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What's Wrong with Jumpstart(ing) Our Business Startups (JOBS) Act?

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WHAT'S WRONG WITH JUMPSTART(ING) OUR
BUSINESS STARTUPS (JOBS) ACT?

LYNNISE E. PHILLIPS PANTIN*

Lack of access to financial capital is a barrier for many entrepreneurs who seek to grow their business venture. In an effort to democratize the entrepreneurial ecosystem, Congress and the Obama Administration enacted the JOBS Act, which implements and regulates crowdfunding. The democratic nature of the online crowdfunding platforms is a seemingly attractive solution to structural and institutionalized barriers to fundraising within the entrepreneurship ecosystem. Although the JOBS Act is a laudable step, the legislation does not in practice help entrepreneurs and herein lies one of its greatest shortcomings. The JOBS Act is unduly burdensome and is yet another barrier for entrepreneurs. Merely permitting underrepresented entrepreneurs and unsophisticated investors to engage in an alternative investment scheme of crowdfunding to raise capital does not solve the problems of access to traditional sources of capital. This article makes concrete proposals for addressing these shortcomings.

* Clinical Professor of Law, Columbia Law School. I received valuable feedback on early versions of this Article at the U. Mass. Dartmouth Junior Faculty Scholarship Exchange in Fall 2017. This Article was presented at the 2018 Clinical Law Review Writers' Workshop at New York University Law School, the 2018 New England Clinical Conference at Boston University School of Law and the 2017 11th Annual Lutie A. Lytle Black Women Law Faculty Writing Workshop at the University of Michigan College of Law. I thank the facilitators and participants at each workshop for their insightful comments and suggestions. For additional helpful comments and suggestions, I would like to thank Alina Ball, Deborah Burand, Ted De Barbieri, Jennifer Fan, Bernice Grant, Mike Haber, Renee Hatcher, Kari Hong, Jaime Lee, Patricia H. Lee, Praveen Kosuri, Gowri Krishna, Patricia McCoy, Brenda Smith, Sandy Tarrant, and Paul Tremblay. For truly exceptional research assistance, I thank Amani Kancey, Anisha Mohin and Ji-Su Park.

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INTRODUCTION

The current federal securities laws were developed in the wake of the 1929 stock market crash, which resulted in the Great Depression.¹ Historians have found that the cause of the

1. See, e.g., Steven A. Ramirez, *The Virtues of Private Securities Litigation: An Historic and Macroeconomic Perspective*, 45 LOY. U. CHI. L.J. 669, 680 (2014).

Great Depression was widespread speculation and fraud.² In the period leading up to the stock market crash, companies issued stock and then aggressively, and in some instances fraudulently, promoted the value of their companies in an effort to encourage investors to purchase their shares.³ The stock was therefore sold based on the promise of large returns with little disclosure of relevant information about the company. Yet, investors bought stock *en masse* in hopes of reaping huge profits, leading to a speculative frenzy. The U.S. stock market collapsed in October 1929 because those same investors attempted to sell their investments all at the same time.⁴

Describing the aftermath of the 1929 crash, Irving Kahn, one of America's longest living investors noted to a journalist that, "[t]here were also no legal protections. We had no securities laws. While everyone knows the system was flawed before the recent crash, at least there were some protections in place. In the Twenties we had nothing. And when the Depression hit, there were bread lines and families homeless in Central Park with nowhere to go."⁵

In response to the unprecedented effects of the market crash, President Franklin Roosevelt encouraged Congress to enact laws to prevent future speculative frenzies like the ones that occurred before the crash.⁶ Congress held several hearings that exposed the levels of abuse and prevalence of fraud that led to the stock market crash.⁷ As a result Congress enacted the Securities Act of 1933 (the "Securities Act") and the

2. See, e.g., *id.* at 678–79 (quoting American economist John Kenneth Galbraith, "American enterprise in the twenties had opened its hospitable arms to an exceptional number of promoters, grafters, swindlers, imposters and frauds. This, in the long history of such activities, was a kind of flood idea of corporate larceny.").

3. *Securities Law History*, LEGAL INFO. INST., https://www.law.cornell.edu/wex/securities_law_history.

4. BARRIE A. WIGMORE, *THE CRASH & ITS AFTERMATH: A HISTORY OF SECURITIES MARKETS IN THE UNITED STATES, 1929–1933* 5 (Robert Sobel ed., Greenwood Press 1985).

5. Richard Evans, *108-Year-Old Investor: 'I Doubled My Money in 1929 Crash – and I'm Still Winning'*, TELEGRAPH (Aug. 23, 2014, 9:53 AM BST), <http://www.telegraph.co.uk/finance/personalfinance/investing/11048689/108-year-old-investor-I-doubled-my-money-in-1929-crash-and-im-still-winning.html>.

6. Ramirez, *supra* note 1, at 680–81.

7. See *id.* at 672 ("Prior to the enactment of the federal securities laws, the disclosure obligations of publicly traded firms defied any economic logic

Securities Exchange Act of 1934 (the “Exchange Act”). These two laws, known as the “Federal Securities Laws,” aimed to regulate securities transactions.

Investor protection and issuer disclosure are major themes of the Federal Securities Laws. The Federal Securities Laws require companies to give investors information about the securities that are being offered and sold by a company.⁸ These disclosure requirements were put into effect to mitigate against fraud by issuers and sellers of securities. The goal of Congress was to protect investors by ensuring them access to truthful information.⁹

After the passage of the Federal Securities Laws, the United States did not experience a significant economic crisis for several decades.¹⁰ In fact, the next six decades are referred to as the “golden era of financial stability.”¹¹ During that era, Congress amended the Federal Securities Laws, but such amendments were mild and generally consistent with the underlying goals of investor protection and issuer disclosure.¹² That period of economic stability was interrupted by the Great Recession.¹³

Between 2008–2009,¹⁴ the period of the Great Recession, the United States saw the most dramatic employment contrac-

and instead operated to assure that ordinary investors could not possibly know the material facts regarding their investment.”).

8. *Id.* at 680–83.

9. *Id.* at 680–81 n.66 (citing *SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953)).

10. *See id.* at 670 n.2 (explaining that between the Great Depression and Great Recession, “experts can identify no other financial crisis of similar magnitude.”).

11. *Id.* at 670.

12. *Id.* at 686–87.

13. The Great Recession was spurred by the collapse of Lehman Brothers, runs on money market mutual funds, and other financial institutions that caused credit spreads to skyrocket and key sources of credit to dry up and burst the \$8 trillion housing bubble. The loss of consumer spending combined with the chaos in the financial markets resulted in massive job loss, decreases in income and wealth, and an increase in poverty. *See Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*, FIN. CRISIS INQUIRY COMM’N (Jan. 2011), http://fcic-static.law.stanford.edu/cdn_media/fcic-reports/fcic_final_report_full.pdf.

14. Officials estimate that the “Great Recession” lasted from December 2007 to June 2009. *See* NAT’L BUREAU OF ECON. RESEARCH, BUSINESS CYCLE

tion since the Great Depression.¹⁵ The rise in unemployment, paired with a credit crunch, caused millions of Americans to lose their homes, resulting in a major economic crisis. President Obama took several actions to fix the economic crisis, repair the financial system, and stabilize the housing market.¹⁶ Entrepreneurship and job creation were key parts of the government's economic recovery strategy.¹⁷

In January 2011, President Obama launched the Startup America Initiative and rolled out a series of entrepreneurship-focused initiatives.¹⁸ In a speech announcing the initiatives, President Obama stated, “[e]ntrepreneurs embody the promise of America: the idea that if you have a good idea and are willing to work hard and see it through, you can succeed in this country. And in fulfilling this promise, entrepreneurs also play a critical role in expanding our economy and creating jobs.”¹⁹

Many of the policies implemented by the Obama Administration to facilitate the economic recovery from the Great Recession were aimed at creating jobs and encouraging entrepreneurship.²⁰ A major component of the recovery legislation was the Jumpstart Our Business Startups Act of 2012 (“JOBS Act”

DATING COMMITTEE (Sept. 20, 2010), <http://www.nber.org/cycles/sept2010.html>.

15. *See id.*

16. *Helping Responsible Homeowners*, OBAMA WHITE HOUSE, <https://obamawhitehouse.archives.gov/economy/middle-class/helping-responsible-homeowners>; Martin Wolf, *How Barack Obama Rescued the U.S. Economy*, FIN. TIMES (Jan. 10, 2017), <https://www.ft.com/content/b5b764cc-d657-11e6-944b-e7eb37a6aa8e>.

17. *See, e.g.*, Thomas Kalil & Doug Rand, OBAMA WHITE HOUSE (Nov. 30, 2016), <https://obamawhitehouse.archives.gov/blog/2016/11/30/president-obamas-top-ten-actions-accelerate-american-entrepreneurship>. Entrepreneurship theory reflects the American sense of rugged individualism and self-determination and posits that entrepreneurship or business development is a mechanism for wealth accumulation and revitalization of economies. *See* Scott Newbert, *Realizing the Spirit and Impact of Adam Smith's Capitalism Through Entrepreneurship*, 46 J. BUS. ETHICS 251, 259 (2003).

18. *See, e.g.*, *Startup America*, OBAMA WHITE HOUSE, <https://obamawhitehouse.archives.gov/economy/business/startup-america> (last visited Apr. 15, 2017).

