gets exacerbated by social networking aspect of crowdfunding.<sup>25</sup> An example supporting this is that the crowd is subject to herding behavior in the context of funding, such as funders relying heavily on accumulated capital as a signal of quality. Herding behavior can be efficient under certain conditions but lead to suboptimal outcomes in others.<sup>26</sup> As such, the aggravated information problem can significantly increase the cost of creator incompetence, fraud, and project risk on the part of funders, and may even lead to potential market failure.<sup>27</sup>

Given the concerns and problems about equity crowdfunding as sketched above, and the reduced potential of reputation as a mechanism to incentivize the entrepreneur to behave in line with the interests of the investor given the lack of repeated interactions in the world of crowdfunding,<sup>28</sup> it is necessary to have some rules in place for the industry. This is done through policing the three primary factors in equity crowdfunding, namely, the fundraising entrepreneur / issuer, the crowd, and the platform.<sup>29</sup> Based on a 2015 survey from the IOSCO, jurisdictions reported a variety of approaches to regulate crowdfunding, either applying general securities regulatory framework, which often allows the use of certain built-in flexibilities, or introducing / proposing *ad hoc* regulatory crowdfunding regimes.<sup>30</sup> While there is still no common international approach to the oversight and supervision of crowdfunding industry,<sup>31</sup> one major commonality of these regulatory efforts is that they all aim at achieving a balance between risks / investor protection related concerns and letting the securities markets play a positive role in supporting economic recovery and growth through the promotion of crowdfunding.<sup>32</sup> A typical example is that, to the extent that (equity) crowdfunding is allowed, lighter entry requirements

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<sup>24</sup> Ajay Agrawal *et al.*, *Some Simple Economics of Crowdfunding*, 14 INNOVATION POLICY AND THE ECONOMY 63 (2014), available at: <http://www.nber.org/papers/w19133>, at 20.

<sup>25</sup> Kirby & Worner, *supra* note 2, at 44.

<sup>26</sup> Agrawal *et al.*, *supra* note 27, at 29.

<sup>27</sup> *Id.* See also Thomas, *supra* note 18.

<sup>28</sup> Agrawal *et al.*, *supra* note 27, at 23.

<sup>29</sup> Garry A. Gabison, *Understanding Crowdfunding and its Regulations, How can Crowdfunding help ICT innovation?*, European Union Joint Research Centre Science and Policy Report (2015), available at: <http://publications.jrc.ec.europa.eu/repository/bitstream/JRC92482/lbna26992enn.pdf>, at 20.

<sup>30</sup> IOSCO, *IOSCO Crowdfunding 2015 Survey Responses Report* (FR29/2015, Dec. 2015), available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD520.pdf>, at iii.

<sup>31</sup> *Id.*, at v.

<sup>32</sup> *Id.*, at iii.

are imposed for the funding portals; and there are limited reporting requirements for issuers. These flexibilities then are usually counterbalanced by a number of focused restrictions or tailored rules meant to ensure integrity of information and protect investors.<sup>33</sup> Such counterbalancing regulations can be on the part of the funding platforms, by setting limitations on the services and activities that they are permitted to perform,<sup>34</sup> and can also be on the part of investors, by addressing the questions of who can invest, how much can be invested per project / overall, and how frequent can such investments take place.<sup>35</sup>

Besides regulation, a contractual technique commonly employed in practice to tackle the information and incentive problems in equity crowdfunding is syndication. Instead of the crowdfunders each investing individually, they are pooled into a new vehicle, which will actually make the investment and become a new shareholder of the fundraising company. The leading investor of the syndicate (the “lead”), which is typically a business angel with a past investment track record, will perform pre-investment screening and post-investment monitoring on behalf of all the investors (the “backers”), and will be able to collect a carried interests from the backers for such services. As such, syndicates can greatly expand the access to pre-VC investment opportunities for general investors, while significantly reducing the risk of doing so.<sup>36</sup> To the larger extent, syndicates are considered to be able to “combine the global reach abilities of the online world with the face-to-face due diligence and monitoring abilities of the offline world”.<sup>37</sup> Therefore, although the syndicates is still a recent phenomenon in crowdfunding, it has been increasingly used in practice.<sup>38</sup>

## II. CHINA’S EQUITY CROWDFUNDING INDUSTRY

### 2.1 *Industry Overview*

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<sup>33</sup> *Id.*

<sup>34</sup> *Id.*, appendix B (2. Intermediaries / Portals).

<sup>35</sup> See Gabison, *supra* note 29, at 23. For a list of examples of such regulations, see IOSCO, *id.*, at 22.

<sup>36</sup> Agrawal *et al.*, *supra* note 3, at 9.

<sup>37</sup> *Id.*, at 2.

<sup>38</sup> *Id.*

While equity crowdfunding has a comparatively small market value than the other three major crowdfunding types (lending, donation-based, and reward-based) on a global scale,<sup>39</sup> it is rather the mainstream crowdfunding practice in China,<sup>40</sup> through which the campaigners are often able to raise larger amount of funds (USD 50,000 or more) than other crowdfunding models.<sup>41</sup> As of the end of 2015, there are altogether 141 equity crowdfunding portals in the country; and with the help of these platforms, an aggregate of 2338 projects have managed to meet or exceed their fundraising goals, amassing a fortune of nearly RMB10 billion.<sup>42</sup> Given that AngelCrunch (<http://angelcrunch.com/>), the country's very first equity crowdfunding portal, was set up in 2011,<sup>43</sup> the industry has shown a massive growth spurt in 2015, which has witnessed the launching of 84 out of the 141 funding portals, and contributed half of the market size in terms of both the number of projects and the amount raised.<sup>44</sup>

To be sure, the significant features of Chinese crowdfunding are similar to those in developed regimes. Internet technologies are used to leverage the influence of social media, and portals collect fees or commissions on the funds raised or the profits and require minimum investment.<sup>45</sup> Similar to major international crowdfunding platforms, investors in China also need to confirm and accept a standard service contract upon opening an investment account with the portal. The terms and conditions of such service contracts focus primarily on the intermediary role of the portal between the entrepreneurial firm and the investors.<sup>46</sup> When it comes to how crowdfunding works in practice, most portals adopts the “all-or-nothing” model rather than the “keep-it-all” model,<sup>47</sup> meaning that the entrepreneurial firm sets a fundraising

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<sup>39</sup> Based on the data from *Massolution Crowdfunding Industry Report 2015*, available at: <http://crowdexpert.com/crowdfunding-industry-statistics/>.

<sup>40</sup> Tianlong Hu & Dong Yang, *The People's Funding of China: Legal Developments of Equity Crowdfunding—Progress, Proposals, and Prospects*, 83 UNIVERSITY OF CINCINNATI LAW REVIEW 445, 449 (2014).

<sup>41</sup> Zhang *et al.*, *supra* note 5, at 14.

<sup>42</sup> Shen Lingkun, *Qingke Guancha: 2016 guquan zhongchou baogao fabu, pandian 2015 Jingdong, Ali yinling de guquan zhongchou yuannian* [Zero2IPO Observer: China Equity Crowdfunding Market Research Report 2016 Is Issued; Recapitulate 2015: JD and Alibaba Led the First Year of China's Equity Crowdfunding], ZERO2IPO RESEARCH CENTER, Mar. 21, 2016, available at: <http://research.pedaily.cn/201603/20160321394726.shtml>.

<sup>43</sup> Emily Shen, *China Equity Crowdfunding Market Research Report 2016 Is Issued; “Equity-for-Fee” Model Is Popular Among Platforms*, ZERO2IPO RESEARCH CENTER, Mar. 15, 2016, available at: <http://en.pedaily.cn/Item.aspx?id=220799>.

<sup>44</sup> Shen, *supra* note 42.

<sup>45</sup> Hu & Yang, *supra* note 40.

<sup>46</sup> *Id.*, pp. 461-462.

<sup>47</sup> Douglas J. Cumming *et al.*, *Crowdfunding Models: Keep-It-All vs. All-Or-Nothing* (May 2015) (unpublished manuscript, available at: <http://leeds-faculty.colorado.edu/bhagat/CrowdfundingModels-KeepItAll-AllorNothing.pdf>).

goal before the campaign starts, and will only get the pledged capital when the amount equals or exceeds such pre-determined goal. Because this type of fundraising model shifts the risk to the entrepreneur, portals that implement this model demand less fees than those adopting the “keep-it-all” model.<sup>48</sup>

## 2.2 *Business Practices*

### 2.2.1 Syndication

The prevalent practice of conducting equity crowdfunding in China is through syndication, or more vividly, the so-called “angel + backers” model.<sup>49</sup> Globally, the largest and most prominent equity crowdfunding portal enabling syndicate-like investing is AngelList (<https://angel.co/>),<sup>50</sup> which is also the role model that most Chinese online platforms followed in the first place.<sup>51</sup> This said, it must be noted that there is a significant difference between the Chinese “angel + backers” model and AngelList syndicates. In the AngelList syndication, it is the angel investors that first create a syndicate profile online, which provides the basic information for potential backers such as how many deals they expect to syndicate each year and their typical investment size.<sup>52</sup> Interested backers apply to participate in the syndicate, and the lead has the right to decide whether to accept them. Once accepted, the backers agree to invest in the lead’s syndicated deals on the same terms as the lead and to pay the lead a carry.<sup>53</sup> Instead of investing directly into a company, syndicate investors will be pooled into a special purpose fund, formed as a series LLC, which is specifically created for the project. The fund is managed and advised by two affiliates of AngelList, which are charged with the task of setting up and managing these LLC funds.<sup>54</sup> The lead usually does not invest through the fund but is required to disclose to the fund’s advisors how she votes, or if she buys or sells shares.<sup>55</sup>

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<sup>48</sup> Zero2IPO, *China Crowdfunding Market Research Report 2015*, available at: <http://files.ctex.cn/uploadatt/demo/20151215/1450147327153.pdf>, at 5.

<sup>49</sup> Shen, *supra* note 43.

<sup>50</sup> Agrawal *et al.*, *supra* note 3, at 3.

<sup>51</sup> Zero2IPO, *supra* note 48, at 9.

<sup>52</sup> Agrawal *et al.*, *supra* note 3, at 3.

<sup>53</sup> *Id.*

<sup>54</sup> The fund is managed by Assure Fund Management and advised by AngelList Advisors. See <https://angel.co/help/syndicates> (question: What is AngelList Advisors?), and also <https://angel.co/assure-fund-management> (pointing out that Assure sets up and manages LLC Funds for AngelList).

<sup>55</sup> Help, ANGELLIST, <https://angel.co/help/syndicates>.



So although backing a syndicate is different than investing in a venture capital fund,<sup>56</sup> important similarities do exist for the two so that they can be compared together in the first place. Essentially, it is the investment thesis of an angel lead that the backers choose to endorse and thus they form a syndicate on that basis,<sup>57</sup> rather than on a deal-to-deal basis. This is the most fundamental difference between the AngelList syndicate and the “angel + backers” model employed by the Chinese equity crowdfunding industry. The following example, taken from Zero2IPO’s 2015 Crowdfunding Market Research Report, vividly explains how the “angel + backers” syndicates work in one particular equity crowdfunding portal, namely, Dajiatou ([www.dajiatou.com](http://www.dajiatou.com); literally, everybody invests). Suppose an entrepreneur intends to raise RMB1 million for her project, and for that she intends to sell 20% equity. One angel invests RMB 50,000 and wants to lead the deal. Several backers follow by committing RMB 200,000, 100,000, 30,000, 500,000, and 120,000, respectively. The RMB1 million fundraising goal is thus met and a limited partnership (“LP”) is set up accordingly.<sup>58</sup> The LP then invests in the entrepreneur’s project. To summarize, backers are willing to back one project and form a syndicate with the lead not really because they are consistently buying into the investment thesis and/or the reputation of an angel lead,<sup>59</sup> but more because the project seems to be “investment worthy”, based on the due diligence results and negotiated project valuation presented to them by the angel lead.<sup>60</sup> Actually, it is not uncommon to see that some projects are already highly funded while are still in search for a leading investor.<sup>61</sup> This further reinforces the argument that backers are essentially backing the good projects rather than good angels. A more detailed comparison of how syndicate works in AngelList, the global leader in equity crowdfunding, and in AngelCrunch, the first mover and also the largest equity crowdfunding portal in China,<sup>62</sup> is presented in Table 2.2.1 below.

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<sup>56</sup> Agrawal *et al.*, *supra* note 3, at 4. See also <https://angel.co/help/syndicates> (question: How does investing in a syndicate differ from investing in a VC fund?).

<sup>57</sup> *Id.*, at 3.

<sup>58</sup> Zero2IPO, *supra* note 48, at 24.

<sup>59</sup> According to AngelList, when naming their syndicates, most leads use their full name, because they expect investors to join the syndicate on the basis of their personal reputation. See <https://angel.co/help/syndicates>.

<sup>60</sup> <http://www.dajiatou.com/help-17.html>.

<sup>61</sup> See *Tianshuhui lingtouren guize [AngelCrunch Guidelines for Leads]*, ANGELCRUNCH, <http://angelcrunch.com/help/leadinvest>. It is pointed out that an angel-stage investment does not necessarily need a lead. And when this is the case, the cornerstone investor, i.e., the first investor that confirms to make an investment, will help the issuer with respect to fixing the issuing price.

<sup>62</sup> Zero2IPO, *supra* note 48, at 21.



TABLE 2.2.1: SYNDICATES IN ANGELLIST AND ANGELCRUNCH

	AngelList	AngelCrunch
Syndicate based on particular deals	No	Yes
Investor can opt out a particular deal?	Yes	N/A
Deal carry	0 – 25%, paid to the lead 5% to AngelList Advisors	5 – 20%, paid to the lead 5% to AngelCrunch Also 1% as a reward for helping getting following investors in
Legal structure of syndicate	Series LLC	LP
Does the lead invest through syndicate?	No. Leads usually invest directly in the company.	Yes
Syndicate managed by	Assure Fund Management	Lead
Syndicate advised by	AngelList Advisors, for which the lead serves as a contractor.	Lead
Does the syndicate charge a management fee?	No	No
Maximum number of investors in a syndicate	99 in a deal Qualified investors are exempted.	30
Total number of investors at any time in the issuer / project entity	2000	200
Maximum number of leads per deal	N/A	2
Minimum commitment by the lead into the syndicate	0 Need to make significant investment in each deal	5% of the funds raised for a deal
Investment by the lead into a deal	2.5 – 20% of the amount the syndicate raised from INDIVIDUAL investors Unlimited, for capital raised from INSTITUTIONAL investors	5 – 50% of the funds raised for the deal

Summarized on the basis of the relevant information from the websites these portals.