19. *Id.*

20. *See, e.g.*, EXEC. OFFICE OF THE PRESIDENT, THE ECONOMIC RECORD OF THE OBAMA ADMINISTRATION: PROGRESS REDUCING INEQUALITY 11 (2016), https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160923_record_inequality_cea.pdf.

or “the Act”) that President Obama signed into law on April 5, 2012.²¹ In the unstable economy, entrepreneurs had little luck in seeking traditional sources of financing.²² The JOBS Act was meant to invigorate the economy by loosening the rules for investing and fundraising and to encourage funding of small businesses by reducing existing securities regulations.²³ President Obama stated the goal of the Act and related legislation as, “put[ting] more people back to work and more money in the pockets of those who are working.”²⁴

The JOBS Act fundamentally changed the landscape of the Federal Securities Laws. Primarily aimed at entrepreneurs seeking capital, the JOBS Act theoretically increases the ability of small businesses and startups to access capital and generate jobs, through the use of crowdfunding.²⁵ Crowdfunding is the act of raising capital from large amounts of people through the use of the internet.²⁶ After the passage of the Act, entrepreneurs were legally allowed to sell their companies’ securities to online investors without registering an offering with the Securities and Exchange Commission (“SEC”).²⁷ Since 2016, when the Act became fully effective, crowdfunding has become a part of the entrepreneurial landscape. Scholars theorize that the changes in the securities laws brought on by the JOBS Act democratize entrepreneurship, allowing for success-

21. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (codified as amended in scattered sections of 15 U.S.C.). *See also* Mark Landler, *Obama Signs Bill to Promote Start-Up Investments*, N.Y. TIMES (Apr. 5, 2012), <http://www.nytimes.com/2012/04/06/us/politics/obama-signs-bill-to-ease-investing-in-start-ups.html>.

22. Traditional sources of financing are typically unavailable to entrepreneurs, but during the Great Recession access to financial capital were further restricted.

23. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (codified as amended in sections of 15 U.S.C. (2017)); *see also* Jeff Mason, *Obama Signs Small Business Bill Into Law*, REUTERS (Sept. 27, 2010), <https://www.reuters.com/article/us-usa-economy-obama/obama-signs-small-business-bill-into-law-idUSTRE68Q4H220100927>.

24. *Transcript: Obama’s Speech to Congress on Jobs*, N.Y. TIMES (Sept. 8, 2011), <http://www.nytimes.com/2011/09/09/us/politics/09text-obama-jobs-speech.html>.

25. *See* Christine Hurt, *Pricing Disintermediation: Crowdfunding and Online Auction IPOs*, 2015 U. ILL. L. REV. 217, 220 (2015).

26. *See* Andrew A. Schwartz, *The Digital Shareholder*, 100 MINN. L. REV. 609, 615–16 (2015).

27. Jumpstart Our Business Startups Act § 302.

ful participation in entrepreneurship by all.²⁸ Crowdfunding may appear to be revolutionary; it has the potential to mitigate some of the disparities between businesses that have access to capital and those that do not.²⁹ The reality, however, is that investment crowdfunding is not likely to democratize entrepreneurship. Given the extensive SEC regulatory requirements, it is unlikely that entrepreneurs will turn to investment crowdfunding to raise capital.

Although the JOBS Act was intended to provide greater access to capital for entrepreneurs and increase economic opportunity for ordinary investors, its greatest shortcoming is that it is unduly burdensome. The premise of this Article is that while laudable steps have been taken to democratize the entrepreneurial ecosystem by implementing crowdfunding, isolated regulation such as the JOBS Act will do little to support entrepreneurs in their startup ventures, resulting in grave effects on this country's entrepreneurial ecosystem.³⁰ Crowdfunding has several barriers to entry. These include transaction costs, disclosure requirements, portal registration, and capital limitations.³¹

This Article argues that the limits of and the restrictions in the rules prevent the JOBS Act from changing the existing dynamics within the entrepreneurial landscape. Scholars who have critiqued the crowdfunding legislation raise concerns related to investor risk,³² fraud,³³ investor protection,³⁴ and is-

28. See, e.g., Schwartz, *supra* note 26 at 619 (“[C]rowdfunding can democratize the market for financing speculative companies by inviting ordinary people to make investments that are currently offered solely to accredited (wealthy) investors.”).

29. *Id.*

30. Entrepreneurial ecosystem is a metaphor for promoting entrepreneurship as an economic development strategy.

31. See Hurt, *supra* note 25, at 217.

32. Terrell McSweeney, *Backers Beware: Crowdfunding Risks and Rewards*, HUFFINGTON POST, June 11, 2016, http://www.huffingtonpost.com/terrell-mcsweeney/crowdfunding-know-the-ris_b_7564466.html.

33. Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws – Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure*, 90 N.C. L. REV. 1735, 1737 (2012).

34. Karina Sigar, *Fret No More: Inapplicability of Crowdfunding Concerns in the Internet Age and the Jobs Act's Safeguards*, 64 ADMIN. L. REV. 473, 488 (2012).

suer compliance and transaction costs.³⁵ The legal scholarship has not addressed crowdfunding as it relates to the user experience in capital-raising for entrepreneurs. This study highlights that even with the loosened securities regulations, entrepreneurs, particularly those with startup ventures, will still struggle to access capital within the current financing framework, and the ordinary investor may be subjected to fraud and misinformation.

This article proceeds in four parts. Part I describes the securities laws and the financial landscape before the JOBS Act. Part II explains how crowdfunding operates within the statutory framework of the crowdfunding legislation. Part III assesses crowdfunding and illustrates the problems raised by the investment crowdfunding legislation. Part IV offers recommendations and suggestions towards changing parts of the JOBS Act.

I.

THE FEDERAL SECURITIES LAWS

Under the old regime, the Securities Act banned general solicitation,³⁶ requiring that a company that offers or sells its securities must (1) register the securities with the Securities and Exchange Commission (“SEC”), or (2) find an exemption from the registration requirements, and (3) restrict investors to accredited investors.³⁷

The Exchange Act regulates financial markets, securities exchanges, and their participants.³⁸ The Exchange Act created the SEC, the federal agency responsible for the enforcement of the Federal Securities Law and tasked with the authority to regulate the securities industry. The SEC has the power to promulgate rules pursuant to the Federal Securities Laws and to enforce federal law and its own rules. Under the Exchange Act, the SEC has the authority to register, regulate and disci-

35. Patricia H. Lee, *Access to Capital or Just More Blues? Issuer Decision-Making Post SEC Crowdfunding Regulation*, 18 *TRANSACTIONS: TENN. J. BUS. L.* 19, 55 (2016).

36. General solicitation is advertising investment opportunities to the general public for private companies.

37. Securities Act of 1933, Pub. L. No. 73-22, §§ 2-4, 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a-77m (2017)).

38. Securities Exchange Act of 1934, Ch. 404, title I, § 1, 48 Stat. 881 (codified as amended at 15 U.S.C. §§. 78a et seq.).

pline broker-dealers, regulate the securities exchanges, and review actions of the securities exchanges' self-regulatory organizations.³⁹ Before Congress enacted the Federal Securities Laws, most states also had their own securities laws, known as "blue sky laws."⁴⁰ Congress drafted the federal securities laws against the backdrop of pre-existing state regulation.⁴¹

A. *The Pre-2012 Federal Securities Law Regime*

Under the Federal Securities Laws, companies seeking to raise capital through the sale of securities must either register the offering with the SEC or rely on an exemption from registration.⁴² Rule 506 of Regulation D is the most commonly used exemption from registration.⁴³ A qualified offering under Regulation D allows for an issuer to raise an unlimited amount of capital from an unlimited number of "accredited investors" and up to 35 non-accredited investors.⁴⁴

39. Securities Exchange Act of 1934, Ch. 404, title I, § 1, 48, Stat. 881 (codified as amended at 15 U.S.C. §§. 78a et seq.).

40. *Blue Sky Laws*, U.S. SEC. AND EXCH. COMM'N, <https://www.sec.gov/fast-answers/answers-blueskyhtm.html> (last modified Oct. 14, 2014).

41. In interpreting the federal securities laws, courts often reach back into relevant state law to interpret definitions or concepts that Congress used when drafting federal law. State law and federal law do not, however, correspond perfectly. Although there is some overlap, state law may provide for causes of action unavailable under federal law and vice-versa. State laws can be very different from state-to-state, and from federal law. Key differences are: (1) the kinds of products and transactions covered by the laws; (2) the registration requirements for brokers, dealers, and issuers; and (3) the breadth and causes of action available under anti-fraud provisions. For example, New York's securities law, the Martin Act, permits only the Attorney General to bring a suit for violations. In New York, individual investors must bring private suits for common-law fraud law in order to recover. In many cases, federal law preempts state blue sky laws, requiring investors to sue in federal court and under federal law. LEGAL INFO. INST., *supra* note 3.

42. *The Laws That Govern the Securities Industry*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/answers/about-lawsshtml.html#secexact1934> (last updated Oct. 1, 2013).

43. *The Most Common Exemption – Regulation D Rule 506*, CAP. FUND LAW, <https://www.capitalfundlaw.com/blog/2015/04/05/the-most-common-exemptionregulation-d-rule-506> (last visited Oct. 7, 2019).

44. 17 C.F.R. § 230.506 (effective Sept. 23, 2003).