### 2.2.2 Direct Investment

Despite the fact that the “angel + backers” model is the mainstream practice in China’s equity crowdfunding industry, some projects also choose to adopt a more straightforward approach to the end of raising capital from the crowd. In these projects, investors either enter into investment agreements directly, or designate an authorized representative to execute the agreements on their behalf with the entrepreneur / campaigner to form the new business, instead of first being pooled into a separate entity. Such business model is best represented by Renrentou,<sup>63</sup> a crowdfunding portal that specializes and also excels itself in raising funds from the “grassroots” for all kinds of physical shops in the lines of consumer business.<sup>64</sup> According to its website, the projects presented for crowdfunding primarily fall into two types, literally, the “equity type”, and the “yield type”.<sup>65</sup> By design, investing in equity type projects will provide the investors with a flexible return, based on the actual net profit of the project and shared among the campaigner and the crowdfunders. Comparatively, yield type projects promise an investment return expressed as certain pre-defined percentage of a crowdfunder’s investment and/or the project’s revenue.<sup>66</sup> Thus far, the equity type projects are the mainstream – they outnumber the other type by more than one fold as of June 30, 2016.<sup>67</sup>

The paramount legal question here is how can the many crowdfunders, each of them contributing a rather small amount of money, properly exercise their investor rights in a non-public firm, where the fundraising campaigner presumably still wants to keep control. For the purposes of shedding light on this question, I examine the investment contracts of Renrentou’s

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<sup>63</sup> This being said, Renrentou is not the only example of the direct investment model. Even in AngelCrunch, an LP is only set up when the total number of investors in a crowdfunding deal is more than 10. Otherwise, the investors are not pooled into a separate LP but simply enter into an “agreement for acting in concert”, designating the lead as the representative of all the investors to manage the investment in the issuer. *See AngelCrunch Guidelines for Leads*, *supra* note 61.

<sup>64</sup> *See supra* note 8. On this webpage Renrentou claims itself as the oldest, largest and fastest growing equity crowdfunding portal specializing in raising funds for consumer business physical shops.

<sup>65</sup> On Renrentou’s website (accessed as of June 30, 2016), the projects are actually divided into four types in the filter section. They are: equity type, yield type, consumption type, and product type. However, there are no projects when either of the last two types is chosen as a filter.

<sup>66</sup> *See* Table 3.1.A, *infra*.

<sup>67</sup> As of June 30, 2016, the total number of equity projects online ([www.renrentou.com/project/list](http://www.renrentou.com/project/list), project type filter set as “equity”, and all other filters remain default) is 40, while the total number of yield projects online (project type filter set as “yield”, and all other filters remain default) is 18.

crowdfunding projects, which can be found under the “fundraising information” tab after clicking open a project. Because the contracts use rather standard templates with minor revisions to contain deal-specific information, I choose only the projects that are marked as “(fundraising) successful”, “returns distributed to investors”, and “closed”, whose contracts are already the execution version, thus are able to show the tailored details to the maximum extent. As of June 30, 2016, there are 37 of such equity type projects and 16 yield type projects on Renrentou.com. The contractual terms of these agreements are summarized in Section 3.1, which will discuss Renrentou as a case study in more details.

### 2.3 *The (Remaining) Legal Issues*

In January 2015, eight equity crowdfunding platforms became the first group to be granted with the membership of Securities Association of China (“SAC”).<sup>68</sup> The direct propelling reason for this was the introduction of an *ad hoc* regulation for equity crowdfunding in China in December 2014, namely, the Crowdfunding Measures. According to these measures, an equity crowdfunding platform shall file itself with the SAC, and in the meantime also become a member thereof.<sup>69</sup> Although such filing registration does not mean the recognition by the SAC of the portal’s quality of internal control and continuous compliance, nor does it constitute a guarantee of the security of investors’ capital,<sup>70</sup> the posture of willingly choosing to be the first movers to comply with a potential regulation, arguably signals the eagerness of these eight portals to show the outside world their good quality.

While the Crowdfunding Measures clearly demonstrate the China’s resolve to set sail for an orderly regulation of equity crowdfunding, they cannot and should not be the only resort for solving all the problems present in this new business. According to Hu and Tang (2014), which is effectively the first academic piece in English that systematically researches into the legal issues in China’s equity crowdfunding, there are three major legal risks associated with the business. Firstly, crowdfunding activities that reward investors with equity must be precisely calculated to avoid violating the strict distinction between public and private offerings. However,

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<sup>68</sup> Wang Ying, *Guquan zhongchou zhengguihua zai maijin 8 pingtai shuaixian cheng zhongzhengxie huiyuan* [Normalization of Equity Crowdfunding Further Progresses: 8 Portals Obtained SAC Membership], YICAI.COM, Jan. 20, 2015, available at: <http://m.yicai.com/news/4065772.html>.

<sup>69</sup> Crowdfunding Measures, *supra* note 9, art. 6.

<sup>70</sup> *Id.*

such calculations are likely to trigger heightened attention from regulatory authorities, and it is also questionable whether they can be relied on to attract and retain a stable source of investors and keep the business running on a long-term basis.<sup>71</sup> Secondly, although the prevalent “angel + backers” business model certainly brings about efficiency, it also gives rise to possible fraud and manipulation through investment contracts, as backers may follow blindly the decision of the leading angels.<sup>72</sup> Lastly, the ambiguous identification and function of Chinese equity crowdfunding portals, combined with their standard service contracts which investors can only choose to accept or walk away, give the portals too much discretion and leave the investors under-protected.<sup>73</sup>

The legal risks and the policy recommendations in Hu and Yang (2014) were mapped on a theoretical level, primarily by analyzing the applicability of the existing legal framework and predicting its potential effect on the development of equity crowdfunding in China. While certainly pioneering, they still need to be tested in light of empirical evidence. In this sense, the transactional documents collected from Renrentou, which will be analyzed in more details below, already help to reveal some important particulars about how the China’s crowdfunding contracts actually work in practice. This said, many questions still remain unanswered at a macro level about the operation of the industry as a whole, which would require further inside information than merely investment contracts. Such information is typically available only to an equity crowdfunding portal by virtue of overseeing its fundraising projects. Apparently, this sort of information is very difficult to get hold of unless the portal is willing to share it on its own initiative. In this sense, the attempt of Zhongtou8 ([www.zhongtou8.cn](http://www.zhongtou8.cn)) to get quoted on China’s New Third Board provides a precious opportunity to gain an inside view of the industry’s practice beyond the point of contract execution. The following Section 3.2 sketches this case study.

### III. TWO CASE STUDIES

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<sup>71</sup> Hu & Yang, *supra* note 40, at 456.

<sup>72</sup> *Id.*, pp. 459-460.

<sup>73</sup> *Id.*, pp. 461-462.

### 3.1 Case Study I – Renrentou

Renrentou is launched online in the beginning of 2014.<sup>74</sup> It is among the first group of eight equity crowdfunding platforms that were granted with the membership of SAC as mentioned above.<sup>75</sup> On its website, it claims that, to the extent that the general line of physical consumption business is concerned, it is the earliest established crowdfunding portal that has the most users, fastest growth, and largest scale.<sup>76</sup> A great advantage of Renrentou is that it allows one to download the deal agreements of the projects after being recognized as a qualified investor on the website.<sup>77</sup> This provides a great opportunity for one to gain understanding of how its equity crowdfunding deals are legally structured, and how the rights and obligations are distributed among the relevant parties in practice. Typically, the legal documentation of a project can consist of three agreements, namely:

- an Equity Return Investment Agreement (“Investment Agreement”) that lays down the ground for and defines the roles of the parties in the crowdfunding transaction,
- an Investment Management Power Of Attorney (“Power of Attorney”) that commissions a third party manager to manage the money of each of the crowdfunders in the project entity, and
- a Limited Partnership Agreement (or in rarer cases, an Agreement for Incorporating a Joint Stock Company) that stipulates the key rights and obligations of the investors (as limited partners) and campaigner (as the general partner) in the project entity (mostly a limited partnership but occasionally can also be a joint stock company).<sup>78</sup>

The terms of these agreements are summarized in Tables 3.1.A, 3.1.B, 3.1.C, and 3.1.D below.

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<sup>74</sup> See *supra* note 8.

<sup>75</sup> See *supra* note 68 and the accompanying text.

<sup>76</sup> See *supra* note 8.

<sup>77</sup> Note that, although being recognized as a qualified investor of an equity crowdfunding portal generally does enable one to access more information, such as the “fundraising documents”, about a crowdfunding project presented on the website, there is no guarantee that such documents are the core legal agreements of the fundraising transaction. In contrast, they might just be pitches and business plans, and the legal documents may be only available when one actually makes an investment into a project. In this sense, the fact that transactional documents are directly available is an advantage of Renrentou.

<sup>78</sup> Please note that this does not mean that every project must have all the three documents simultaneously. For example, a project may not engage a Third Party Manager to exercise the Investor’s rights in the Project Entity, or a project may choose not set up a new legal entity to run the business, but rather loosely contain the rights and obligations of the parties in an Equity Interest Investment Agreement.

TABLE 3.1.A: EQUITY RETURN INVESTMENT AGREEMENT SUMMARY OF TERMS\*

Key Term	As in Template Agreement <sup>79</sup>	As in Final Agreement of Yield Type Projects <sup>80</sup>	As in Final Agreement of Equity Type Projects
<b>Key Contract Parties</b>	Executing party A: Investor Executing party B: Campaigner, who is to operate the business entity set up after the crowdfunding campaign ("Project Entity") Non-executing party: Third Party Manager, which is commissioned collectively by the Investors to monitor the business operations of the Project Entity.	Only one company is identified as the Third Party Manager, namely, Beijing Mingyue Asset Management Co., Ltd. <sup>81</sup> Some projects do not engage a Third Party Manager at all. <sup>82</sup>	Two other companies have been identified to have served as the Third Party Manager: <sup>83</sup> Beijing Renrentou Network Technology Co., Ltd.; and Beijing Renren Jinfu Network Technology Co., Ltd.
<b>Contract Performance Deposit ("Deposit")</b>	As soon as the fundraising campaign is successfully completed, the Campaigner should deposit at the Third Party Manager an amount of money, which is to serve as a guarantee for paying out the potential returns to the Investors. Such Deposit should be certain percentage of the capital needed to operate the project.	Typically set at 10% of the total amount of investment raised. Some projects do not impose a Deposit on the part of the Campaigner. <sup>84</sup>	Not applicable.

<sup>79</sup> This template of "Equity Return Investment Agreement", together with the template of "Investment Management Power of Attorney", are used by 19 equity type projects and 4 yield type projects. These templates leave the deal specific terms blank, which are to be filled in in the final executed version.

<sup>80</sup> For the avoidance of doubt, the final agreement are tailored to reflect the deal specific terms of the projects. In most cases, they are just the template agreement with blanks filled in; but some projects have also chosen to deviate from the template to a greater extent, making changes to the general terms here and there. The key deviations are summarized in this table.

<sup>81</sup> Mingyue began to serve the role officially from April 2016 according to an announcement from Renrentou. See [http://www.renrentou.com/article\\_5586.html](http://www.renrentou.com/article_5586.html). There is no information on whether Mingyue is also somehow affiliated with Renrentou.

<sup>82</sup> Examples of these projects are: Health Baths ([http://www.renrentou.com/project/detail/project\\_id/17734](http://www.renrentou.com/project/detail/project_id/17734)), Qiao Ting Live Fish Town, [http://www.renrentou.com/project/detail/project\\_id/18654](http://www.renrentou.com/project/detail/project_id/18654), Crown Rainforest Fitness Leisure Subject Hotels (Shenyang) ([http://www.renrentou.com/project/detail/project\\_id/17465](http://www.renrentou.com/project/detail/project_id/17465)), Crown Rainforest Fitness Leisure Subject Hotels (Nationwide) ([http://www.renrentou.com/project/detail/project\\_id/17463](http://www.renrentou.com/project/detail/project_id/17463)), and Yike Apartments ([http://www.renrentou.com/project/detail/project\\_id/17399](http://www.renrentou.com/project/detail/project_id/17399)).

<sup>83</sup> Based on the limited partnership agreement of the equity type projects, Renrentou served directly as the Third Party Manager itself in contracts numbered as "v. 20150812", Renren Jinfu appeared in contracts numbered "v. 20150920". Renren Jinfu should be an affiliate of Renrentou, if judged from their names.

<sup>84</sup> See *supra* note 82, and also Growth Bay Kids Profession Experience Club ([http://www.renrentou.com/project/detail/project\\_id/18772](http://www.renrentou.com/project/detail/project_id/18772)).

Key Term	As in Template Agreement <sup>79</sup>	As in Final Agreement of Yield Type Projects <sup>80</sup>	As in Final Agreement of Equity Type Projects
<b>Investment Term</b>	Investment term = closed period + redemption period.	Yield type projects have pre-defined term, which can vary from one year to three years.	Equity type projects have indefinite term.
<b>Investment Return</b>	Fixed return = Remaining Investment (Total Investment – Redeemed Investment) * ____%	A project can have only fixed or only flexible return, or can also have a combination of both. Annual rate of fixed return varies from 9% to 15%.	In equity type projects, investment return is just a share of the project's profit. More specifically, Investor's investment return = (Net profit – enterprise development fund – Campaigner's carried interests – fees for Third Party Manager, if applicable) x Investor's equity interests
	Flexible return = Revenue (of every month / quarter / half year) * ____% * (Remaining Investment / Total Investment)	Rate of flexible return vary greatly across projects, from 0.5% to 40%.	Most projects choose to pay their investment returns either monthly or quarterly.
<b>Payment of Investment Return</b>	To be paid every month / quarter / half year	Most projects choose to pay their investment returns either monthly or quarterly. The payout frequency is not always the same for fixed and flexible returns.	Equity type projects are divided on this topic. One project only imposes an overdue penalty on the Campaigner and do not allow redemption or replacement of Campaigner when the situation in item (a) happens.
<b>Investment Guarantee Mechanisms</b>	Upon the occurrence of any of the following event, the Investor or the Third Party Manager can replace the Campaigner as the operator of the Project Entity, and ask for redemption of their investment. This does not exempt the Campaigner from paying investment returns to the Investor:	To the extent the contract touches upon this topic, most yield projects simply use the template's language. This being said, a few projects only impose an overdue penalty on the Campaigner and do NOT allow redemption or replacement of Campaigner, when	While one project gives the Investor the right of having its investment redeemed at a rate of 120% under both items (a) and (b).
	a. If the Campaigner is too late in paying the investment returns to the Investor, AND not restoring the deposit that has previously been used to pay out the returns;	The situation in item (a) happens.	