B. *The Accredited Investor Standard*

The SEC created the notion of “accredited investors” to mitigate the tension between protecting individual investors in private securities offerings and promoting investment in private offerings to promote growth.⁴⁵ An “accredited investor” is an individual or an entity that is presumed to not need the protection of federal or state securities laws based on their income or net worth.⁴⁶ Qualifying as an accredited investor is significant because accredited investors may, under SEC rules, participate in investment opportunities that are generally not available to non-accredited investors or “ordinary investors.” These opportunities include investments in private companies and offerings by hedge funds, private equity funds, and venture capital funds. Arguably, the accredited investor rules are in place to prevent non-wealthy people from making risky investments that they cannot afford.⁴⁷ As of 2010, only 7.4% of U.S. households were accredited based on net worth.⁴⁸ This means that only a small percentage of the U.S. population can participate in private offerings, which require accredited investor status. This fact that wealthy investors have access to special kinds of investments that ordinary investors do not is, according to Professor Usha Rodrigues, “securities law’s dirty little secret.”⁴⁹

In 2012, President Obama signed the Dodd–Frank Wall Street Reform and Consumer Protection Act (the “Dodd–Frank Act”) into law, which revised the accredited in-

45. See Michael L. Monson, *The Evolution and Future of the Accredited Investor Standard for Individuals*, UTAH B.J. Nov.–Dec. 2010, at 36.

46. Regulation D Revisions; Exemption for Certain Employee Benefit Plans, Securities Act Release No. 33-6683, 37 SEC Docket 588 (Jan. 16, 1987) (the “Regulation D Revisions Proposing Release”) (The Accredited Investor standard is “intended to encompass those persons whose financial sophistication and ability to sustain the risk of loss of investment or ability to fend for themselves render the protections of the Securities Act’s registration process unnecessary.”).

47. Luis A. Aguilar, *Increasing the Vulnerability of Investors*, U.S. SEC. & EXCH. COMM’N (Aug. 29, 2012), <https://www.sec.gov/News/PublicStmnt/Detail/PublicStmnt/1365171491128>.

48. Jeff Thomas, *Making Equity Crowdfunding Work for the Unaccredited Crowd*, 4 HARV. BUS. L. REV. 62, 63 (2014), https://www.hblr.org/wp-content/uploads/sites/18/2014/04/Thomas_Making-Crowdfunding-Work.pdf.

49. Usha Rodrigues, *Securities Law’s Dirty Little Secret*, 81 FORDHAM L. REV. 3389 (2018).

vestor standard.⁵⁰ The Dodd–Frank Act directs the SEC to review the accredited investor definition as it relates to natural persons every four years to determine whether the definition should be modified or adjusted for the protection of investors, “in the public interest and in light of the economy.”⁵¹

Before the Dodd–Frank Act, accredited investors were individuals with a net worth of above \$1 million or an income above \$200,000 per year. Under the current accredited investor definition, individuals are accredited investors if their income exceeds \$200,000 in each of the two most recent years (or \$300,000 in joint income with a person’s spouse) and that individual reasonably expects to reach the same income level in the current year.⁵² Individuals are also accredited investors if their net worth exceeds \$1 million (individually or jointly with a spouse), excluding the value of their primary residence.⁵³ Certain enumerated entities with over \$5 million in assets qualify as accredited investors,⁵⁴ while others, including regulated entities such as banks and registered investment companies, are not subject to the assets test.⁵⁵ The accredited investor standard took on increased significance with the passage of the JOBS Act.

C. *General Solicitation*

In addition to the accredited investor standard, rules before 2012 prohibited the general solicitation of the public in securities offerings. Most of the exemptions from registration prohibit companies from engaging in general solicitation or general advertising—advertising in newspapers or on the internet to the public in connection with securities offerings.⁵⁶ In other words, before the JOBS Act, private companies were only allowed to raise money from accredited investors and from those with whom they had a substantial pre-existing rela-

50. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 413, 124 Stat. 1376, 1577 (2010).

51. *Id.* § 413(b)(2)(A).

52. SEC General Rules and Regulation, 17 C.F.R. § 230.501(a)(6) (2017).

53. *Id.* § 230.501(a)(5).

54. *Id.* § 230.501(a)(1), (3), (7).

55. *Id.* § 230.501(a)(1), (2), (8).

56. *Id.* § 230.501. For calculation purposes, the value of primary residence is excluded.

tionship or to whom they were introduced via a registered broker-dealer. The rationale for the ban on general solicitation was to protect unsophisticated investors from fraud due to lack of information, education or disclosures.⁵⁷

D. *Changes to the Federal Securities Laws After the JOBS Act*

The JOBS Act changed the Federal Securities Laws by lifting the ban on private companies from publicly advertising their fundraising efforts.⁵⁸ The JOBS Act also exempts private companies from registering with the SEC if they offer securities amounting to \$50 million or less every 12 months. By removing the general solicitation restriction, “Congress sought to make it easier for a company to find investors and raise capital.”⁵⁹ The JOBS Act requires the SEC to revise the rules to permit general solicitation and general advertising in offerings where all purchasers are accredited investors and the issuer takes reasonable steps to verify their accredited investor status.⁶⁰ Effectively, the Act changes the way companies can raise money and from whom they can raise it, without requiring a pre-existing relationship between the investor and the issuer.

In the aftermath of the financial crisis and in response to backlash against the Dodd–Frank Act, Congress moved quickly to pass legislation addressing business leaders’ concerns that the existing regulatory framework was overly burdensome and hindered entrepreneurship.⁶¹ The various legislative proposals to rescue the economy and support business growth came to

57. See Erin Griffith, *Does General Solicitation Matter for Tech Startups? Not Really*, PANDO (July 10, 2013), <https://pando.com/2013/07/10/does-general-solicitation-matter-for-tech-startups-not-really/>.

58. *Fact Sheet: Eliminating the Prohibition on General Solicitation and General Advertising in Certain Offerings, SEC Open Meeting*, U.S. SEC. & EXCH. COMM’N (July 10, 2013), <https://www.sec.gov/news/press/2013/2013-124-item1.htm> [hereinafter SEC Fact Sheet (July 10, 2013)]; see also *Fact Sheet: Eliminating the Prohibition on General Solicitation and General Advertising in Certain Offerings*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/News/Article/Detail/Article/1365171492649> (last modified July 2, 2013).

59. SEC Fact Sheet (July 10, 2013), *supra* note 58.

60. Jumpstart Our Business Startups Act § 201 (a). The SEC revised Rule 506 in July 2013. See *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*, 78 Fed. Reg. 44771, 44776 (July 10, 2013) (the “Rule 506(c) Adopting Release”).

61. See *The JOBS Act*, MORRISON & FOERSTER (Mar. 26, 2012), <https://media2.mofo.com/documents/120326-TheJOBS-Act.pdf>.

gether under the JOBS Act.⁶² As a result, it was hastily drafted, not well thought through, and it has taken years for regulations to be established that flesh out the substance.⁶³

Through the efforts of Congress and the Obama Administration to democratize capital formation, the current legislation deviates significantly from the original goals of the Federal Securities Laws, which were investor protection and issuer disclosure. These changes in the Federal Securities Laws have laid the groundwork for investment crowdfunding and as a result of the JOBS Act, private companies are legally permitted to make solicitations to the general public.

II.

REGULATION OF CROWDFUNDING⁶⁴

Typically, the success of a venture, whether it is a low-growth or high-growth venture, is directly tied to the founder's ability to finance the venture. Research shows that capital is

62. See HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, GOING PUBLIC HANDBOOK § 1:36 (2018), Westlaw SECGRAPH-HB ("H.R. 3606, the Jumpstart Our Business Startups Act, was introduced in the House of Representatives on December 8, 2011. The stated purpose of the bill was to "encourage small companies to go public in the U.S., to spur economic growth, and to create jobs." The House passed the JOBS Act on a bipartisan basis by a vote of 390 to 23 on March 8, 2012. The crowdfunding provisions of the House bill came under particular attack in the Senate, and ultimately the Senate adopted a different, enhanced version of the House's crowdfunding provisions. The Senate passed its crowdfunding amendment 73-26 (CROWDFUND ACT S.2190) on March 22, 2012. Later that day, the Senate passed the full JOBS Act (as amended from the House bill), 73-26. On March 27, 2012, the House concurred in the Senate amendment to the JOBS Act, by a vote of 380 to 41, 19 not voting. H.R. 3606 was presented to the President on March 27, 2012. The legislation was signed by President Obama on April 5, 2012, to become Public Law No. 112-106. The SEC had publicly opposed the enactment of numerous provisions of the JOBS Act notwithstanding Presidential endorsement of the legislation. President Obama viewed the measure as a component of his jobs creation program.").

63. Dina ElBoghdady, *JOBS Act Falls Short of Grand Promises*, WASH. POST (Mar. 28, 2013), https://www.washingtonpost.com/business/economy/jobs-act-falls-short-of-grand-promises/2013/03/28/5a660a14-8675-11e2-98a3-b3db6b9ac586_story.html.

64. JOBS Act, Title I, Title II, Title III, H.R. 3606, 112th Cong. (2012); Final Rule: Crowdfunding, Release Nos. 33-9974, 34-76324 (effective May 16, 2016) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240, 249, 269, 274), <https://www.sec.gov/rules/final/2015/33-9974.pdf>.

the number one predictor of a startup's success.⁶⁵ Undercapitalized businesses suffer from lower sales, profits, and lack of employment, and are more likely to fail than businesses receiving optimal levels of startup capital.⁶⁶ Therefore, those who can access capital will have a greater chance of startup success, even if the idea is not the most innovative.⁶⁷ Crowdfunding, an outgrowth of social media, was argued to be an important aspect of the entrepreneurial landscape that presents one possible way for entrepreneurs to access capital and raise funding.⁶⁸ On its face, crowdfunding seems a fair and equitable way to level the playing field within the startup ecosystem. This section describes the mechanics of crowdfunding, a capital-raising scheme that would seem to be an antidote for outside fundraising challenges.

Crowdfunding is the practice of raising small amounts of money from a large number of individuals (the crowd) over the internet. The original purpose of crowdfunding was to make certain types of investments easier for both investors and founders alike. Whereas seeking angel investment and venture capital investment are private forms of capital-raising, crowdfunding is similar to an initial public offering ("IPO")⁶⁹ in that companies solicit investment from the general public. Successful projects typically receive about 25–40% of their funding from the founders' first, second, and third degrees of connections.⁷⁰ Crowdfunding platforms are used to raise

65. Mark Fahey, *Alive at Five: The Key Year for Companies' Survival*, CNBC MKTS. (June 12, 2015), <https://www.cnbc.com/2015/06/12/alive-at-five-the-key-year-for-companies-survival.html>.

66. See Alicia Robb, *Access to Capital Among Young Firms, Minority-owned Firms, Women-owned Firms, and High-tech Firms*, U.S. SMALL BUS. ADMIN. OFF. ADVOC. 6 (Apr. 2013).

67. Fahey, *supra* note 65; Utpal Bhattacharya et. al., *Firm Mortality and Natal Financial Care*, 50 J. FIN. & QUANTITATIVE ANALYSIS 61, 62 (2015), https://www.cambridge.org/core/services/aop-cambridge-core/content/view/F66C23FC7125282A4290F42A1F018E98/S0022109014000581a.pdf/firm_mortality_and_natal_financial_care.pdf.

68. Jonny Price, *Equity Based Crowdfunding*, FELS INST. GOV'T U. PA. (Feb. 2, 2018), <https://www.fels.upenn.edu/recap/posts/1508>.

69. An IPO is a solicitation to the general public to purchase equity in a venture in exchange for money.

70. See, e.g., *North Central Economic Development Association Economic Development Guide to Investment Crowdfunding through MNVest Legislation*, NORTH. CENT. ECON. DEV. ASS'N., https://northcentraleda.org/wp-lib/wp-content/uploads/2016/06/Practitioners-Guide_FINAL.pdf.

money for everything from launching a new tech venture to raising money for a local charity.⁷¹

A. *Types of Crowdfunding*

There are generally two categories of crowdfunding: project-based crowdfunding and investment-based crowdfunding.

1. *Project-Based Crowdfunding*

With project-based crowdfunding, investors receive the outcome of a project in exchange for their investment.⁷² Before the JOBS Act, project-based crowdfunding was the predominant model for solicitation via the internet because entrepreneurs were prevented from soliciting the public to invest in the securities of their company. As a result, crowdfunding was primarily used for donations and fundraising for feel-good projects or to support the arts.⁷³ With this type of crowdfunding, nonprofit organizations and individuals used the internet to garner financial support for specific projects.⁷⁴ It is a fundraising vehicle that builds momentum and rallies people around an idea, rather than spurring on investment opportunities. Creators keep the funds raised without obligation to funders, as opposed to investment-based crowdfunding, where

71. See e.g., CIRCLEUP, <https://www.circleup.com>; WEFUNDER, <https://www.wefunder.com>; ANGELIST, <https://angel.co/>; FUNDABLE, <https://www.fundable.com>; CROWDFUNDER, <https://www.crowdfunder.com/>; EQUITYNET, <https://www.equitynet.com/>; ONEVEST, <https://www.onevest.com/>. Using the equity crowdfunding platform, companies raise the money they need in an average of 60 days—a process that otherwise takes 8 to 12 months.

72. Schwartz, *supra* note 26, at 615.

73. See Andrew Schwartz, *Crowdfunding Securities*, 88 NOTRE DAME L. REV. 1457, 1459 (2013).

74. See *id.* An example of a notable donation-based crowdfunding campaign is the Mott Hall Scholarship Fund, which was started by the founder of Humans of New York. The crowdfunding campaign raised over \$1 million dollars in a little over a week's time. See Winnie Hu & Jonah Bromwich, *A Boy Praises the Principal of His Brooklyn School, and a Fund-Raising Campaign Takes Off*, N.Y. TIMES (Jan. 29, 2015), <http://www.nytimes.com/2015/02/01/nyregion/a-boy-praises-the-principal-of-his-brooklyn-school-and-a-fund-raising-campaign-takes-off.html>.

funders receive a security in return.⁷⁵ Kickstarter,⁷⁶ GoFundMe⁷⁷ and Indiegogo⁷⁸ are examples of popular crowdfunding websites primarily used for project-based crowdfunding. Kickstarter is a common launching pad for art projects, particularly film and music projects.⁷⁹ Indiegogo is a common platform for crowdfunding based on donations. There are no criteria for the kind of project that can become an Indiegogo campaign.⁸⁰ This type of crowdfunding has helped to fund video games, film projects, music and the arts, in addition to supporting individuals and nonprofit organizations in need.⁸¹

2. *Investment Crowdfunding*

As described above, investment crowdfunding was effectively prohibited under the securities laws pre-JOBS Act.⁸² The SEC and many in the finance industry worried that ordinary people could lose their life savings in a crowdfunding scheme because of fraud or naiveté.⁸³ Yet, the passage of the JOBS Act

75. *What Do Backers Get in Return?*, KICKSTARTER, <https://help.kickstarter.com/hc/en-us/articles/115005047953-What-do-backers-get-in-return-> (last visited Oct. 7, 2019). There is, however, a fee associated with the use of the platform. *Fees for the United States*, KICKSTARTER, <https://www.kickstarter.com/help/fees> (last visited Oct. 7, 2019).

76. As of the writing of this article, Kickstarter has facilitated over \$4.5 billion in crowdfunding contributions since its inception. *See Kickstarter Stats*, KICKSTARTER, <http://www.kickstarter.com/help/stats> (last visited Oct. 11, 2019).

77. GOFUNDME, <https://www.gofundme.com/> (last visited Oct. 11, 2019).

78. As of the writing of this article, Indiegogo has expanded into investment crowdfunding. *See How It Works*, INDIEGOGO, <https://www.indiegogo.com/how-it-works> (last visited Oct. 11, 2019).

79. *See Kickstarter vs. GoFundMe vs. Indiegogo*, GRASSHOPPER, <http://grasshopper.com/resources/tools/crowdfunding-platforms-kickstarter-gofundme-indiegogo/> (last visited Oct. 11, 2019).

80. There are some limitations on the types of ventures that can be funded. For example, marijuana related products cannot be sold.

81. *Is My Campaign Allowed on Indiegogo?*, INDIEGOGO, <https://support.indiegogo.com/hc/en-us/articles/360000574528-Is-My-Campaign-Allowed-on-Indiegogo->

82. *See, e.g., In the Matter of Michael Miglozzi II and Brian William Flatow*, Securities Act Release No. 9216 (June 8, 2011).

83. *See* Stacy Cowley, *New Crowdfunding Rules Let the Small Fry Swim with the Sharks*, N.Y. TIMES (May 14, 2006), <http://www.nytimes.com/2016/05/15/business/dealbook/new-crowdfunding-rules-let-the-small-fry-swim-with->

allowed for investment crowdfunding. Investment crowdfunding involves companies making an offering for sale of securities to the general public using the internet.⁸⁴ With investment crowdfunding, instead of receiving a product or supporting the outcome of a project, investors receive a security in exchange for money. Investment offerings may include offerings of stock, interest-bearing loans, revenue sharing, convertible debt, and future equity.⁸⁵

The most common types of investment crowdfunding are debt and equity. Debt crowdfunding is when a group of people or businesses lend money to an individual or company with the understanding that the loan will be repaid with interest.⁸⁶ Equity crowdfunding is where the exchange between the company and investor is represented by company equity, or ownership, as opposed to goods or services.⁸⁷ The idea is very similar to how common stock is bought and sold on the stock market.

B. *How Crowdfunding Works*

Crowdfunding works by using an online platform to raise funds from the public (the “crowd”). With investment crowdfunding, securities are generally sold through a broker or SEC-approved funding portal.⁸⁸ These brokers are facilitators who have an obligation to provide information, reduce the risk of fraud, and are responsible for investors’ and issuers’ compliance with the law.⁸⁹ The broker/portal model

sharks.html; *see also* Ryan Caldbeck, *What Is General Solicitation, and Why Does It Matter To You?*, FORBES (Oct. 28, 2013), <https://www.forbes.com/sites/ryan-caldbeck/2013/10/28/what-is-general-solicitation-and-why-it-matters-to-you>.

84. James Chen, *Investment Crowdfunding*, INVESTOPEDIA, <https://www.investopedia.com/terms/i/investment-crowdfunding.asp> (May 10, 2019).

85. Jack Wroldsen, *Crowdfunding Investment Contracts*, 11 VA. L. & BUS. REV. 543 (Spring 2017).

86. *The Ultimate Crowdfunding Guide*, CROWDFUND INSIDER, <http://www.crowdfundinsider.com/the-ultimate-crowdfunding-guide/>.