Key Term	As in Template Agreement <sup>79</sup>	As in Final Agreement of Yield Type Projects <sup>80</sup>	As in Final Agreement of Equity Type Projects
	b. If the accumulated loss exceeds 30% of the total raised amount, or the project incurs loss for more than five months, AND the Campaigner fails to raise the amount of the deposit.	Item (b) is not found being used in practice.	
	Two guarantors will be jointly liable for the contractual obligations of the Campaigner.	Guarantor as an investment guarantee mechanism is used in all projects. But in practice projects only have one guarantor, who normally is the actual controlling person of the Campaigner.	Projects have only one guarantor, who normally is the actual controlling person of the Campaigner.
	The campaigner shall produce a list of assets, which will be used as a collateral the investment returns and redemption the investors.	Some projects choose to use guarantor(s), collateral, and pledge of shareholder / partner rights simultaneously, but some projects also choose only one or two of these mechanisms.	Not found being used in practice.
	The Campaigner shall also pledge its shareholder / partner rights in the Project Entity to the Investor or the Third Party Manager.		Not found being used in practice.
	1. <u>Within the closed period</u> a. And less than six months after the successful completion of the fundraising campaign: can only get back X% (X<100%) of investment plus fixed return; b. And more than six months but less than one year after the successful completion of the fundraising campaign: can get back Y% (X<Y<100%) of	In practice, most projects do not allow Investors to exit project within the closed period at all.  One project allows exit within the closed period, on the condition that the investment return previously paid to the Investor should be deducted when paying the redemption price.  Only one project exactly uses the templates language.	Not applicable.
<b>Investment Withdrawal and Exit</b>			



Key Term	As in Template Agreement <sup>79</sup>	As in Final Agreement of Yield Type Projects <sup>80</sup>	As in Final Agreement of Equity Type Projects
	investment plus fixed return AND flexible return;		
	2. After the closed period: <sup>85</sup> Campaigner SHOULD redeem the Investor's investment UPON REQUEST according to a pre-defined schedule in installments.	Some contracts simply use the template's language.  In some contracts, Campaigner SHOULD redeem the Investor's investment UPON REQUEST, but in full and only on pre-defined open dates.  In some contracts, Campaigner shall redeem after the closed period according to pre-defined schedule in installments, but doing so is NOT upon the request of the Investor but is a form of mandatory redemption right on the part of the Campaigner. See "mandatory redemption right" below.	
	3. Investment not yet redeemed shall STILL generate fixed and flexible return.	Most contracts do not mention this issue at all.  To the extent this issue is mentioned, the contracts adopt opposite positions.	
	Getting investment return		
<b>Rights of Investor</b>	Information right		
	Authorizing the Third Party Manager to monitor, on behalf the Investor, the Campaigner and the Project Entity		

<sup>85</sup> Here, the natural interpretation is that after the closed period and within the investment term. However, one contract (Qiao Ting Live Fish Town, [http://www.renrentou.com/project/detail/project\\_id/18654](http://www.renrentou.com/project/detail/project_id/18654)), where both the closed period overlaps investment term (both one year), stipulates that redemption takes place AFTER the investment term in installments. In the end, an Investor can only get 100% of his/her investment back three years after the end of the investment term.

<b>Template Agreement<sup>79</sup></b>	<b>As in Final Agreement of Yield Type Projects<sup>80</sup></b>	<b>As in Final Agreement of Equity Type Projects</b>
arranging its shareholder / partner upon the prior consent of the Third Party Manager	In all projects, this is to be agreed by the Campaigner.	
allow investment and exiting from the		
the investment		
investment back to the Campaigner if the latter exercises the mandatory redemption right		Equity type projects are divided in terms of whether Campaigner has mandatory redemption right. If Campaigner does not have mandatory redemption right, Investors willing to exit should consult with the Campaigner.
the management fee of the Third Party Manager	Priced at 5% of the investment return.	Priced at 5% of the investment return.
the financial monitoring fee and inspection fee incurred by the Third Party Manager		
investing from defaming the project or Campaigner or the Third Party Manager, otherwise the Investor will be deemed to have given up their investment, and shall be liable for any losses suffered therefrom	Only one contract mentions this issue.	
the template is silent on whether the Investor or MUST sell the investment back	Refer to mandatory redemption right below.	Not applicable.

Key Term	As in Template Agreement <sup>79</sup>	As in Final Agreement of Yield Type Projects <sup>80</sup>	As in Final Agreement of Equity Type Projects
	to the Campaigner and exit the project as of the end of investment term.	In only one project, <sup>86</sup> if the Investor fails to request for redemption five months after the end of the Investment term, he/she will be deemed to have given up the right and remain with the project.	
<b>Rights of Campaigner</b>	The Campaigner is the shareholder / general partner of the Project Entity. Except for the shareholder/partner rights enjoyed by the Investors, the Campaigner has all the remaining shareholder / partner rights.		
	Mandatory redemption right: Campaigner MAY, DURING the investment term, redeem the Investor's investment (with an agreed premium), and Investor SHOULD cooperate.	Variation 1: Campaigner SHALL mandatorily redeem the Investor's investment in full at the end of the investment term. <sup>87</sup> Variation 2: Campaigner SHALL redeem after the CLOSED PERIOD according to pre-defined schedule in installments. Variation 3: No mandatory redemption at all. <sup>88</sup> The price for redemption can be without any premium, or can have different premiums depending on the actual return of the project.	Equity type projects are divided in terms of whether Campaigner has mandatory redemption right.  One project enables such right, when exercised at the Campaigner's discretion, the Campaigner must buy out the Investor at a rate of 150%.
	Not mentioned.	Not mentioned.	In equity type projects, Campaigner also has the right to collect enterprise development fund, which is 10% of the Project Entity's net profit, to be extracted monthly

<sup>86</sup> This project is Bailang Pearl Dream Paradise ([http://www.renrentou.com/project/detail/project\\_id/19054](http://www.renrentou.com/project/detail/project_id/19054)).

<sup>87</sup> Typically, these projects have short investment term, such as the ones mentioned in *supra* note 82 (except Yike Apartments and Qiao Ting Live Fish Town, see *supra* note 85).

<sup>88</sup> This is the project mentioned above, see *supra* note 86.

Key Term	As in Template Agreement <sup>79</sup>	As in Final Agreement of Yield Type Projects <sup>80</sup>	As in Final Agreement of Equity Type Projects
			until the amount of the fund equals to 10% of the entity's registered capital.
<b>Obligations of Campaigner</b>	Paying investment return to the Investor		
	Refraining from transferring its contract rights, unless upon the prior written approval of the Investor or the Third Party Manager		
<b>Risk Triggering Events and Remedies</b>	Campaigner is in breach of the contract;	Most projects do not list all of these risk triggering events, but only mention part of them.  One project also adds "having used the Deposit for more than [three] times" as a risk triggering event.	One equity type project also adds "campaigner fails to start business within [four] months after the success of the fundraising" as a risk triggering event.
	Campaigner fails to set aside or restore the Deposit;		
	The operating entity is or is likely to be suspended, revoked of business license, liquidated, bankrupt, dissolved, etc.;		
	Campaigner has engaged in fraudulent activities ;		
	Other situation that may negatively affect the recoup of investment and any potential returns thereof;		
	The Project Entity is in violation of the relevant laws and regulations, which affects the execution of this contract; or		
<b>Remedies for Risk</b>	Campaigner changes the pre-agreed location of the Project Entity.		
	Ask the Campaigner to correct the breach;		

Key Term	As in Template Agreement <sup>79</sup>	As in Final Agreement of Yield Type Projects <sup>80</sup>	As in Final Agreement of Equity Type Projects
Triggering Events	Seek damages; or	Most contracts only mention the option of redemption, and are silent on the first two remedies. Redemption can be done with or without premium.	
	Urge the Campaigner to redeem the investment with an agreed premium.		Redemption can be done with or without premium.

\* All unfilled blanks mean that they are same as the template.

TABLE 3.1.B: INVESTMENT MANAGEMENT POWER OF ATTORNEY SUMMARY OF TERMS

Key Term	As in the Template <sup>89</sup>	Variation
Key Contract Parties	Executing Party A: Investor	
	Executing Party B: Third Party Manager Non-executing party: Campaigner	
Term of Power of Attorney	Until the expiration of the Investment agreement and/or Limited Partnership Agreement; or until the Investor fully exits the project.	
Scope of Power of Attorney	The Third Party Manager is authorized to manage the investment and exercise the shareholder / partner rights on behalf of the Investor. Such power of attorney includes but not limited to:	Some contracts also add “monitoring the use of Deposit” into the power of attorney.
	Establishing the Project Entity with the Campaigner and signing the relevant business registration documentation;	
	Participating in the business operations of the Project Entity;	

<sup>89</sup> See *supra* note 79.

Key Term	As in the Template <sup>89</sup>	Variation
	Attending shareholders / partners' meetings and voting therein, as well as receiving, sending and executing the relevant legal documents;	
	Collecting investment return and consideration for redemption / transfer;	
	Engaging in the relevant dispute resolution proceedings where the Investor is involved; and	
	Requesting the Campaigner to redeem the Investor's investment upon the occurrence of a redemption event in accordance with the relevant provisions in the Investment Agreement and Limited Partnership Agreement.	Some contracts do not give Third Party Manager this right.
<b>Remuneration</b>	Management Fee: for yield type projects, 5% of the investment return (including both the fixed and flexible return)	For equity type projects, 5% of the net profit of the Project Entity
<b>Rights and Obligations of Investor</b>	Out of pocket fees = fees for purchasing, installing and maintaining the necessary monitoring system and equipment + fees for physically inspecting the business	
	Monitoring the Third Party Manager; Refraining from transferring its investment unless upon the prior consent of the Third Party Manager; and Paying the relevant costs incurred by the Third Party Manager from monitoring the Campaigner and the operations of the Project Entity.	
	If the project undergoes a material change (e.g., failing to obtain business license), which will adversely affect the interests of the Investor, the Third Party Manager may terminate this power of attorney and no management fee will be charged, and neither the Investor nor the Third Party Manager shall be liable for the termination.	

\* All unfilled blanks mean that they are same as the template.

TABLE 3.1.C: LIMITED PARTNERSHIP AGREEMENT: KEY DIFFERENCES BETWEEN YIELD TYPE AND EQUITY TYPE PROJECTS

Yield Type Project	As in Equity Type Project
General Partner ("GP"): Campaigner Limited Partner ("LP"): Third Party Manager Non-executing party: Investor	General Partner ("GP"): Campaigner Limited Partner ("LP"): Investor Non-executing party: Third Party Manager <sup>90</sup>
Finite limited term At the end of the limited term, GP will redeem investment unless LP is willing to prolong the term. In this case, the partnership shall continue to be in force.	Infinite term
Partnership interests = (Deposit + GP's investment) / (GP's investment + LP's investment) <sup>91</sup>	GP's partnership interests = GP's investment / (GP's investment + LP's investment)
	Except for one project, <sup>93</sup> all equity type projects have this fund. 10% of the partnership's net profit, to be extracted monthly until the amount of the fund equals to 10% of the partnership's registered capital. This fund is set aside for the purposes of making up losses and working capital, and meeting other possible urgent needs.
	All equity type projects have this. The GP's carried interests can vary from 5% to 15%.

<sup>90</sup> Regulations of Hunan Hubei ([http://www.renrentou.com/project/detail/project\\_id/10499](http://www.renrentou.com/project/detail/project_id/10499)) and Hani Children Sports Club ([http://www.renrentou.com/project/detail/project\\_id/11136](http://www.renrentou.com/project/detail/project_id/11136)), do not engage a Third Party Manager at all. As such, no management fee is paid to the Third Party the returns to the partners.

<sup>91</sup> Land Phase III, [http://www.renrentou.com/project/detail/project\\_id/17878](http://www.renrentou.com/project/detail/project_id/17878), GP's partnership interests = (Deposit \* 2 + GP's investment + LP's investment) / (GP's investment + LP's investment) in those projects where a joint stock company, rather than a limited partnership, is incorporated as the Project Entity. For the

<b>Yield Type Project</b>	<b>As in Equity Type Project</b>
Investment Return” in the Investment Agreement Table	LP’s investment return = (Net profit – partnership development fund – GP’s carried interests – management fee for the Third Party Manager <sup>94</sup> ) x LP’s partnership interests
Payment of Investment Return” in the Investment Agreement Table	Investment return is paid out monthly in most contracts. A few contracts also stipulate frequency of every three months.
Amount left after paying the LP’s investment	GP’s investment return = (Net profit – partnership development fund – GP’s carried interests – management fee for the Third Party Manager) x GP’s partnership interests
Applicable, as the LP is the Third Party Partner	To be approved by the GP and LP(s) representing more than half of the total LP interests. Newly admitted partner shall have the same rights and obligations as the original partner(s).
Investment Withdrawal and Exit” in the Investment Agreement Table	<ol style="list-style-type: none"> <li>Before the first anniversary of the partnership’s start of business: <ol style="list-style-type: none"> <li>And also before the pre-defined break-even point: No transfer or withdrawal of investment allowed;</li> <li>After the pre-defined break-even point: LP may transfer or withdraw his/her investment only when the partnership fails to realize break-even by then. If no transfer is possible, GP shall redeem at least X% (X &lt;100%)<sup>95</sup> of the LP’s investment;</li> <li>Investment return previously paid to the LP should be deducted when paying the redemption price.</li> </ol> </li> <li>After the first anniversary of the partnership’s start of business: LP is entitled to transfer or withdraw partnership interests. If transfer is not</li> </ol>

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payment of such management fee to the Third Party Manager only starts when the principal of all the Investors’ investment is fully



Yield Type Project	As in Equity Type Project
	possible, GP shall redeem at least Y% ( $X \leq Y \leq 100\%$ ) <sup>96</sup> of the LP's partnership interests.