87. *See id.*

88. Wroldsen, *supra* note 85, at 546.

89. *Frequently Asked Questions Regarding Regulation Crowdfunding and Intermediary Requirements*, U.S. SEC. & EXCH. COMM’N (Sept. 25, 2018), <https://www.sec.gov/divisions/marketreg/tmcompliance/cfportal-faqs.htm>.

educates both companies and investors and standardizes the process of online solicitation.⁹⁰

Crowdfunding is thought to be a key to economic growth. As a result, three of the JOBS Act titles—Title II, Title III, and Title IV—created three different sets of regimes in which private companies can raise investment capital online. Title II permits companies to publicly advertise that they are raising capital⁹¹ (although they can only sell to accredited investors).⁹² Title III creates the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act (the “CROWDFUND Act”), which exempts businesses from the SEC registration requirements in connection with online capital raising from anyone, including unaccredited investors. However, there is a limit on the amount of capital that can be raised under Title III.⁹³ Title IV, referred to as “registered crowdfunding,” allows startups to raise up to \$50 million per year from both unaccredited and accredited investors via an update to existing Regulation A, now referred to as Regulation A+. It should also be noted that Title VII of the JOBS Act obligates the SEC to reach out to small businesses, as well as businesses owned by women, veterans, and minorities, regarding the changes made by the JOBS Act.

C. *Title II: “Access to Capital for Job Creators”*

As described in Part II above, prior to Title II going into effect in September 2013, federal regulation prohibited the general solicitation or advertisement of securities in a private placement exemption, requiring issuers to have some preexisting relationship with potential purchasers before conducting a private placement.⁹⁴ The preexisting relationship requirement

90. *Updated Investor Bulletin: Crowdfunding for Investors*, U.S. SEC. & EXCH. COMM’N (May 10, 2017), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_crowdfunding.html.

91. Jumpstart Our Business Startups Act § 201(a)(1).

92. An “accredited investor” is an individual \$1 million net worth (excluding the value of primary home), or over \$200,000/year (or \$300,000 together with a spouse). 17 C.F.R. § 230.501(a)(1).

93. Companies may now offer securities in reliance on the exemption under Section 4(a)(6) of the Securities Act. Press Release, U.S. Sec. & Exch. Comm’n, SEC Issues Proposal on Crowdfunding (Oct. 23, 2013), <https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540017677>.

94. 15 U.S.C. § 77d (2012) (amended 2015).

created a significant limitation on an issuer's ability to find and raise capital, since issuers were required to know all potential investors. Title II changed that limitation, creating a new registration exemption often referred to as "Accredited Crowdfunding," which creates a streamlined registration process for startups and private companies to raise any amount of money online, as long as the ultimate purchasers are accredited investors and the issuer goes through extra steps to verify their investors' accredited status.⁹⁵ Title II allows founders to publicly advertise investment opportunities online via crowdfunding platforms, foregoing the requirement of a pre-existing relationship.⁹⁶

The effect of Title II is that some small businesses and startups can market their business to strangers, unencumbered by the former restriction of a preexisting relationship, and raise an unlimited amount of money from accredited investors via online crowdfunding portals.⁹⁷ Elimination of the preexisting relationship requirement means that entrepreneurs may now connect to a wider source of capital they might otherwise be unable to access, and accredited investors have access to investments that they might not otherwise find. Arguably, this change helps entrepreneurs reach investors previously unknown to them who may already meet the accreditation standards and helps investors seeking to make investments in emerging companies.

D. *Title III: "CROWDFUNDING"*

On October 30, 2015, the SEC adopted the final rules for the implementation of investment-based crowdfunding and in May 2016, the SEC final rules for Title III went into effect. The new rules created an additional private placement exemption from registration of a securities offering.⁹⁸ Unlike Title II, Ti-

95. It remains unclear what steps the SEC will require from issuers to verify that purchasers under Rule 506 are actually accredited investors.

96. 15 U.S.C. § 77b, d(a)(6) (2012) (amended 2015). Anna Pinedo & David Lynn, *A Quick Guide to the JOBS Act*, MORRISON & FOERSTER LLP (Dec. 4, 2016), <https://media2.mofo.com/documents/120416-pli-quick-guide-jobs-act.pdf>.

97. Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Rules for Crowdfunding (Oct. 30, 2015), <https://www.sec.gov/news/pressrelease/2015-249.html>.

98. *Id.*

tle III permits investment crowdfunding to be made available online to unaccredited investors via crowdfunding portals registered with the SEC. Effectively, Title III permits companies to sell securities to both accredited and non-accredited investors without registering or complying with the full disclosure requirements of a public offering. The rules provide that any investor, regardless of whether they are accredited, may invest in a startup business by investing in equity, debt, or other financial instrument.⁹⁹ Businesses are limited to raising up to \$1 million annually from unaccredited investors. Unaccredited or ordinary investors may invest a maximum of \$2,000 or 5% of their income if their net worth and annual income are both less than \$100,000.¹⁰⁰ Investors with over \$100,000 in net worth or income may invest up to 10% of either.¹⁰¹

E. *Title IV: "Small Company Capital Formation"*

Title IV revived the already existing, but little used, Regulation A, which offers another exemption from registration by adding a new provision many have referred to as "Regulation A+" or "Registered Crowdfunding."¹⁰² Regulation A+ targets startups by allowing them to raise up to \$50 million per year from accredited and unaccredited investors (unaccredited investors are limited to investing 10% of their self-reported income or net worth). It gives entrepreneurs the ability to raise larger amounts of capital than under Title III from a larger pool of investors than the typical traditional accredited investor.¹⁰³

Title IV also allows Regulation A+ companies to avoid individual state securities laws and to gauge investor interest in an offering before formally filing with the SEC. Regulation A+ effectively allows companies to advertise online, avoid individual state's financial regulations, and confidentially "test the waters" to gauge potential investor interest before registering with the SEC. This option is mostly for late-stage startups because it requires significant time and money (six to eight

99. 15 U.S.C. § 77d(a)(6) (2012) (amended 2015).

100. 15 U.S.C. § 77d(a)(6)(B)(i) (2012) (amended 2015).

101. 15 U.S.C. § 77d(a)(6)(B)(ii) (2012) (amended 2015).

102. SEC Adopts Rules for Crowdfunding, *supra* note 97.

103. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21806-01 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, 260).

months, \$50,000 to \$150,000) in the initial SEC registration and ongoing financial reporting. By contrast, a full IPO costs \$2.6 million. While Title IV allows unaccredited investors to participate, there have only been a few investment crowdfunding platforms catering to unaccredited investors.

F. *Intermediaries*

Crowdfunding intermediaries or brokers are responsible for helping issuers comply with the JOBS Act. Brokers are obligated under the JOBS Act to make sure that each investor receives (1) issuer disclosures, and (2) reviewed investor information materials to ensure transparency and protect against fraud. The intermediary must also affirm that the investor can bear the risk and confirm their understanding of the risks of investment via questionnaire. The intermediary is required to (1) conduct a background check on each officer, director, and 20% or more shareholder of the issuer, (2) protect investor privacy, (3) ensure that no offering proceeds are provided to the issuer unless the target offering amount has been met, (4) allow investors to cancel their commitments, (5) ensure that no investor exceeds the allowable investment limited from all crowdfunding investments within a 12-month period, and (6) take measures to reduce the risk of fraud.¹⁰⁴

G. *Disclosure Requirements Under the JOBS Act*

There are three tiers of financial disclosure, which depend on the targeted size of the offering. All issuers must provide a description of their financial condition, certain financial information, and after a crowdfunding round, file with the SEC, and make available to investors financial statements and a report on the results of operations.¹⁰⁵ Tier 1 requires that for offerings of \$100,000 or less, an issuer must disclose its most recent income tax return or a copy of its financial statements, certified by the principal executive officer to be true and com-

104. *Regulation Crowdfunding: A Small Entity Compliance Guide for Crowdfunding Intermediaries*, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/divisions/marketreg/tmcompliance/cfintermediaryguide.htm#requirements-for-intermediaries> (last modified May 13, 2016).

105. *Updated Investor Bulletin: Crowdfunding for Investors*, U.S. SEC. & EXCH. COMM'N (May 10, 2017), https://www.sec.gov/oiea/investor-alerts-bulletins/ib_crowdfunding.html.

plete in all material respects.¹⁰⁶ Tier 2 is for issuers that want to raise more than \$100,000, but not more than \$500,000. It requires financial statements reviewed by an independent public accountant. Tier 3 is when an issuer wants to raise \$500,000 or more. In this tier, issuers need to provide audited financial statements. Tier 2 and tier 3 disclosure requirements may prove to be the breaking point for a number of issuers who will have to decide whether the cost and effort of audited financials justifies the additional offering amount. In theory, the JOBS Act worked to balance making capital more accessible with potential fraud, but the reality is that in practice, startups may raise \$500,000 or less to avoid the audited financial statement requirement.

This section discussed the variations of crowdfunding, how crowdfunding works, and the new crowdfunding rules and legislation, and the next section makes some observations about the crowdfunding rules and identifies some problems and barriers to entry for entrepreneurs.

III.