TABLE 3.1.D: LIMITED PARTNERSHIP AGREEMENT: SUMMARY OF COMMON TERMS

Most Agreements	Variations / Notes
will license the relevant intangible assets (such as trademark, patent, proprietary technology) to the partnership, so that with these resources the partnership can run the business in compliance with the relevant standards for the brand.	
will refrain from engaging activities that would defame the GP and the partnership. If such activities have adversely affected the partnership's business, will force such LP to exit the partnership by redeeming the investment of the 100% of its face value back. This does not exempt such LP from paying the damages caused by the defamation.	
will cooperate with LP(s) with respect to the latter monitoring the interests of the partnership;	
will send financials to LP(s) and also publish them on <a href="http://renrentou.com">renrentou.com</a> on a monthly basis;	
will engage professional accountant to process the financials of the partnership;	
can initiate or authorize a third party to review and inspect the accounts of the partnership;	LPs can only do so upon the request of more than 2/3 of the LPs.

Common Term	As in Most Agreements	Variations / Notes
<b>Operation of Partnership Business</b>	If the total amount of funds raised is greater than 1 million, auditing is needed upon the request of LP(s);	If the total amount of funds raised is greater than 1 million, annual auditing is needed; and/or If requested by more than 2/3 of the LPs, auditing is needed.
	GP should report the progress of the project on a monthly basis;	
	GP should report on final accounts of the project upon the request of LP(s).	Only three projects adopt this.
	GP manages the business of the partnership.	
	LP has information right, monitoring right, and right of making proposals.	
	GP should report to LP(s) about the business operations and financials of the partnership.	
	GP should, within 90 days after the execution of the partnership agreement, complete the relevant preparation work (such as renting and construction of the premise, procurement of stock material, and obtaining business license) for the partnership, and start business within 120 days after the execution of the partnership agreement.	
	GP may engage a third party to serve in the management of the partnership.	
	The partners should have one or two meetings every month. A resolution passed by partners representing at least 2/3 partnership interests shall be binding on all partners.	Not present in in contracts where Third Party Manager is the LP itself. In four projects, the frequency of such meetings is at least once a week.
	LPs should elect one representative to assist the Third Party Manager in monitoring the GP.	Not present in contracts where Third Party Manager does not exist, or is the LP itself.
	GP should not compete with the Project Entity within defined scope and territory.	Only two projects adopt this.

<b>Common Term</b>	<b>As in Most Agreements</b>	<b>Variations / Notes</b>
	LP(s) can ask the partnership to install and use financial monitoring system (both hardware and software), and surveillance at inventory and cashier area, and GP should cooperate with respect to such monitoring and surveillance.	
<b>Issues Requiring Unanimous LP Approval</b>	Changing name, business scope, and project location of the partnership;	
	Transferring the premise to any third party;	
	Related transactions between the GP and the partnership;	Related transactions between the GP and the partnership are allowed, but the GP need to make sure these transactions are conducted on the arm's length basis.
	Using partnership assets to provide guarantee to a third party;	
	GP transferring its partnership interests;	
	Increasing the amount of investment in the project; and	In some contracts, unanimous LP approval is needed when the amount of investment will deviate 20% or more from the original budget.
	Dissolving or liquidating the partnership.	In one project, this is to be decided by 2/3 of ALL partners.
<b>Liabilities for Breach of Contract</b>	GP generally shall be liable for the damages to the Investor, the partnership, and/or any third party resulted from its intentional misconduct and gross negligence in running the business.	

\* All unfilled blanks mean that they are same as the template.

Judged from these contractual terms, it is obvious that the utmost task of the terms of these agreements is to safeguard the economic right of a crowdfunder, i.e., the right to get return from the project he/she invests in. Such right is secured through different mechanisms in equity and yield projects because of their different contract designs. With pre-defined rates of return applied on the investment itself and/or directly on the business revenue, the logic of yield type projects is that an investor should get a stable cash flow irrespective of the profitability of the project, but is expected to exit the project at the end of the investment term, leaving the campaigner with everything else on the table. Such a contractual design is supported primarily by two important mechanisms: on the one hand, the campaigner typically sets aside a “contract performance deposit” for the purposes of securing the payment of the investment return, and on the other, the campaigner has also got a mandatory redemption right to buy out the crowdfunders, and the investors must cooperate by selling their equity interests back to the campaigner at the end of the investment term or closed period. In essence, the contract design of yield type projects resembles a loan, with the return being the interest, and the investment being the principal that is to be paid back in the end. It is worth noting that, according to the Crowdfunding Measures, a campaigner or issuer should NOT promise to investors that they will not lose their principal or will get a minimum return from a crowdfunding project.<sup>97</sup> As such, the payout structure of the yield type projects as discussed in Renrentou case study will surely be invalid if such provision manage to stay in the finalized Crowdfunding Measures after consultation.

In comparison, equity type projects do not promise their investors with a stable cash flow, but rather allow them to share both the upside and downside of the business. Return to the crowdfunders is only possible when the project is able to generate positive net profit in the first place. But the money is not to be immediately distributed among investors yet. Before that, the GP will first get an extra share, typically 10% of the net profit ahead of the investors in the form of carried interests, as a result of rewarding it actively managing the business. Some projects also take another 10% and set it aside as the “enterprise development fund” to be used for making up losses and working capital, and meeting other possible urgent needs. After that, another 5% will be taken away to pay for the third party manager for monitoring the business operation of the project entity. Therefore, only around 75% of the net profit will be shared among the campaigner

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<sup>97</sup> Crowdfunding Measures, *supra* note 9, art. 13.1.

and crowdfunders according to their respective equity interest percentage. Since crowdfunders are not guaranteed with a preferred return, there is also no mandatory requirement that they must sell their investment back to the campaigner and exit the project within certain term.

Compared to the economic right of the crowdfunders, their control rights are rather minimal, and even those are largely commissioned upon the third party manager to be exercised. In general terms, the control rights of an investor consist of information right, monitoring right, and the right of making proposals (see Table 3.1.D). The content and scope of these rights are defined in more details in the Power of Attorney (see Table 3.1.B), and the Limited Partnership Agreement (see Table 3.1.D). From these provisions, it is easy to see that the information and monitoring rights are there primarily for the purposes of ensuring that the business is able to deliver return to investors. This is done, for example, through stipulating how often the campaigner should publish project financials and report to the investors / third party manager, how to process the accounts of the business to the satisfaction of the investors / third party manager, and how the campaigner should cooperate with respect to assisting the investors / third party manager in monitoring the financials of the business. Other than the ones securing their economic rights, crowdfunders do not seem to have much control with respect to the merits of the project's business operations. The reason for this is rather straightforward. When each of the many crowdfunders contribute rather small amount of money,<sup>98</sup> it is difficult to enable all of them to have a say about the business operations of the project entity, especially when the crowdfunders are not first pooled into a separate entity when make the investment.

Although the third party manager seems to be, based on the terms of the Power of Attorney, clearly authorized to attend investor meetings and vote therein, it is questionable what such monitoring rights really mean in practice. To begin with, the issues requiring approval from limited partner(s) (crowdfunders or the third party manager) are quite limited in the first place. Secondly and more importantly, based on the contracts collected in the sample and to the extent that the relevant information is available, it seems that many projects share one company as their third party manager, and such third party manager is either Renrentou itself or its affiliate, or a

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<sup>98</sup> Renrentou's minimum investment amount is typically small if compared to other equity crowdfunding portals, and it can be as low as several thousands Renminbi, see <http://www.renrentou.com/project/list>. This corresponds with Renrentou's positioning as a portal for the "grassroots". For example, projects on Dajiatou generally require at least tens of thousands Renminbi to participate in a deal, see <http://www.dajiatou.com/project-1-1.html>. Zhongtou8 imposes similar amount, see <http://www.zhongtou8.cn/financing>.

company commissioned by Renrentou.<sup>99</sup> Therefore, it is reasonable to doubt whether such third party manager is able to, other than making sure the investment return of the crowdfunders is not going to be seriously impaired, really exert great efforts in monitoring the campaigner and the business of each of the many projects. Moreover, one must note that being a crowdfunding platform, Renrentou is not only willing to see as many crowdfunding successes as possible, but also the projects running well as a going concern in general. It will definitely help to attract more potential entrepreneurs to start crowdfunding campaigns, which would both enhance its reputation and bring in new business revenue, if the projects on Renrentou are not only doing well financially but the crowdfunding investors and the campaigner can also maintain an amiable and cooperative relationship with each other. In other words, this means that crowdfunders should have the feeling of security that they can trust Renrentou as a reliable platform to make investment in and get return from crowdfunding projects; while the campaigners should also have the freedom they want in running the business without being overly bothered by small investors. Along this line of reasoning, it is actually in the interests of Renrentou and its commissioned third party manager to exercise the monitoring rights in a rather minimal manner, as long as they do not directly concern the distribution of financial returns.

It is worth noting that although limited partnership is used as prevalent business form to contain the new project entity, this is not always the case. Two variations are identified based on the contracts in the sample. One is not setting up a separate project entity at all, and letting the Investment Agreement define all important rights and obligations between the investors and the campaigner. This option is chosen in particular by those yield type projects with short term and a straightforward contractual design – typically one or two years, with mandatory redemption of crowdfunders’ investments thereafter. Investors are explicitly excluded from having any control rights in these projects, and accordingly they also do not engage a third party manager.<sup>100</sup> The other variation is to organize the project entity as a joint stock company. Note that, given its intrinsic feature of separation of ownership and control, limited partnership is the business form that is readily suitable for crowdfunding projects. As the one who manages and controls the business, campaigner serves as the general partner and shall bear unlimited liability for the partnership’s debts. Crowdfunders will be limited partners as they are not allowed to participate

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<sup>99</sup> See *supra* notes 81 & 83 and the accompanying text.

<sup>100</sup> See *supra* note 82.

in business management and are primarily concerned about getting investment returns. In contrast, because all shareholders are inherently equal in a joint stock company, the separation of ownership and control between the campaigner and crowdfunders needs to be specifically defined there. This is done, according to the “Investment Cooperation Agreement” of the two projects that are identified to have adopted joint stock company as the business form of their project entity,<sup>101</sup> by designating the campaigner as the “executing shareholder”, who is to be unanimously approved by the investors as “non-executing shareholders”. But other than these differences, these joint stock company agreements are actually written based on the template of the Limited Partnership Agreements, thus their contractual terms are essentially the same with respect to arranging the rights and obligations of the campaigner vis-a-vis the crowd investors. In short, no matter which business form is used, one thing remain unchanged – the campaigner always keeps control and runs the business of the crowdfunding project.

### 3.2 Case Study II – Zhongtou8

Zhongtou8 is also an equity crowdfunding portal created in 2014.<sup>102</sup> Same as Renrentou, it is also among the first group of eight equity crowdfunding platforms that were granted with the membership of SAC as mentioned above.<sup>103</sup> According to its website, it has reached the position of “top three in the industry” after two years of development, and has already been reformed into a joint stock company so as to get quoted on China’s NEEQ.<sup>104</sup> For that purpose, the company has submitted, in October 2015, a Prospectus for Share Quotation and Transfer (“Prospectus”) to be examined and reviewed by the regulatory authority of NEEQ, namely, NEEQ Co., Ltd..<sup>105</sup> In compliance with the relevant requirements for quotation application,<sup>106</sup> the Prospectus was also

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<sup>101</sup> These two projects are Lavande Hotels ([http://www.renrentou.com/project/detail/project\\_id/13738](http://www.renrentou.com/project/detail/project_id/13738)) and 7 Days Inn ([http://www.renrentou.com/project/detail/project\\_id/15518](http://www.renrentou.com/project/detail/project_id/15518)).

<sup>102</sup> *Gongsi jianjie [About Us]*, ZHONGTOU8, <http://www.zhongtou8.cn/corp/about> (last visited June 20, 2016).

<sup>103</sup> See *supra* note 68 and the accompanying text.

<sup>104</sup> See *supra* note 102.

<sup>105</sup> Quanguo zhongxiao qiye gufen zhuanrang xitong youxian zeren gongsi guanli zanxing banfa [Tentative Administrative Measures for the NEEQ Co., Ltd.] (promulgated by the CSRC, Jan. 31, 2013), available at: [http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgz/scjy/201310/t20131021\\_236593.html](http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgz/scjy/201310/t20131021_236593.html), art. 21.

<sup>106</sup> Quanguo zhongxiao qiye gufen zhuanrang xitong guapai shenqing wenjian neirong yu geshi zhiyin (shixing) [(Trial) Guidelines for the Content and Format of Application Documentation for Quotation on the NEEQ] (promulgated by NEEQ Co., Ltd., Feb. 8, 2013, amended Dec. 30, 2013), available at: <http://www.neeq.com.cn/upload/A0/B0/C2/F218.pdf>.

supported by a legal opinion, a sponsoring report from its chief agency broker, and the company's financials and auditing report. Upon reviewing this set of documentation, NEEQ Co., Ltd. gave its feedback about Zhongtou8's quotation application on November 10, 2015 (the "Feedback Letter"), ordering the company to work on a number of issues and report back. In response to this, Zhongtou8 turned in two response letters in December 2015 and January 2016, respectively (the "First Response Letter" and the "Second Response Letter", collectively, the "Response Letters"). All these documents mentioned above can be found on the official website of NEEQ ([www.neeq.com.cn](http://www.neeq.com.cn)), by going to the "Information Disclosure" tab, choosing "Examination and Review Information", and then typing in Zhongtou8 (in Mandarin Chinese) in the search bar.

Being the core document in the whole quotation application set, the Prospectus is divided into five sections, presenting information on the company's basics, business and technologies, corporate governance, financials, and declarations from the relevant parties, respectively.<sup>107</sup> Such information was further supplemented by the two Response Letters, which specifically address, *inter alia*, certain important particulars of the company's operations and project portfolio, its business model, and the legitimacy of that under the current regulatory framework.<sup>108</sup> Combined, these three documents offer very important inside information about the equity crowdfunding business practice of Zhongtou8. If considering that Zhongtou8 has also a decent share and position in the market, the value of this case study becomes even greater as it may reveal some common practice and issues about this industry as a whole.