THE PROBLEM WITH CROWDFUNDING

Because crowdfunding has the potential to increase the capital-raising opportunities available to entrepreneurs and investment opportunities available to non-wealthy investors, the JOBS Act has been touted by scholars as having the potential to bring about a powerful shift in the existing traditional fundraising mechanisms.¹⁰⁷ On its face, crowdfunding seems to be exactly what entrepreneurs and investors need. Certainly, it seems plausible that, given the issues with respect to traditional capital raising, crowdfunding would be a welcome and meaningful way for entrepreneurs to have equal access to capital. Supporters of the new securities regulations argue that these opportunities can change outcomes for certain groups of participants in the financial markets, since entrepreneurs who have been historically shut out of the market for traditional sources of funding now have the opportunity to appeal to their networks and to strangers over the Internet to support

106. Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), 80 Fed. Reg. 21806-01 (Apr. 20, 2015) (to be codified at 17 C.F.R. pts. 200, 230, 232, 239, 240, 249, 260).

107. Schwartz, *supra* note 73, at 1459-61.

their business.¹⁰⁸ In addition, it is argued that crowdfunding enables non-wealthy investors to participate in the financial markets in a new way.¹⁰⁹ Therefore, the purported value of crowdfunding is that it allows more individuals to engage as producers and consumers in the economy, *without* relying upon that portion of the country that is wealthy or has access to wealth.

The project-based model of crowdfunding has been operating for nearly a decade and has developed into a robust market, but the investment-based model of crowdfunding made possible by the JOBS Act has not had that much time to develop, and its impact is unknown.¹¹⁰ Yet scholars have written about the potential for disastrous consequences for both investors and issuers.¹¹¹ The use of the Internet for anonymous investment transactions raises concerns about the risk to those who invest with issuers when they do not have a pre-existing relationship.¹¹² In addition, critics cite transaction costs, fear of fraud, shareholder dilution, and information asymmetry as consequences of the new changes to the Federal Securities Laws.¹¹³

108. Venkat Kuppaswamy & Kathy Roth, *Research on the Current State of Crowdfunding: The Effect of Crowdfunding Performance and Outside Capital*, U.S. SMALL BUS. ADMIN. (May 2016), <https://www.sba.gov/sites/default/files/433-Crowdfunding-Performance-and-Outside-Capital.pdf>; Daniel Winnike, Jeffrey Vetter & Robert Freedman, *New Crowdfunding Rules: An Overview*, FENWICK & WEST LLP (Dec. 4, 2015), <https://www.fenwick.com/publications/pages/new-crowdfunding-rules-an-overview.aspx>.

109. Adam Sharp, *Your Right to Invest in Startups*, TALKMARKETS (Aug. 7, 2015), <https://talkmarkets.com/content/investing-ideas—strategies/your-right-to-invest-in-startups?post=70745>.

110. There is little to no existing empirical data on crowdfunding at the time this Article was written.

111. See, e.g., Joan Macleod Heminway & Sheldon Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 933–34 (2011); Sarah Kessler, *Equity Crowdfunding for Non-Rich People Is Coming*, FAST COMPANY (May 10, 2016), <https://www.fastcompany.com/3059707/equity-crowdfunding-for-non-rich-people-is-coming>.

112. Andrew Schwartz, *The Nonfinancial Returns of Crowdfunding*, 34 ANN. REV. BANKING & FIN. L. 565, 570–71 (2015). But see Lisa M. Fairfax, *With Friends Like These . . . : Toward a More Efficacious Response to Affinity-Based Securities and Investment Fraud*, 36 GA. L. REV. 63, 77 (2001).

113. See, e.g., John S. Wroldsen, *The Social Network and the Crowdfund Act: Zuckerberg, Saverin, & Venture Capitalists' Dilution of the Crowd*, 15 VAND. J. ENT. & TECH. L. 583 (2013).

There were many naysayers when the JOBS Act was first proposed. The lengthy delay between the time that the JOBS Act was signed in 2012 and the rulemaking that went into effect in 2016 can be attributed to the SEC's fear, reflected by many scholars, that both the public and entrepreneurs were not ready to democratize investment. Proponents of crowdfunding argue that it has the potential to play a positive role in improving the trajectory of a startup business and argue that crowdfunding can also play a role in providing investment vehicles for non-wealthy investors, who have been traditionally shut out of Wall Street.¹¹⁴ Some have claimed that investment crowdfunding is the best source of startup funding for women and people of color.¹¹⁵ But if investment crowdfunding is so great, more entrepreneurs would seemingly have tried it. Of the 6 million businesses in the U.S., only 1400 entrepreneurs have turned to investment crowdfunding.¹¹⁶ Crowdfunding has not been widely used by anyone, not just entrepreneurs.

There is not enough empirical evidence about whether the JOBS Act has created more economic opportunity for startup businesses. Bloomberg reports that, in the first year equity crowdfunding was allowed by the SEC, 142 companies raised a total of \$37.6 million.¹¹⁷ In contrast, venture investors invested

114. See Rodney Sampson, *Crowdfunding's Power to Close the Racial Wealth Gap*, HUFFINGTON POST (May 16, 2016), http://www.huffingtonpost.com/rodney-sampson/crowfundings-power-to-cl_b_9994080.html ("I personally believe that equity crowdfunding is the most significant piece of financial based legislation for African Americans since the Emancipation Proclamations 1863 emancipation of the Southern Slaves.").

115. Habib Jamal, Sherwood Neiss & Jason Best, *Crowdfunding's Potential for Minority and Women Owned Enterprises*, CROWDFUND CAP. ADVISORS (July 2014), <https://www.scribd.com/book/235308665/Crowdfunding-s-Potential-for-Minority-and-Women-Owned-Enterprises>.

116. Howard Marks, *What is Equity Crowdfunding?*, FORBES (Dec. 19, 2018, 8:00AM), <https://www.forbes.com/sites/howardmarks/2018/12/19/what-is-equity-crowdfunding>; Rebecca Lake, *Crowdfunding for Non-Accredited Investors*, INVESTOPEDIA, <https://www.investopedia.com/articles/entrepreneurship-small-business/050216/guide-crowdfunded-investments-nonaccredited-investors.asp> (last updated Sept. 19, 2019).

117. Lizette Chapman, *U.S. Startups Fail to Attract Expected Crowd of Small Investors*, BLOOMBERG (May 19, 2017, 7:00 AM), <https://www.bloomberg.com/news/articles/2017-05-19/u-s-startups-fail-to-attract-expected-crowd-of-small-investors>.

\$69 billion according to the National Venture Capital Association.

Although the JOBS Act was intended to provide greater access to capital for entrepreneurs, the legislation and current capital raising schemes available to entrepreneurs may not be enough to meaningfully democratize the entrepreneurial ecosystem.

A. *The Allowable Fundraising Amounts Are Too Small*

Title III on its face appears to enable the opening of access to capital for entrepreneurs, but there are some significant hurdles and limitations, not the least of which is that companies can only raise \$1 million in equity crowdfunding within a 12-month period. This amount is minor compared to the amount of work, legal, and otherwise a company needs to do in order to comply with all the regulations. Currently, a startup's first outside capital is averaging between \$1.7 and 1.9 million. If a startup wants to meet the average, they will need to conduct a financing round in addition to a crowdfunding round.

The amount unaccredited investors can invest in a business is capped in a given year at \$2,000, or 5% of their annual income or net worth (whichever is greater) if the investor makes less than \$100,000 annually. Unlike Title II investments, these new classes of investors can "self-certify." The crowdfunding websites are not required to ask for individual tax returns or bank statements to prove how much the investors are worth; these investors are simply required to check a box indicating that they acknowledge that the JOBS Act limits Title III investors from spending more than 5% of their income on crowdfunding offerings (although accredited investors can invest up to 10%).¹¹⁸ Any investor can invest in Title III exempted crowdfunding campaigns. Issuers are limited to no more than a million dollars annually via crowdfunding sources.¹¹⁹ Public companies, registered and exempt investment companies, and non-U.S. companies are prohibited from using the crowdfunding exemption.¹²⁰

118. 15 U.S.C. § 77d(a)(6)(B)(i).

119. 15 U.S.C. § 77d(a)(6)(A).

120. 15 U.S.C. § 77d-1(f).

B. *The Requirements Are Too Costly*

While Title III of the JOBS Act was written with specificity for smaller startups raising money, the rules may be too limited and demand too much to be actually useful for a startup business. Title III limits a business to raising up to \$1 million per year. While raising \$1 million would be a great opportunity for a startup, the money raised does not come without a cost. The expected costs of crowdfunding are problematic.¹²¹ Professor Patricia H. Lee found that the compliance costs and liabilities for issuers may reduce the impact of crowdfunding.¹²² She writes that transaction costs come from “heavy regulatory burden[s] imposed, including issuer disclosure requirements, entrepreneur’s reporting requirements and the requirement that sales take place through a new SEC-registered framework called a funding portal.”¹²³ Further, she asserts that crowdfunding financing may be one of the most expensive ways to obtain capital because of the cost of the regulatory burdens.¹²⁴ Despite the JOBS Act waiving the registration requirements,¹²⁵ crowdfunding under Title III is still costly for issuers, due to an obligation to abide by regulations that generally requires professional assistance that averages between \$50,000 to \$100,000.¹²⁶ Raising money with Regulation A+ still involves quite a bit of work and expense for the issuer, approximately \$50,000–\$100,000, along with ongoing bi-annual financial reporting. Further, equity crowdfunding may be cost prohibitive to all but the wealthiest startups. Issuers must be able to produce and offering disclosure documents, enlist a fund-

121. Jeff Thomas, *Making Equity Crowdfunding Work for the Unaccredited Crowd*, 4 HARV. BUS. L. REV. 62, 62 (Apr. 14, 2014), https://www.hblr.org/wp-content/uploads/sites/18/2014/04/Thomas_Making-Crowdfunding-Work.pdf.