### 3.2.1 Business Model and Operations

Similar to other major equity crowdfunding portals in China, Zhongtou8 also adopts a "lead + backers" model. Under this model, as already explained in Section II, investors from a crowdfunding campaign will first be pooled into a limited partnership, which will invest in the issuing company as ONE new shareholder. Every fundraising project must have at least one leading investor, who is followed by a group of maximum 49 crowdfunders.<sup>109</sup> This is to comply

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<sup>107</sup> See the Prospectus (Table of Contents), available at: [www.neeq.com.cn](http://www.neeq.com.cn).

<sup>108</sup> See the Feedback Letter, available at: [www.neeq.com.cn](http://www.neeq.com.cn).

<sup>109</sup> See *Zhongtou touzi liucheng* [Crowdfunding Investment Process], ZHONGTOU8, <http://www.zhongtou8.cn/help/index/id/15>, indicating that a project can only contain a maximum of 50 investors in a single fundraising round.



with China's legal requirement that a limited partnership should have no more than 50 partners in total.<sup>110</sup> If there are more than 50 investors in a project, two or more partnerships will be set up to contain them.<sup>111</sup> Ultimately, an issuer should not have more than 200 shareholders in total after the crowdfunding round in order to still remain as private company.<sup>112</sup> Given this mandatory limit, pooling small crowdfunding investors first into a new entity is apparently beneficial, as only one new shareholder will be added into the issuer. An aggregate of 90 days are allowed to raise funds for a project, starting from the day of the project's online launch. Whether fundraising is successful depends on the amount of capital being subscribed as of the end of these 90 days. A fundraising campaign fails if only less than 50% of the planned amount is subscribed; if the subscribed capital is between 50% to 80%, the campaigner may choose to adjust the amount of equity to be sold, or otherwise the fundraising fails; if between 80% to 100%, the fundraising is deemed successful, provided that the lead makes up the difference.<sup>113</sup>

In comparison to the direct investment model as shown in the Renrentou cases study above, where a third party manager needs to be specifically commissioned to exercise the control rights on behalf of the crowdfunders, the design of the "lead + backers" solves this issue in a more clear-cut way. Given its status as a professional investment manager itself, the lead is naturally assigned to represent all the followers in the issuing company, where it manages the investment, participates in the decision making process for certain material business issues, and also joins the board of directors.<sup>114</sup> Note that, this last point is never mentioned in Renrentou's investment contracts, which are very explicit about the crowdfunding campaigner being in control in terms of running the business. Essentially, this is why limited partnership is chosen as favorite business form for most of the project entities – to give crowdfunders the status of limited partners and preclude them from having most control rights. In comparison, projects on Zhongtou8 typically do not involve setting up a new business entity. Equity to be sold in crowdfunding is created by increasing the share capital of the issuer, which is always a joint stock company, and crowdfunders as a group will be pooled together and join the issuing

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<sup>110</sup> Zhonghua renmin gongheguo hehuo qiye fa [Partnership Enterprise Law (P.R.C.)] (promulgated by the Nat'l People's Cong., Feb. 23, 1997) (amended Aug. 27, 2006) (took effect June 1, 2007), LAWINFOCHINA, available at: <http://www.lawinfochina.com>, art. 61.

<sup>111</sup> An example in Zhongtou8's project portfolio is Juzhu Jiabang. See notes to Figure 3.2.2.B, *infra*.

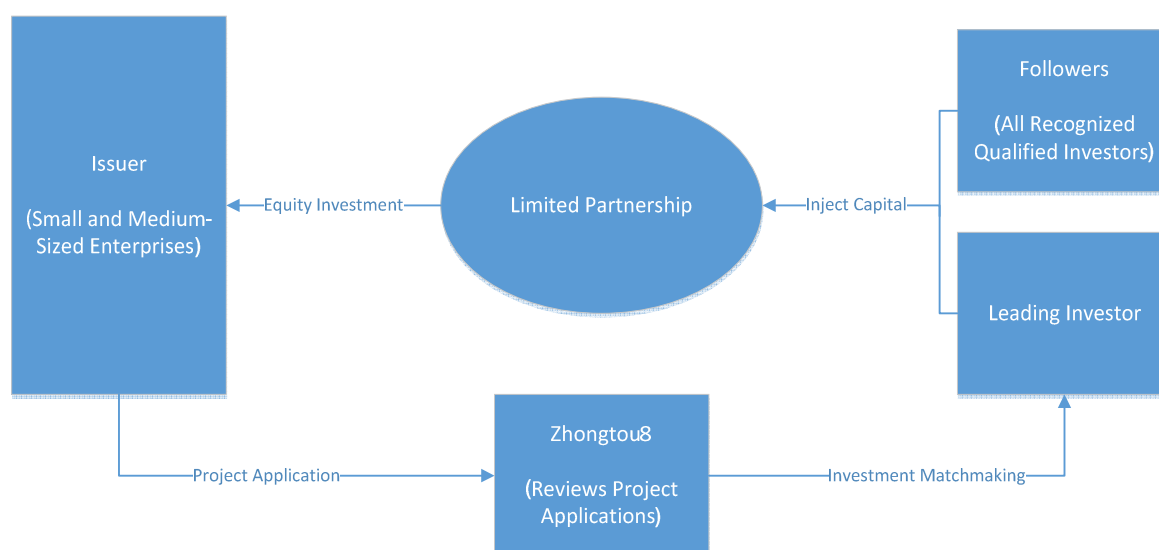
<sup>112</sup> Crowdfunding Measures, *supra* note 9, art. 12.

<sup>113</sup> See *supra* note 109.

<sup>114</sup> *Id.*

company as one new shareholder by subscribing such share capital. It remains nevertheless unclear, without seeing the real contractual terms in the investment agreements of Zhongtou8's projects, whether the discard of the intrinsic feature of separation of ownership and control in a limited partnership and the ability to join the issuer's board of directors can be taken as signs that crowdfunders here are able to share more control rights with the issuer. After all and as already discussed in Section 3.1 above, even when joint stock company is used as the business form, the investment contracts are still written in such a way that the campaigner keeps control of business operations.<sup>115</sup> Figure 3.2.1 illustrates the business model of Zhongtou8.

FIGURE 3.2.1: BUSINESS MODEL OF ZHONGTOU8



Source: Zhongtou8.

Based on the figure above and its NEEQ quotation application, Zhongtou8 claims itself as an “institution providing services to small and medium-sized enterprises (“SMEs”) investment and financing”, including information sharing and project investment matchmaking.<sup>116</sup> Before a project can be launched online for crowdfunding, Zhongtou8 will conduct an initial due diligence about it to see whether the basic requirements are met. According to its website, these requirements are: issuing company has been in existence for at least two years; annual revenue of

<sup>115</sup> See *supra* note 101 and the accompanying text.

<sup>116</sup> The First Response Letter, p. 21.

the last year is no less than RMB10 million and net profit is no less than RMB1 million (exceptions can be made for really good projects); and the minimum amount to be raised from the crowdfunding round should be at least RMB10 million. In addition to these, Zhongtou8 pays special attention in particular to firms from the lines of Internet, WAP, cultural communication, consumption & services, environmental friendly industries, new materials, new energy, and health & wellness.<sup>117</sup>

### 3.2.2 Related Party Transactions and Conflict of Interests

In a crowdfunding project, all investors are followers by default. In order to become a lead, an investor will need to apply to the issuer and Zhongtou8, who will jointly decide whether the applicant can become the lead of this project.<sup>118</sup> This corresponds with the discussion in Section II above, namely, it is more accurate to say that followers choose to back a certain lead because of a good project, rather than to say that they choose to back a certain project because of a good lead. Because the lead is picked out of the existing investors of a project, there is no question of leading investors conducting pre-investment screening of potential projects on behalf of the backers, which is an important advantage of AngelList type of syndicates.<sup>119</sup> Based on the information published on its website, Zhongtou8 abides by a number of principles when selecting a potential leading investor. These consist of the following: the potential lead should be a professional investor; is most helpful to the project among all the candidates; has ample investment experience, especially in similar lines of business as the project; has resources both upstream and downstream to help project development when necessary; and is able to bring in more followers.<sup>120</sup> A lead also needs to make a substantial investment itself into the project, typically between 20% and 50% of the total amount to be raised.<sup>121</sup> As a reward for such large capital commitment and also the efforts to manage investment and exercise control in the issuing company, a lead is entitled to a 10% carried interest, and is also given the access to the pool of potential crowdfunding projects prior to normal following investors.<sup>122</sup>

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<sup>117</sup> *Zhongtou xiangmu shenhe biao zhun [Standards for Reviewing Crowdfunding Projects]*, ZHONGTOU8, <http://www.zhongtou8.cn/help/index/id/20>.

<sup>118</sup> See *supra* note 109.

<sup>119</sup> See *supra* note 36.

<sup>120</sup> *Lingtou zige shenhe biao zhun [Standards for Assessing Competence of Potential Leading Investors]*, ZHONGTOU8, <http://www.zhongtou8.cn/help/index/id/22>

<sup>121</sup> *Lingtou jieshao [An Introduction of Leading Investors]*, ZHONGTOU8, <http://www.zhongtou8.cn/help/index/id/13>.

<sup>122</sup> *Id.*

Although the issuer has the final say if there are more than one suitable candidates for leading investors,<sup>123</sup> the fact that Zhongtou8 also participates in the selection inevitably makes one wonder its role is in this process. To be sure, one cannot and should not expect to completely rule out the relationship between a crowdfunding portal and potential leads. This is simply because the portal has the natural information advantage relative to the issuer when it comes to connecting to the professional investor community. Otherwise, the issuer would not need to resort to crowdfunding in first place. Ideally, a good crowdfunding portal should be an efficient platform where both investors and entrepreneurs can quickly find and match with each other. The ability to make this happen is certainly a bonus point when an entrepreneur considers which portal to choose. But can things be different if the leading investor candidates and potential winner are introduced to the issuer by or even related to the crowdfunding platform? Is this just some remote doubt or rather real concern in practice? Figures 3.2.2.A and 3.2.2.B below help to shed light on these issues.

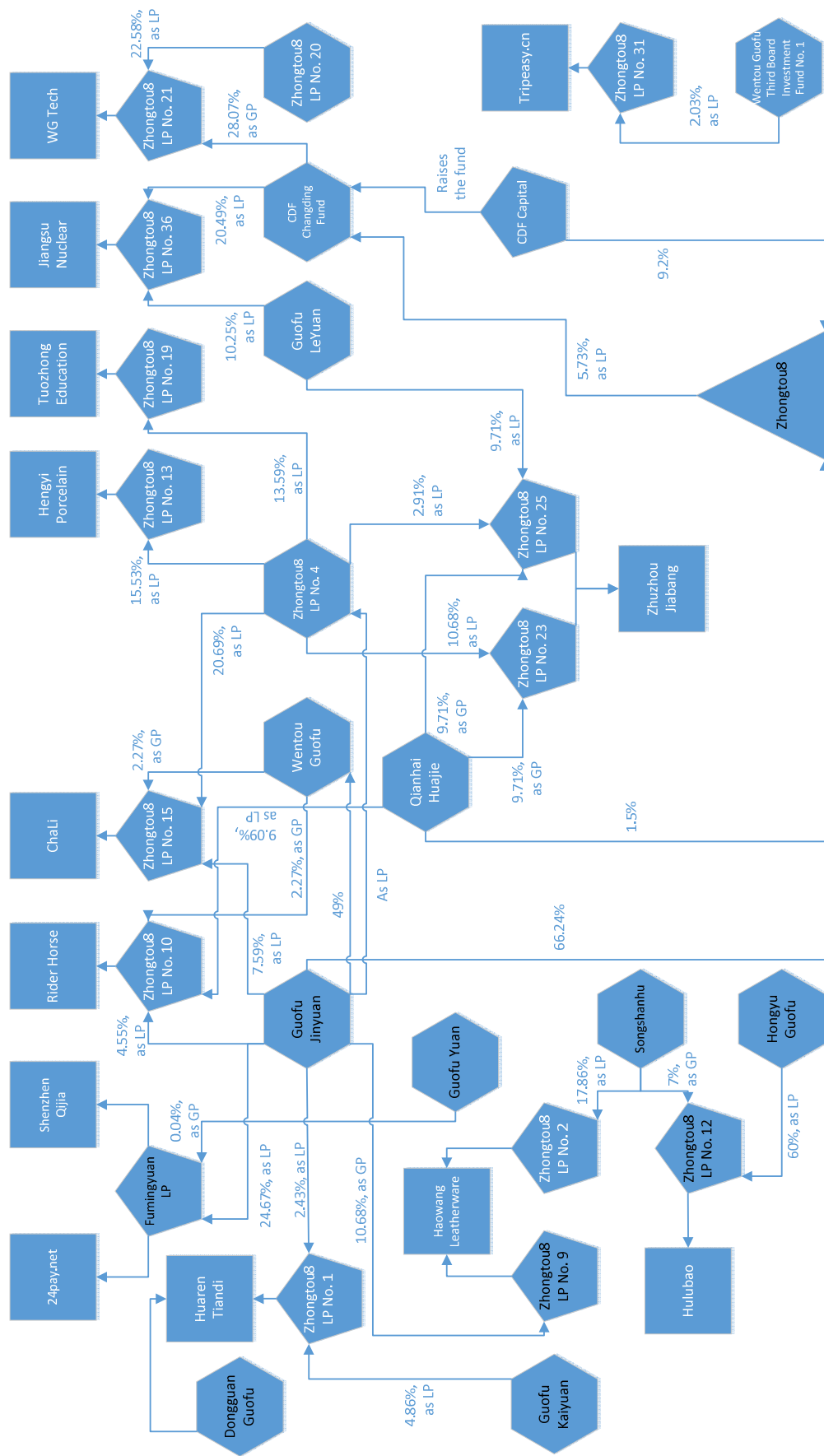
FIGURE 3.2.2.A: EQUITY STRUCTURE OF ZHONGTOU8

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<sup>123</sup> See *supra* note 109.