122. Lee, *supra* note 35, at 36.

123. *Id.* at 38.

124. *Id.* at 39.

125. All crowdfunding offerings are exempt from registering the offering with the SEC. This is good for startups because registration is costly. On average the cost of initial securities registration is \$2.5 million with additional \$1.5 million in costs related to compliance with ongoing requirements. See Thomas, *supra* note 121, at 62.

126. Chance Barnett, *Why Title III of the JOBS Act Will Disappoint Entrepreneurs*, FORBES (May 13, 2016, 9:57 AM), <http://www.forbes.com/sites/chancebarnett/2016/05/13/why-title-iii-of-the-jobs-act-will-disappoint-entrepreneurs/>.

ing portal, conduct background checks, and file an annual report. According to the SEC's Regulation Crowdfunding Study survey estimates, the total cost of creating a campaign page, issuer disclosures, film, and video, and hiring a marketing firm, a lawyer, and an accountant amounts to approximately 5.3% of the amount raised.¹²⁷ NextGen found that companies spend \$20,000 to \$50,000 on legal accounting and marketing—a heavy burden for startups generally, particularly if the startup is only looking to raise a couple hundred thousand dollars.¹²⁸

C. *The Requirements Are Too Risky*

The obligations on the startup fundraiser may be too risky. The burden is on the company to prove the eligibility of their investors. The company must have written confirmation by a certified public accountant, an attorney, an investment advisor, a broker-dealer, or income-related IRS forms.¹²⁹ It may therefore simply be easier for companies to seek investment from only accredited investors, rather than the ordinary investor, because there is too much additional risk that these small, emerging companies take on by participating in crowdfunding and offering to ordinary investors. For example, failure of a startup to prove status of its investor means that the startup could be banned from offering securities for one year, which could be fatal for a startup enterprise. Under the JOBS Act, companies face new liability. Investors can bring suit against a company they have invested in for material misstatements and omissions.

D. *The Requirements Are Too Burdensome*

One of the purposes of the JOBS Act is to increase access to capital by reducing the disclosure requirements of the securities laws, but the JOBS Act is unduly burdensome and is

127. U.S. SEC. & EXCH. COMM'N, REPORT TO THE COMMISSION: REGULATION CROWDFUNDING 2019 (June 18, 2019), https://www.sec.gov/files/regulation-crowdfunding-2019_0.pdf.

128. *U.S. Startups Fail to Attract Crowd of Small Investors*, SEATTLE TIMES (May 20, 2017), <https://www.seattletimes.com/business/us-startups-fail-to-attract-crowd-of-small-investors/>.

129. Final Rule: Crowdfunding, *supra* note 64; SEC Fact Sheet (July 10, 2013), *supra* note 58.

likely to be another barrier for entrepreneurs. The JOBS Act contains restrictive disclosures described in Part II above, that describes the specific disclosures that need to be made by issuers to the SEC, investors, intermediaries, and the public. These disclosures include the name of the company, its legal status, the physical address and website URL, along with information about officers, directors, and equity holders that own 20% or more of the company.¹³⁰ Issuers must also provide a description of the business, a business plan, planned use of the proceeds, terms of indebtedness, employment information, other offerings conducted, financial statements, and capital structure and risks.¹³¹

The restrictions on its users create practical problems for founders and investors. For instance, companies can only conduct crowdfunding transactions through funding portals, and companies that use crowdfunding are required to file annual reports with the SEC. Preparing such disclosure statements that protect the business may be too costly and burdensome, either in time and/or technical expertise, or transaction costs for some startups, because of the scarcity of resources. The rules require that all companies that use crowdfunding file financial statements for the last two fiscal years (or less).¹³² Companies must submit audited financial statements for offerings of more than \$500,000.¹³³ Because of the audit costs, it is likely that companies might only raise \$490,000 to avoid the cost of audited financial statements.

Further, tracking crowdfunding investors may be too burdensome, so crowdfunding investors might be the least preferable investor in a startup venture. A startup venture looking to raise \$1 million might prefer to receive the money from a single individual (or a single fund) as opposed to hundreds or even thousands of ordinary investors. The logistics of keeping track of all of those investors may prove problematic and may overly complicate a company's cap table.¹³⁴

130. 15 U.S.C. § 77d-1(b)(1).

131. *Id.*

132. 15 U.S.C. § 77d(d)(3)(J)(i).

133. 15 U.S.C. § 77d-1(b)(1)(D)(iii).

134. A capitalization table that specifically outlines the equity and debt ownership of a company in its entirety.

E. *The High-Growth v. Low-Growth Distinction*

Further, it seems as though the JOBS Act was put in place to promote certain kinds of businesses, for example, high-tech or high-growth ventures. The JOBS Act was enacted to level the playing field, and the legislation was used as a tool to promote entrepreneurship in an effort to stimulate the economy, but the legislation targets the high-growth venture to the exclusion of low-growth smaller businesses.¹³⁵ The statute's focus on high-tech companies seems to have a narrow view of entrepreneurship. Therefore, while crowdfunding might work for scalable high-tech ventures, it is unlikely to favor most modest low-growth potential enterprises—the kinds that are run by most entrepreneurs. The crowdfunding opportunity is most favorable for scalable enterprises with an exit strategy and may not be a great fit for neighborhood businesses or low-growth businesses.

Scholars argue that the most promising companies—the high-growth ventures delivering the remarkable returns that keep the entire venture capital industry afloat—may also be the one least likely to raise money via crowdfunding.¹³⁶ Because crowdfunding rules cap fundraising at \$1 million every 12 months using equity-based crowdfunding, there is not that much money to be made from crowdfunding. Therefore, the high-growth ventures—the unicorns and blockbusters—may not bother raising such a small amount (only up to \$1 million) from a crowd.¹³⁷ Many high-growth or tech companies may opt out and may raise capital through traditional private channels.

F. *The Dumb Money Effect of Crowdfunding*

The use of crowdfunded financing does not provide the added benefit of access to an experienced investor willing to serve as advisor to the venture. With angel investors and venture capital, the entrepreneur has the ability to develop a rela-

135. In passing the legislation Congress and the Obama Administration asserted that high-growth businesses are vital to moving the U.S. economy. See NAT'L ADVISORY COUNCIL ON INNOVATION & ENTREPRENEURSHIP, U.S. DEP'T OF COMMERCE, REPORT TO SECRETARY LOCKE, IMPROVING ACCESS TO CAPITAL FOR HIGH-GROWTH COMPANIES, at iv (2011).

136. See Cowley, *supra* note 83.

137. *Id.*

tionship and consult with experienced investors, capitalizing on the investors' expertise and their network. Both types of investment are invaluable to a founder, because the money comes with the investors' expertise and network.¹³⁸ Furthermore, practitioners would argue that having too many investors proves problematic for companies, particularly when shareholder approval is required for action.

G. *The Ordinary Investor*

In addition to targeting small businesses and startups, the JOBS Act also sought to target investors of modest means to invest in startup companies.¹³⁹ In his speech when he signed the bill, President Obama¹⁴⁰ said, "For the first time, ordinary Americans will be able to go online and invest in entrepreneurs they believe in."¹⁴¹ Certainly, crowdfunding appeals not only to entrepreneurs, but to investors as well. The JOBS Act shifted the investing landscape from only institutional and expert investors to unsophisticated retail investors. Under the crowdfunding rules, ordinary investors have access to companies that they would not ordinarily have access to, since before the JOBS Act such investment was only available to wealthy investors who were friends and family of the founders. Investing in such ventures is another way for ordinary investors to potentially build wealth. Under the previous regime, the SEC rules

138. Investors can be categorized as either smart money investors or dumb money investors. Smart money is investment plus expert assistance, social capital and/or mentoring. Dumb money is money that is just money without expert assistance, social capital or mentorship. Caroline Banton, *Smart Money*, INVESTOPEDIA, <https://www.investopedia.com/terms/s/smart-money.asp> (last updated May 20, 2019).

139. Press Release, The White House, Office of the Press Sec'y, President Obama to Sign Jumpstart Our Business Startups (JOBS) Act (Apr. 5, 2012), <https://www.whitehouse.gov/the-press-office/2012/04/05/president-obama-sign-jumpstart-our-business-startups-jobs-act>.

140. Press Release, The White House, Office of the Press Sec'y, Remarks by the President at Global Entrepreneurship Summit and Conversation with Mark Zuckerberg and Entrepreneurs (June 25, 2016), <https://obamawhitehouse.archives.gov/the-press-office/2016/06/25/remarks-president-global-entrepreneurship-summit-and-conversation-mark> ("I believe we are better off in a world in which we are trading and networking and communicating and sharing ideas. But that also means that cultures are colliding and sometimes [it] is disruptive, and people get worried. You're the bridge, you're the glue . . .").

141. Landler, *supra* note 21.

“created an investment climate that the rich get richer, while the poor get left behind.”¹⁴² Yet, while the rhetoric of crowdfunding provides an opportunity for investors as well as founders, it is unlikely that investing in crowdfunding opportunities will build enough wealth and capital to provide a meaningful economic opportunity because it is unlikely that the return on a crowdfunding investment will come close to that of an investment in the private market, a market that is still only available to accredited investors. Additionally, the rules around unaccredited investors may be such a burden for startups that they may choose to solely appeal to accredited investors, since the rules allow companies to raise money from accredited investors without spending much cash or having to publicize disclosures regarding company finances.