FIGURE 3.2.2.B: OVERVIEW OF RELATIONSHIPS AMONG ZHONGTOU8, LEADING INVESTORS, AND PROJECTS



Notes:

1. Summarized on the basis of the relevant information from the Prospectus and the two Response Letters.
2. The squares are the issuing companies that use Zhongtoug8 as the platform to raise funds. The Pentagons are the limited partnerships that pool crowd investors and invest in the companies. The hexagons are the partners (either general or limited) in the limited partnerships.
3. Zhongtoug8 claims that for the sake of efficiency, it is a customary practice for the crowdfunding platform to first set up a series of “shell” LPs under its name (i.e., Zhongtoug8 LP No. X), and then transfer these LPs to the real investors once the crowdfunding campaign is completed. The figure above only intends to depict the relationships between the issuing companies and Zhongtoug8 (and its related parties) that still exist after the crowdfunding campaign is closed and the capital is actually invested.
4. The shapes with black texts are entities controlled, directly or indirectly, by Zhu Pengwei.
5. Haowang Leatherware has two LPs investing in it because it has conducted two crowdfunding campaigns via Zhongtoug8. Zhuzhou Jiabang has only conducted one crowdfunding campaign but the investors are pooled into two LPs to invest in it.
6. Zhongtoug8 LP No. 4 is a normal private equity fund instead of a special purpose vehicle created to pool crowdfunding investors.

TABLE 3.2.2.C: ALL CROWDFUNDING PROJECTS SERVED BY ZHONGTOUG8 AS OF JANUARY 2016

	Issuing Company	Investing LP(s)	Capital Raised (RMB M)	Leading Investor	Leading Investor's Relationship with Zhongtoug8 and its Affiliates	Targeted and Realized Exit
1	Huaren Tiandi	Zhongtoug8 LP No. 1	24.7	Wentou Guofu	49% owned by Guofu Jinyuan, 51% owned by Guangdong Wentou.	Explicitly named NEEQ as a potential exit channel.
				Guofu Jinyuan	90% owned by Zhu Pengwei.	Already quoted on NEEQ, company code 830898.
2	Haowang Leatherware	Zhongtoug8 LP No. 2	8.4	Songshanhu	Controlled by Zhu Pengwei.	Explicitly named NEEQ as a potential exit channel.
3			10.3	Guofu Jinyuan	90% owned by Zhu Pengwei.	

	Haowang Leatherware	Zhongtoutu8 LP No. 9		Chuangfuzhi	One of Zhongtoutu8's director (Wang Wei) is the chairman of Chuangfuzhi.	Explicitly named NEEQ as a potential exit channel.
4	Rider Horse	Zhongtoutu8 LP No. 10	22	Wentou Guofu	49% owned by Guofu Jinyuan, 51% owned by Guangdong Wentou.	
				Guangdong Wentou		
5	Hengyi Porcelain	Zhongtoutu8 LP No. 13	10.3	Guofu Yuan	Controlled by Zhu Pengwei.	Explicitly named NEEQ as a potential exit channel.
6	ChaLi	Zhongtoutu8 LP No. 15	7.25	Wentou Guofu	49% owned by Guofu Jinyuan, 51% owned by Guangdong Wentou.	
7	Tuozhong Education	Zhongtoutu8 LP No. 19	10.3	Guofu Yuan	Controlled by Zhu Pengwei.	Explicitly named NEEQ as a potential exit channel.
8	Zhuzhou Jiabang	Zhongtoutu8 LP No. 23 and 25	20.6	Qianhai Huajie	Owens 1.5% in Zhongtoutu8.	Explicitly named NEEQ as a potential exit channel.
9	WG Tech	Zhongtoutu8 LP No. 21	15.5	CDF Capital	Controlled by Zhu Pengwei's sister. CDF Capital also owns 9.2% in Zhongtoutu8.	Explicitly named NEEQ as a potential exit channel. Already quoted on NEEQ, company code 832766.
10	Zigong Haichuan	Zhongtoutu8 LP No. 11	7.68	RC Investments		Explicitly named NEEQ as a potential exit channel.
11	Hulubao	Zhongtoutu8 LP No. 12	5.15	Hongyu Guofu	Controlled by Zhu Pengwei.	Did not explicitly name NEEQ as a potential exit channel. Already quoted on NEEQ, company code 832588.



12	Jiangsu Nuclear	Zhongtoug8 LP No. 36	7.68	(Fund under) Guofu Yuan	Controlled by Zhu Pengwei.	Did not explicitly name NEEQ as a potential exit channel. Already quoted on NEEQ, company code 832026.
13	TripEasy.cn	Zhongtoug8 LP No. 31	10.3	Wentou Guofu	49% owned by Guofu Jinyuan, 51% owned by Guangdong Wentou.	Explicitly named NEEQ as a potential exit channel.
14	24pay.net	Fumingyuan LP	20	Shenzhen IDH	Controlled by CDF Capital.	
15	Shenzhen Qijia	Fumingyuan LP	23	Kaisa Group		
16	Beijing Zeepson	Zhongtoug8 LP No. 32	22.04	Guofu Yuan	Controlled by Zhu Pengwei.	Explicitly named NEEQ as a potential exit channel.
17	Limsam Network	Zhongtoug8 LP No. 35	18	Guofu Yuan	Controlled by Zhu Pengwei.	Explicitly named NEEQ as a potential exit channel.
18	TDYH Vinegar Drinks	Zhongtoug8 LP No. 55 and 59	6.25	(Fund under) Guofu Yuan	Controlled by Zhu Pengwei.	Quoted on NEEQ, company code 832898.
19	JPM.com	Zhongtoug8 LP No. 60	10	(Fund under) Wentou Guofu	49% owned by Guofu Jinyuan, 51% owned by Guangdong Wentou.	
20	Shenzhen Jiayinking <sup>124</sup>	Unknown	Unknown	Unknown	Unknown	Quoted on NEEQ, company code 831491.
21	Duoyoumi.com <sup>125</sup>	Unknown	Unknown	Unknown	Unknown	
22	1hhd.com		16.13	Zhenshun Fund		

<sup>124</sup> This project cannot be found on Zhongtoug8's website.

<sup>125</sup> *Id.*

		Zhongtoug8 LP No. 65		Qianhai Huajie	Owens 1.5% in Zhongtoug8.	Explicitly named NEEQ as a potential exit channel.
23	Beijing HEcom <sup>126</sup>	Zhongtoug8 LP No. 62	Unknown	Unknown		Quoted on NEEQ, company code 834218.
24	Guangzhou Hengfu <sup>127</sup>	Zhongtoug8 LP No. 63	Unknown	Unknown		Quoted on NEEQ, company code 832453.
25	Hepuyi Advertisement	Zhongtoug8 LP No. 16	10	Guofu Yuan	Controlled by Zhu Pengwei.	Explicitly named NEEQ as a potential exit channel.
	<b>Campaigner</b>	<b>Investing LP(s)</b>	<b>Capital Raised (RMB M)</b>	<b>Name of Fund</b>	<b>Campaigner's Relationship with Zhongtoug8 and its Affiliates</b>	<b>Note</b>
26	Wentou Guofu	Zhongtoug8 LP No. 22	51.5	Wentou Guofu NEEQ Fund No. 2	49% owned by Guofu Jinyuan, 51% owned by Guangdong Wentou.	
27	Zero2IPO Growth Capital Hangzhou	Unknown	500	Zero2IPO-Zhongtoug8 NEEQ Fund of Funds	Controlled by Ni Zhengdong, who owns 2.76% and is also a director of Zhongtoug8.	
28	CDF Capital	Unknown	26.2	CDF Changding Fund	Controlled by Zhu Pengwei's sister. CDF Capital also owns 9.2% in Zhongtoug8.	The first lead fund raised via the platform of Zhongtoug8.
29	Eagle Investment Holdings	Zhongtoug8 LP No. 39	25.5	Eagle Investment NEEQ Lead Fund		

<sup>126</sup> *Id.*

<sup>127</sup> *Id.*

Note: This list of fundraising projects is made based on the second Response Letter, which discloses all the projects that Zhongtong8 has provided services as of January 2016. Some information is supplemented based on the disclosure on Zhongtong8's website. The order of the projects in the list is as originally disclosed; I only group all the investment fund projects (no. 26 – 29) together and put them at the end.

After reviewing Zhongtou8's initial quotation application, NEEQ has particularly requested, in the Feedback Letter, more disclosure about the possible equity holdings in the fundraising projects by Zhongtou8 and its affiliates. Figure 3.2.2.B was plotted based on Zhongtou8's responses to such request in the First Response Letter together with the other relevant information scattered around the other documents in the quotation documentation. As of December 2015 (the date of the First Response Letter), Zhongtou8 has served an aggregate of 25 fundraising projects, among which 16 projects (involving 14 different issuing companies) are disclosed to have equity holdings by related parties.<sup>128</sup> Such equity holdings, as vividly illustrated in Figure 3.2.2.B, are primarily found on two levels, i.e., the level of limited partnerships that are set up to pool crowdfunders (shown as pentagons) the level of investors in the limited partnerships (both GPs and LPs, shown as hexagons). In particular, it is worth noting that the shapes with black (rather than white) text are directly or indirectly controlled by Zhu Pengwei, the founder and controlling person of Zhongtou8. In other cases, such as Wentou Guofu (where Zhu has 49% control indirectly via Guofu Jinyuan) and its fund (Wentou Guofu Third Board Investment Fund No. 1), Zhu Pengwei arguably can still have significant influence although he does not have controlling interests there. In addition to Zhu Pengwei, other Zhongtou8 investors, such as Qianhai Huajie and CDF Capital, are also identified to have equity interests in the platform's crowdfunding projects. It is worth noting that CDF Capital is controlled by Zhu Junhui, who is Zhu Pengwei's sister (see Figure 3.2.2.A).

Read together, Figure 3.2.2.B and Table 3.2.2.C reveal even more striking information. Although Zhongtou8 has put on table a set of decent selection criteria when it comes to choosing potential leading investors, in practice it is the parties controlled or related to the platform that have got the majority of the deals (see Table 3.2.2.C). And in all the projects that have two leads, at least one of the two is served by parties related to or controlled by Zhongtou8. But the story does not end here yet. Next to serving as leads, Zhongtou8 affiliates are also identified to have invested in many issuers as normal following investors. For example, although Guofu Jinyuan is not a lead in Rider Horse, it still has an indirect financial interest in the company by virtue of its 4.55% equity interest as a limited partner in Zhongtou8 LP No. 10. The same holds for 24pay.net (through Fumingyuan LP), Haowang Leatherware (through Zhongtou8 LP. No. 9),

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<sup>128</sup> See the First Response Letter, p. 54. Note that, here Zhongtou8 didn't count the four campaigns for raising investment funds (no. 26 – 29 in Table 3.2.2.C).

ChaLi (through Zhongtou8 LP. No. 15), Hengyi Porcelain, Tuozhong Education, and Zhuzhou Jiabang (all through Zhongtou8 LP. No. 4). To the extent the relevant information is available, there are actually only 2 out of a total of 25 projects that use non-related leading investors,<sup>129</sup> and even in these two projects, one still has a significant investment from Guofu Jinyuan, an entity controlled by Zhu Pengwei.<sup>130</sup> In addition to crowdfunding for SMEs, Zhongtou8 has also been used to raise investment funds. Again, three in the total four of such campaigns (projects 26 – 29 in Table 3.2.2.C) were initiated by Zhongtou8 affiliates.

Therefore, instead of merely acting as a middleman to bring issuers and crowdfunders together, Zhongtou8 actually puts quite some stakes itself in the projects, which will give it potential control (by having its affiliates serving as leads) of and economic returns from the issuers. To be sure, this is not to say that Zhongtou8 affiliates *per se* do not have the qualifications to become the leading investors of the projects or they should not use Zhongtou8 to raise funds. But such practices do raise serious concerns about potential conflicts of interests. To begin with, because potential applications are first submitted to the crowdfunding portal for an initial review before they can be launched online and open to investors, Zhongtou8 will also be the first to know whether a project is better compared to the others based on its assessment of the merits of these projects. As such, there is a possibility that Zhongtou8 may play cherry picking by letting its affiliate(s) investing in the “better projects”. Given its power to select, together with the issuer, a potential lead out of all of the project’s investors, it may also specifically refer its affiliate(s) as “good candidates” when the campaigner asks about its opinion on this issue. In contrast, investment managers not affiliated with Zhongtou8 may only get referred to the issuer of less promising projects.

Secondly, while it should be among the lead’s key tasks to perform, on behalf of all the crowdfunders, post-investment monitoring of the campaigner / issuing company, it becomes questionable whether the lead still can and will do so with its full strength when it is affiliated with the portal. The same rationale argued in the Renrentou case study also applies here. Given that the business revenue of a crowdfunding portal primarily comes from charging the issuers

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<sup>129</sup> These three projects are: Zigong Haichuan and Shenzhen Qijia.

<sup>130</sup> This project is Shenzhen Qijia, where Guofu Jinyuan invests 24.67% as a limited partner in Fumingyuan LP.

(and not the investors) fees for using its platform to raise funds,<sup>131</sup> not pushing monitoring rights to extremes and letting the issuers feel that they are still in control is more in line with Zhongtou8's interests because it helps to bring in more potential clients. Doing so can be at the cost of small crowdfunders though. Faced with the competing needs of keeping a big issuer (thus potential service fee income) for the portal by refraining from overly interfering with its business decisions, and maximizing the shareholder value for small crowdfunders by questioning possible value-destructing activities of the management in the issuer, a portal-affiliated lead may choose the former over the latter, thus sacrificing the interests of small investors.

Finally and more dangerously, we cannot rule out the possibility of Zhongtou8 sitting on two sides of the table. Note that, the arguments made in the points above are based on the assumption that an issuer is not originally related to Zhongtou8 or its affiliates before the fundraising campaign starts. But when this is no longer the case and Zhongtou8 and/or its affiliates already have (significant) financial interests in the issuing company, there is reason to doubt the quality of the crowdfunding project as the portal might be unable to remain impartial in reviewing the project when it has some stakes in the issuer itself. In the worst case scenario, the portal might be abused by lemons to get some easy money in from the crowd, because otherwise they cannot raise capital from professional investors or via a non-related crowdfunding platform. If losing investment, small investors in these lemon projects will hardly have any effective recourse to the issuer or the portal contractually, because equity crowdfunding is intrinsically a risky business and they are deemed to have realized this by virtue of signing the Disclosure of Potential Investment Risks as of becoming an investor of an equity crowdfunding portal in the first place.<sup>132</sup>

### 3.2.3 Exit

As shown in Table 3.2.2.C, the majority of the 25 non-investment-fund projects raised through Zhongtou8 have expressed keen interest in NEEQ, by explicitly naming it in their campaign materials as a potential exit venue for crowdfunding investors. In fact, NEEQ is also

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<sup>131</sup> DAVID M. FREEDMAN & MATTHEW R. NUTTING, EQUITY CROWDFUNDING FOR INVESTORS: A GUIDE TO RISKS, RETURNS, REGULATIONS, FUNDING PORTALS, DUE DILIGENCE, AND DEAL TERMS, 121 (2015).

<sup>132</sup> Crowdfunding Measures, *supra* note 9, art. 8.7 (stipulating that an equity crowdfunding portal should, among other things, educate investors with the relevant knowledge and potential risk associated with crowdfunding, and enter into Disclosure of Potential Investment Risks with investors).

the only form of exit that these projects have actually managed to realize as of January 2016. To be sure, being quoted on NEEQ, which is essentially an over-the-counter market,<sup>133</sup> is different from having an initial public offering (“IPO”) and then getting listed on a public stock exchange. Among other things, the substantive requirements for a NEEQ quotation are much lower than those for an IPO, so are the level of regulatory review from the relevant governmental authorities.<sup>134</sup> As a matter of fact, so long as a firm is a duly incorporated joint stock company existing for more than two years, has clearly-defined business, sound corporate governance framework and a clear equity structure, and has been operating in compliance with the relevant laws and regulations, it is qualified to be quoted on the NEEQ provided that a chief agency broker sponsors its quotation and provides continuous tutoring afterwards.<sup>135</sup> There are no mandatory requirements for the scale and profitability of a potential firm aiming for NEEQ quotation,<sup>136</sup> which often turn out to deter the IPO application of early stage firms as they typically are not profitable yet.<sup>137</sup> Therefore, it is no wonder that NEEQ has generated so much interest among Zhongtou8’s portfolio companies by virtue of being a realistically attainable exit venue.

In stricter terms, neither IPO nor NEEQ quotation means a real exit for existing investors, though. A real exit only happens when the investors sell their equity and regain liquidity in the public market made available to them after the quotation or listing. In this regard, however, NEEQ still has much to be desired if compared to regular stock exchanges. Despite the sheer

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<sup>133</sup> Jing Li, *OTC Stock Market in China – A New Venture Capital Exit?* 6 ASIAN JOURNAL OF LAW AND ECONOMICS 167, 190 (2015).

<sup>134</sup> *Id.*, at 221.

<sup>135</sup> Quanguo zhongxiao qiye gufen zhuanrang xitong yewu guize (shixing) [(Trial) Business Rules for the National Equities Exchange and Quotations] (promulgated by the NEEQ Co. Ltd., Feb. 8, 2013) (amended 30 Dec. 2013), available at: <http://file.neeq.com.cn/upload/A0/B0/C2/F225.pdf>, art. 2.1.

<sup>136</sup> Although this remains true for all NEEQ firms, a new regulatory attempt in May 2016 aims to group the firms into two different tiers, namely, the Innovative Tier, and the Basic Tier. The Innovative Tier does impose, among other things, requirements about business revenue and profitability. Firms cannot meet the entry and/or maintenance requirements of the Innovation Tier will automatically be considered to belong to the Basic Tier. Tailored regulations are going to be put in place to suit the different characteristics of the firms in these two tiers. See Quanguo zhongxiao qiye gufen zhuanrang xitong guapai gongsi fenceng guanli banfa (shixing) [(Trial) Administrative Measures for Dividing NEEQ-Quoted Firms into Tiers] (promulgated by the NEEQ Co. Ltd., May 27, 2016), available at: [http://www.neeq.com.cn/uploads/1/file/public/201605/20160527185900\\_u8n3865s2c.pdf](http://www.neeq.com.cn/uploads/1/file/public/201605/20160527185900_u8n3865s2c.pdf).

<sup>137</sup> For such requirements for IPO applications, see Art. 33 of Shouci gongkai faxing gupiao bing shangshi guanli banfa [Measures for the Administration of Initial Public Offering and Listing of Stocks] (promulgated by the CSRC, May 17, 2006), LAWINFOCHINA, available at: [www.lawinfochina.com](http://www.lawinfochina.com); and art. 11 of Shouci gongkai faxing gupiao bing zai chuanye ban shangshi guanli banfa [Measures for the Administration of Initial Public Offering and Listing of Stocks on the ChiNext] (promulgated by the CSRC, May 14, 2014), LAWINFOCHINA, available at: [www.lawinfochina.com](http://www.lawinfochina.com).

number of companies already quoted in the market, which amounted to 8667 as of mid-August in 2016 and is still growing at a fast pace, in practice around 60% of them have never had any trading since their quotation.<sup>138</sup> As such, although no information is available in Zhongtou8's disclosure about whether the crowdfunding investors in their portfolio firms have managed to sell their shares in NEEQ and thus got to the point of exit, the low level of liquidity in this market still makes one doubt the accountability of this exit channel in general when in fact the shares of most of the NEEQ-quoted firms are not traded at all.

#### IV. A COMMENT ON THE CROWDFUNDING MEASURES

The two case studies lend support from the practice to an in-depth analysis of the Crowdfunding Measures. Based on the findings, I particularly focus on two issues, i.e., the potential conflicts of interests when an equity crowdfunding portal has financial interests in an issuer; as well as the qualifications for an investor and the feasibility of exits. Because these two issues are inherently interrelated and both concern the rights and obligations of the three key parties of equity crowdfunding, the following discussions are organized on the parts of the portal, the campaigner / issuer, and the investors, respectively, which is also consistent with the order of the Crowdfunding Measures.

##### 4.1 Provisions on Crowdfunding Portal

To start with, the Crowdfunding Measures enumerate a number of DO's and DON'Ts for an equity crowdfunding portal.<sup>139</sup> To the extent that the Zhongtou8 case study is concerned, two points are particularly worth discussion. The first point is that the Crowdfunding Measures explicitly prohibit an equity crowdfunding portal from raising funds for itself or its related parties through the platform.<sup>140</sup> There is no definition of what constitutes a "related party" though. As such, while Zhongtou8 certainly did not use the platform to raise funds for itself, it is

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<sup>138</sup> Ye Maisui, *fengceng jin liangyue liudongxing nanti reng wei jie; 5190 jia qiye xinsanban shangshi yilai ling chengjiao* [Almost two months after the creation of two market tiers but still no improvement of liquidity; 5190 NEEQ firms have no trading at all], 21 SHIJI JINGJI BAODAO [21<sup>ST</sup> CENTURY BUSINESS HERALD], Aug. 17, 2016, available at: [http://epaper.21jingji.com/html/2016-08/17/content\\_45243.htm](http://epaper.21jingji.com/html/2016-08/17/content_45243.htm), at 10.

<sup>139</sup> Crowdfunding Measures, *supra* note 9, art. 8 & 9.

<sup>140</sup> *Id.*, art. 9.1.



not clear whether the fact that three out of the four investment funds raised through Zhongtou8 were actually initiated by campaigners that are owned or controlled by the shareholders of this platform (see Table 3.2.2.C) would constitute a violation of this prohibition. The second point is that according to the Crowdfunding Measures, a portal should refrain from abusing its information advantage to obtain investment opportunities or mislead investors.<sup>141</sup> On this issue, there is a high probability that Zhongtou8 might be in violation, when its affiliates have served as the leading investors in almost all the fundraising projects, and are also identified to have financial interests in many projects besides that.

As already presented and analyzed in great details in Section 3.2.2 above, when a crowdfunding portal and/or its affiliates have financial interests in the issuers that use the portal as platform to raise funds, it will easily lead to potential conflicts of interests. This being said, one may still question whether it is necessary to go that far and completely ban a platform from letting a related party use its services. Regulators from other jurisdictions have approached this issue with more generosity. The US, for example, allows an intermediary to have a financial interest in an issuer, as long as the intermediary receives such financial interest on an arm's length basis as compensation for the services provided to issuer through the intermediary's platform; and the financial interest consists of securities of the same class and having the same terms, conditions and rights as the securities being offered or sold through the intermediary's platform.<sup>142</sup> In Italy and France, the regulator imposes a general responsibility on the part of the crowdfunding portal to detect and avoid any potential conflicts of interests that may affect investors and issuers, and to that end, a portal should have in place certain policy or measures to manage the conflicts of interests.<sup>143</sup> Similar to the Crowdfunding Measures, Canada's Ontario and Quebec regime<sup>144</sup> also prohibits not only the portal itself, but also its related parties, from using the platform to raise funds. What's different there, however, is that the prohibition only applies when the funding portal, or any of its officer, director, significant shareholder, or affiliate holds an ownership interest of more than 10% of the issued and outstanding securities of the

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<sup>141</sup> *Id.*, art. 9.4.

<sup>142</sup> IOSCO, *supra* note 30, at 15.

<sup>143</sup> *Id.*, at 14.

<sup>144</sup> For an explanation of the so-called "Ontario and Quebec regime", see *id.*, at 13.

issuer. In addition, a portal is also required to disclose all compensation and fees it receives from an issuer.<sup>145</sup>

To the extent of what has been revealed from Zhongtou8's practice, the Canadian approach arguably serves as an inspirational alternative for regulating conflicts of interests in crowdfunding business. In contrast to the sweeping ban adopted by the Crowdfunding Measures, disclosure is rather the core here. Potential investors are given the freedom to decide, on the basis of the disclosure made by the portal, whether to invest in an issuer where the portal and/or its related parties have small financial interests. Mandatory prohibition is only triggered when the financial interests at stake are too big to ignore potential conflicts. This would be the more consistent solution, when the Crowdfunding Measures have already set high entry requirements to filter equity crowdfunding investors, so that only the sophisticated wealthy ones are allowed into the business.<sup>146</sup> In this case, it is logical that the investors are left with the right to decide whether a project is still worthwhile to pursue. Conversely, the current cautious position from the regulator would be more justified when the investors are truly from the "crowd" and thus lack the sophistication to do that well themselves. Either way, the combination that the Crowdfunding Measures currently choose to have creates inconsistency. Without endeavoring to take a side on this issue now yet, the key point to be made here is that rather than focusing on predetermining on behalf of the investors which projects are risky and thus should not be presented to them, the top priority for the regulator should be ensuring effective disclosure from the parties with better information, so that the investors can use it to make effective decisions themselves. Similarly, when it comes to whether a portal has used its informational advantage to obtain investment opportunities for itself or have misled investors, the prohibitive language in the Crowdfunding Measures is actually toothless because a regulator is not able to verify and enforce this prohibition until an aggrieved investor uses it to seek for damage. Therefore, the better solution here is again disclosure. Since it is difficult to perform *ex ante* verification on "having used its informational advantage", the focus of the disclosure should rather be attached onto the verifiable part, i.e., the financial interests of the portal in the issuer and/or its affiliates. On the basis of such disclosure, the decision on whether or not to still make the investment passes on to

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<sup>145</sup> *Id.*, at 15.

<sup>146</sup> The high entry thresholds for crowdfunding investors are equally, if not more, problematic themselves though. This will be discussed in more details in Section 4.3, *infra*.

the investors; and if something goes wrong, the disclosure then serves as a cause of suit for the investors to resort to *ex post* remedy.

#### 4.2 Provisions on Campaigner / Issuer

Having shown that disclosure is a more efficient approach to the end of regulating the potential conflicts of interest in equity crowdfunding, I go on to point out that it is actually not a completely novel idea in the Crowdfunding Measures. In the section about the DO's and DON'Ts of a campaigner / issuer, one of the obligations for a campaigner is that it should provide an accurate and complete report to the investors about all the material information that may affect their interests.<sup>147</sup> Despite the lack of further information on what shall constitute such "material information", it should be reasonably construed to include the financial interests of the portal in the campaigner / issuer. So if we can assume that the Crowdfunding Measures are made based on one consistent regulatory concept, there should be nothing preventing the same disclosure obligation from being imposed on the part of the portal. Given the disclosures about potential conflicts of interests from both the portal and campaigner, investors will be sufficiently protected and there should be no need for the regulator to predetermine which crowdfunding projects are possibly unsafe and should thus be banned *ex ante*.

#### 4.3 Provisions on Investors

The following Table 4.3 lists side by side the requirements for an investor qualified for engaging in crowdfunding (left column) and for investing in NEEQ (right column). Essentially, all of these requirements are to delineate "investor sophistication", which can be explained as the capability of evaluating the merits and risks of a prospective investment on the basis of sufficient knowledge and experience in financial and business matters.<sup>148</sup> The multiple standards for investors primarily hinge on their wealth, because in general it is reasonable to believe that someone who has acquired a sizable amount of money must know something about making money and thus can afford to take more risk than people who are comparatively financially restrained.<sup>149</sup> The requirements for qualified investors in China are built on the same notion.

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<sup>147</sup> Crowdfunding Measures, *supra* note 9, art. 11.4.

<sup>148</sup> The Office of Investor Education, *Rule 506 of Regulation D*, SEC, <https://www.sec.gov/answers/rule506.htm>.

<sup>149</sup> Kristen McNamara, *Definition of "sophisticated investor" varies*, MARKETWATCH, Apr. 26, 2010, <http://www.marketwatch.com/story/definition-of-sophisticated-investor-varies-2010-04-26>.

These requirements are certainly set very high, when China's national per capita disposable income as of 2015 is only RMB 21,966 (approximately USD 3,349).<sup>150</sup> To the extent the latest data are available, the annual per capita income of the richest Chinese households (top 10%) is RMB 69,877 as of 2012.<sup>151</sup>

TABLE 4.3: REQUIREMENTS FOR QUALIFIED INVESTORS IN CROWDFUNDING AND NEEQ

Crowdfunding Measures <sup>152</sup>	NEEQ <sup>153</sup>
<p>Qualified institutional investors, which include:</p> <ul style="list-style-type: none"> <li>o Legal persons with at least RMB5 million registered capital;</li> <li>o Partnerships with at least RMB5 million paid-up capital;</li> <li>o Collective trust plans, securities investment funds, bank wealth management products, asset management plans of securities companies, as well as other financial products or assets that are managed by financial institutions or other institutions recognized by the relevant supervisory authorities.</li> </ul>	<p>Qualified institutional investors, which include:</p> <ul style="list-style-type: none"> <li>o Entities whose net assets are no less than RMB10 million;</li> <li>o Funds for public or social welfare, such as social insurance funds, enterprise pension funds, or charity funds;</li> <li>o Fund schemes legally set up and filed with the SAC; and</li> <li>o Fund management companies, including the managers therein.</li> </ul>
<p>Natural person investors, provided that they meet ALL of the following requirements:</p> <ul style="list-style-type: none"> <li>o As of the immediate preceding trading day, the total market value of all securities assets under the name of the investor should be no less than RMB5 million; AND</li> <li>o The investor should have at least two years of experience in securities investment, or have had the relevant education or training in areas such as accounting, finance, investment, and economics.</li> <li>o Securities assets include but not limited to funds for securities trading settlement, shares, units of listed investment fund, bonds, collective asset management schemes, but excluding margin trading assets.</li> </ul>	<p>Natural person investors, including:</p> <ul style="list-style-type: none"> <li>o Individual whose financial assets are no less than RMB3 million; or</li> <li>o Individuals whose annual income for the immediate preceding three years is no less than RMB500,000.</li> <li>o Financial assets include but not limited to bank savings, shares, bonds, fund interest units, asset management schemes, bank financial products, trust schemes, insurance products, and futures; and</li> <li>o Such individuals should be able to produce the necessary paperwork for the assets and/or income, and should be able to identify, judge, and bear financial risk.</li> </ul>
Others:	Others:

<sup>150</sup> Chinese personal income rises 7.4 pct in 2015, XINHUA, available at: [http://english.gov.cn/archive/statistics/2016/01/19/content\\_281475274674444.htm](http://english.gov.cn/archive/statistics/2016/01/19/content_281475274674444.htm).

<sup>151</sup> Data from National Bureau of Statistics of China (<http://data.stats.gov.cn>).

<sup>152</sup> Crowdfunding Measures, *supra* note 9, art. 14.

<sup>153</sup> Quanguo zhongxiao qiye gufen zhuanrang xitong touzizhe shidangxing guanli xize (shixing) [(Trial) Administrative Measures for Investor Eligibility of the NEEQ] (promulgated by the NEEQ Co. Ltd., Feb. 8, 2013), available at: <http://www.neeq.com.cn/flfg/xtgz/gfzr/gpgs/201302/P020130208604549659054.pdf>, arts. 3 - 7.

<ul style="list-style-type: none"> <li>o In case a quoted firm conducts a private placement, the directors, supervisors, senior officers, and key employees of the issuer.</li> </ul>	<ul style="list-style-type: none"> <li>o An entity or individual that invests at least RMB1 million into a single fundraising product.</li> </ul>
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According to the drafting notes of the SAC, the regulatory entity that has made the Crowdfunding Measures, the reasons for setting forth such high entry requirements for crowdfunding are twofold. On the one hand, these requirements serve to filter out “retail investors”, whose risk tolerance level is considered not compatible with the potential risk of investing in crowdfunding business. On the other, high qualification thresholds mean that only those with relatively deeper pockets are admitted into the club, so that capital needs of campaigners are more easily met<sup>154</sup> given the 200-shareholder limit for the issuer and the project entity to be set up after crowdfunding.<sup>155</sup> In particular, it is pointed out that the requirements for qualified investors in the Crowdfunding Measures are set forth with reference to those for investors in private equity funds.<sup>156</sup> Moreover, there is no up-limit for the amount or value of securities to be issued in a crowdfunding campaign.<sup>157</sup> Combined together, the four points establish a drastically different manner in which the Chinese regulator approaches the issue of equity crowdfunding regulation. Note that, for the sake of investor protection, securities offers and sales are generally subject to mandatory disclosures as set forth by national securities laws in the registration or prospectus publication requirements,<sup>158</sup> unless the offering qualifies for one or more statutory exemptions.<sup>159</sup> Crowdfunding has also emerged in recent years as a new exemption, basically on the rationale that such offerings are small in size.<sup>160</sup> Because the amount of capital to be raised is relatively small, the potential investors targeted by such offerings should also be a different group than the so-called sophisticated investors, such as the “accredited

<sup>154</sup> Simu guquan zhongchou rongzi guanli banfa qicao shuoming [Drafting Notes for the Crowdfunding Measures] (promulgated by the SAC, Dec. 18, 2014), available at:

[http://www.sac.net.cn/tzgg/201412/t20141218\\_113326.html](http://www.sac.net.cn/tzgg/201412/t20141218_113326.html), at 3.

<sup>155</sup> Crowdfunding Measures, *supra* note 9, art. 12.

<sup>156</sup> *Id.*, art. 14; *see also supra* note 154.

<sup>157</sup> *See supra* note 154.

<sup>158</sup> Zachary Griffin, *Crowdfunding: Fleecing the American Masses*, 4 CASE WESTERN RESERVE JOURNAL OF LAW, TECHNOLOGY & THE INTERNET 375, 394 (2013).

<sup>159</sup> *See, e.g.*, SEC, *Small Businesses and the SEC*, <https://www.sec.gov/info/smallbus/qasbsec.htm#noreg> (briefly explaining the major exemptions allowed under the US securities Act); *see also* Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (L 345), art. 3.2 (enumerate the types of offers that do not require publishing a prospectus).

<sup>160</sup> IOSCO, *supra* note 30, at 5.

investors” as defined in the US Securities Act<sup>161</sup> or “qualified investors” in the European Prospectus Directive<sup>162</sup>. Therefore, rather than imposing high standards to qualify potential investors, existing crowdfunding regulations from most other jurisdictions have instead focused on limiting the size of investment, typically by setting a cap on the amount to be invested per annum / project / portal. For example, starting May 16, 2016, the US allows companies to use crowdfunding to offer and sell securities to the investing public. This means that

“[a]nyone can invest in a crowdfunding securities offering. *Because of the risks involved with this type of investing, however, you are limited in how much you can invest during any 12-month period in these transactions.* The limitation on how much you can invest depends on your net worth and annual income.”<sup>163</sup>

Although specific figures vary across different jurisdictions, these caps are all much smaller if compared to the thresholds set for sophisticated investors.<sup>164</sup>

As such, except that a campaign must still be initiated by an SME or micro business,<sup>165</sup> equity crowdfunding as painted in the Crowdfunding Measures in effect already deviates from the true spirit of the term, that is, to raise small amount capital from the masses.<sup>166</sup> The regulator is apparently not yet comfortable with respect to how this new business will develop itself in China, and thus has chosen to adopt, at least initially with this draft circulating for comments, a quite cautious position in regulating it. While the underlying reasons thereof are certainly legitimate and understandable, such regulatory approach still bears one serious problem, in that it does not really establish something new. For an entrepreneur, no matter she chooses to raise capital through equity crowdfunding or a private placement on the NEEQ, she is essentially targeting at the same one pool of potential wealthy investors, only that the size of the pool in the case of equity crowdfunding becomes somewhat bigger. Although it may be argued that a difference can already be made in terms of absolute number of investors given China’s vast population base, it must also be noted that crowd is by no means able to get involved with such

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<sup>161</sup> See US Securities Act of 1933, 17 CFR 230.501(a).

<sup>162</sup> Directive 2003/71/EC, arts. 3.2.a & 2.1.e.

<sup>163</sup> The Office of Investor Education, *Investor Bulletin: Crowdfunding for Investors*, Feb. 16, 2016, SEC, [https://www.sec.gov/oiea/investor-alerts-bulletins/ib\\_crowdfunding-.html](https://www.sec.gov/oiea/investor-alerts-bulletins/ib_crowdfunding-.html).

<sup>164</sup> IOSCO, *supra* note 30, at 22.

<sup>165</sup> Crowdfunding Measures, *supra* note 9, art. 11.

<sup>166</sup> See Kirby & Worner, *supra* note 2, at 8.

high entry thresholds in place – not even the middle class.<sup>167</sup> Comparatively, because getting quoted on NEEQ is already not so difficult than before,<sup>168</sup> a NEEQ private placement is not much more troublesome than a crowdfunding. For the avoidance of doubt, private placement on NEEQ does not need CSRC's *ex ante* approval either, as long as the company does not and will not have more than 200 shareholders.<sup>169</sup> Although there is indeed such statutory limit that a private placement should not offer shares to more than 35 new investors at one time,<sup>170</sup> nothing however prevents the issuer from adopting the same strategy of first pooling investors into a partnership and then making the investment in the issuer as one new shareholder. It is worth noting that such partnership has to have a paid-up capital of at least RMB5 million.<sup>171</sup> This means that, the only group of fundraising campaigns that cannot be realized through a NEEQ private placement but has to resort to equity crowdfunding, is those ones aiming to raise less than RMB5 million from more than 35 people. While this is certainly an important niche that equity crowdfunding can and should fit itself in, the old question still remains - are the current high entry standards for potential investors really compatible with the characteristics of small and medium-sized campaigns like these? Wouldn't it be a more consistent approach to broaden the investor camp and in the meantime set limits on the maximum amount to be invested, so that wealthy investors can still participate if they want, and crowd investors also get a share subject to the investment limits tailored according to their income and/or net worth?

Therefore, equity crowdfunding is in essence highly similar to a private placement on the NEEQ. Indeed, the potential investors qualified for a NEEQ private placement are somehow wealthier than those for equity crowdfunding, which may be construed to suggest that the former is intended for somewhat larger scale fundraising. But even if this is the case, there is no cap for the amount to be raised from a crowdfunding campaign, either. It is thus justified to conclude that, with the current high entry thresholds for potential investors in place, equity crowdfunding in China does not present itself as a new entrepreneurial fundraising option, nor does it show

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<sup>167</sup> According to the research jointly done by Goldman Sachs and China National Bureau of Statistics, middle class in China has an average annual income of approximately USD 11,733 as of 2014, and makes up 19% of the country's population. See Rachel Chang, *Here's What China's Middle Classes Really Earn – and Spend*, BLOOMBERG, Mar. 9, 2016, <http://www.bloomberg.com/news/articles/2016-03-09/here-s-what-china-s-middle-class-really-earn-and-spend>.

<sup>168</sup> This is discussed in details in Li, *supra* note 133, at 220.

<sup>169</sup> Measures for the Supervision and Administration of Non-Listed Public Companies, *supra* note 7, art. 45.

<sup>170</sup> *Id.*, art. 36.

<sup>171</sup> See Table 4.3, *supra*.

much significant advantage over a NEEQ private placement. In the only niche where it could actually make a difference by becoming the platform for small and medium-sized fundraising campaigns, its accessibility is nevertheless largely limited by the high investor entry requirements. In the large, the NEEQ private placement is arguably more effective in raising capital<sup>172</sup> as it is based on a governmental platform. In China where the worship of officialdom is deeply rooted in the society and culture, an implicit stamping from the government can be a lot more appealing and assuring to investors than the reputation from a private-owned crowdfunding portal. In this sense, it is meaningful for the Chinese regulator to consider lowering the thresholds for investors to participate in equity crowdfunding, so that it becomes a true new financing option for entrepreneurs. Doing so will not only allow China to join the mainstream of crowdfunding regulation in the world, but also improve the consistency within the system as a whole. The attraction of NEEQ as an exit venue for crowdfunding investors will be enhanced, because although the level of liquidity there is not very ideal, things can get somehow balanced out when the potential buyers of their shares are not similar people as themselves but are significantly wealthier and thus have higher purchasing power.

## V. CONCLUSION

Notwithstanding its relatively new presence, crowdfunding industry in China is already sizable and maintains exponential growth. However, besides the prevalent practice of syndicating crowd investors into a limited partnership to hold equity in the issuer, not much is known about how exactly this industry has managed to maneuver itself through the current securities regulation framework. By focusing on the two particular cases of Renrentou and Zhongou8, this paper fills the gap in current research by making the very first endeavor to connect the theory with the practice on equity crowdfunding in China.

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<sup>172</sup> See Ai Bing, *Xinsanban, paomo haishi caifu?* [New Third Board, Bubbles of Fortune?], 6 QIYE GUANCHAJIA [ENTERPRISE OBSERVER] 57, 58 (2015), available at: [http://www.xcf.cn/jrdd/201506/t20150612\\_750904.htm](http://www.xcf.cn/jrdd/201506/t20150612_750904.htm). It is submitted that because quoted firms cannot conduct IPO on the New Third Board, private placements become a feasible option for them to raise funds from investors. In the past three years, private placements have observed tremendous growth and are almost always highly pursued by institutional investors, which, according to the author, is even creating bubbles in the market.



Based on a hand-collected sample of the investment documentation of the 53 crowdfunding projects that are successfully completed as of June 30, 2016 on Renrentou, I find that the utmost task of the contractual terms in these agreements is to secure the investors' right of return. Control on the part of investors is rather minimal, and most of the time only encompasses the basic information and monitoring rights. Although investors are not first pooled to form a new entity before investing, it is still a prevalent practice for projects to commission a third party manager to manage the investment for the crowdfunders and exercise monitoring rights in the project entity on their behalf. In the Zhongtou8 case study, I go beyond the margins of investment contracts and explore the business with a both broader and deeper view. It is found that, the leading investors of crowdfunding projects are very often served by entities that are in some ways related to the founder of the portal. In addition, the portal is also identified to have financial interests in many projects besides that. While these practices do raise concerns about potential conflicts of interests, the regulatory solutions proposed by the Crowdfunding Measures are nevertheless overly cautious and effectually not enforceable. It is therefore argued that the regulator should rather focus on ensuring effective disclosure from the parties with better information, so that the investors can use it to make effective decisions. Furthermore, by setting down high entry thresholds for qualified investors, the Crowdfunding Measures largely fail to establish equity crowdfunding as a new financing alternative, but rather create a minimized version of the NEEQ private placement. As such, it would be meaningful for China to consider lowering the investor qualifications and allow crowds to participate, so that equity crowdfunding can grow into a true new alternative for entrepreneurs to avail in addition to existing fundraising channels.