1. *Fraud*

Despite crowd-funded securities being subject to anti-fraud provisions of the securities laws¹⁴³ and gatekeepers such as auditors, lawyers, and underwriters, fraud remains a major concern because crowdfunding securities are subject to limited disclosure requirements (as described in Part II). Some scholars are therefore concerned that a probable consequence will be increased fraud and inaccurate information, harkening back to the events that sparked the crash of the stock market in 1929.¹⁴⁴ Ordinary crowdfunders lack the ability to vet their investments or engage with a specific strategy in the same way that traditional investors do. As soon as a request is posted on a crowdfunding platform, it goes live and an investor can in-

142. Rodrigues, *supra* note 49, at 3389.

143. The new section of the Securities Act § 4A(c) provides the liability standards for issuers in connection with crowdfunding offerings. In the Proposed Rule for Crowdfunding, the SEC notes: “The anti-fraud and civil liability provisions of the Securities Act, such as Sections 12(a)(2) and 17, apply to exempted transactions, including those transactions that will be conducted in reliance on crowdfunding.” Crowdfunding, Release Nos. 33-9470, 34-70741 (comments to be received on or before Feb. 3, 2014) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240 and 249), <https://www.sec.gov/rules/proposed/2013/33-9470.pdf>.

144. Schwartz, *supra* note 73; *see, e.g.*, Heminway & Hoffman, *supra* note 111.

vest. This is the time period that worries scholars and where the greatest potential for fraud exists.¹⁴⁵

In addition, because of the regulatory burden of crowdfunding using unaccredited investors, the ordinary investor may be effectively excluded from investment crowdfunding anyway. Another issue raised by critics of the JOBS Act is the fallout from the opening up to the masses of investment opportunities once only available to the rich.¹⁴⁶ Opening investment opportunities up to the ordinary investor gives such investor an opportunity to build wealth previously available only to the wealthy or those connected to savvy entrepreneurs or founders of unicorn companies. For example, friends and family of founders of certain companies, such as Twitter, Facebook, Dropbox, Uber, and other unicorns,¹⁴⁷ were able to invest and see their investment grow to be worth million or billions. In contrast, the public had to wait until the IPO (sometimes public investors are subject to losses) to invest in the companies, which allegedly “democratizes investment.”¹⁴⁸

2. *The Ordinary Investor is Unlikely to Build Wealth*

Ostensibly, now the ordinary investor can speculate on companies at the ground floor. The potential in theory is a good thing, but the reality is that it is unlikely to result in an ordinary investor building wealth in practice. Investing is a luxury that requires disposable income. It is inconceivable that the ordinary investor is in a position to become a venture capitalist. The ordinary investor does not have disposable income or the wealth to participate in crowdfunding offerings. Investing, as a mechanism to build wealth, is likely to never be an option for the ordinary investor. As Professor Usha Rodrigues puts it, “even with CROWDFUND, the real homeruns are still reserved for the big wallets.”¹⁴⁹ Meaning that there is more

145. See, e.g., Letter from Charles V. Rossi, President, Sec. Transfer Ass’n, Inc., to Elizabeth M. Murphy, Sec’y, SEC (Sept. 17, 2012), <http://www.sec.gov/comments/jobs-title-i/general/general-207.pdf>.

146. Cowley, *supra* note 83.

147. See, e.g., Jennifer S. Fan, *Regulating Unicorns: Disclosure and The New Private Economy*, 57 B.C. L. REV. 583 (2016).

148. See, e.g., Heminway & Hoffman, *supra* note 111.

149. Rodrigues, *supra* note 49, at 3433.

money in the private markets that are not currently available to the ordinary investor.

3. *Financial Literacy is Needed*

These inexperienced investors will not know how to decide which companies are worthy of their investment. Inexperienced investors may not be savvy enough to understand the risks associated with new ventures. Online investors¹⁵⁰ face greater uncertainty than investors in traditional businesses.¹⁵¹ On the other hand, experienced investors spend copious amounts of time and resources evaluating the companies in which they invest. Conducting due diligence on potential investments is a key part of their investment strategy to determine whether they will receive a return on their investment. Crowdfunding investors will not have the opportunity to conduct due diligence beyond the information that is shared on the crowdfunding platform.

4. *The Exit Strategy for Investors is Complicated*

It is likely that most entrepreneurial ventures will fail. Fifty percent of all businesses will go out of businesses; only ten percent have a likelihood of success.¹⁵² Those ventures that are headed toward a success story with monster returns will take years to build. The average time for a company to go from a startup to an IPO is ten years.¹⁵³ Companies currently go pub-

150. Schwartz, *supra* note 26.

151. See, e.g., Darian M. Ibrahim, *Equity Crowdfunding: A Market for Lemons?*, 100 MINN. L. REV. 561 (2015); Michael Dorff, *The Siren Call of Equity Crowdfunding*, 39 IOWA J. CORP. L. 493 (2014).

152. Glenn Kessler, *Do Nine Out of 10 New Businesses Fail, As Rand Paul Claims?*, WASH. POST (Jan. 27, 2014), <https://www.washingtonpost.com/news/fact-checker/wp/2014/01/27/do-9-out-of-10-new-businesses-fail-as-rand-paul-claims/>; see U.S. SMALL BUS. ADMIN., FREQUENTLY ASKED QUESTIONS, https://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf. See, e.g., Erin Griffith, *Why Startups Fail, According to Their Founders*, FORTUNE (Sept. 25, 2014), <http://fortune.com/2014/09/25/why-startups-fail-according-to-their-founders/>.

153. Alyson Shontell, *Barry Silbert: Here's Why Startups Now Take So Friggin' Long To IPO*, BUS. INSIDER (Mar. 10, 2012), <http://www.businessinsider.com/barry-silbert-heres-why-startups-now-take-so-frigging-long-to-ipo-2012-3>.

lic at a much lower rate than ever before.¹⁵⁴ This length of time before a public offering will be a barrier for many ordinary crowdfunding investors.

Although sold to the general public, shares issued through a crowdfunding offering are privately held and may not be transferred easily. Unlike shares of a public company that are bought and sold on a public exchange, there is no exchange where crowdfunding investors can sell their securities, although there are crowdfunding portals that re-sell crowdfunded securities. Without a robust secondary market, or a clear exit for investors, it is unlikely that as many investors will want to participate in equity crowdfunding; therefore, founders will not be able to fully take advantage of crowdfunding. Crowdfunding is still in its infancy, but creating an exit strategy for investors is important. Not every company will reach the level of an IPO or an acquisition that generates investment returns. Hence, providing investors liquidity is an important issue that needs to be resolved for crowdfunding to takeoff.

IV.

RECOMMENDATIONS TO REVISE THE JOBS ACT

The JOBS Act in its current form is not likely to meaningfully assist entrepreneurs in building their businesses. The legislation needs to be revised to be more user-friendly for entrepreneurs. Congress should introduce legislation that addresses the restrictions and limitations of the JOBS Act, which is identified in Part III above.

The legislation should make crowdfunding mechanisms more appealing to low-growth companies as well as high-growth ventures. For example, the legislation should financially support funding portals for entrepreneurs. Further, Congress should create a registration exemption for small business offerings.

Congress should include funding that supports more crowdfunding platforms and support for entrepreneurs. Congress should expand Title VII of the JOBS Act to educate entrepreneurs about the JOBS Act and dedicate resources to

154. Matt Egan, *America's Stock Market is Shrinking*, CNN MONEY, (July 9, 2015), <http://money.cnn.com/2015/07/09/investing/stock-market-shrinking/index.html>; see Shontell, *supra* note 153.

overcome the barrier of the costs related to equity crowdfunding. Crowdfunding's effects on entrepreneurship needs to be studied and better understood in order to create meaningful legislation that will support investors and entrepreneurs.

The SEC should limit the liability of a crowdfunding intermediary or portal's liability while extending at least a 5-year grace period for portals to make a good-faith effort to comply with all crowdfunding rules as proposed by the Fix Crowdfunding Act (H.R. 4855).

The SEC should increase the annual fundraising limit from \$1 million to \$5 million, which enables entrepreneurs who require larger amounts of capital in the seed round to use equity crowdfunding as a potential source of funding. Allowing companies the opportunity to raise more money during a crowdfunding round will help startups protect their valuation and also save money on the necessary legal and accounting fees required to utilize equity crowdfunding.¹⁵⁵

These recommendations for change, specifically as they relate to the Title III rules, will encourage more entrepreneurs to launch crowdfunding campaigns without the fear of transaction costs, burdensome due diligence, and bureaucracy. Lastly, the SEC should allow for the use of special purpose investment vehicles, which would help entrepreneurs keep their cap tables organized because the investors of low-dollar amounts are grouped together into one large fund that appears on the cap table as one large entity.

CONCLUSION

Entrepreneurship was touted as the means to overcome the economic crisis and the solution to level the playing field in the entrepreneurship ecosystem. Crowdfunding is an apt metaphor for entrepreneurship as an economic development strategy. Crowdfunding was introduced to resolve some of the inequities existing within the entrepreneurial landscape. The

155. Rodney Sampson, *Scaling Diversity in Venture Capital: A Nod to Continued Innovation in America's Capital Formation Legislation*, HUFFINGTON POST (July 5, 2016), https://www.huffingtonpost.com/rodney-sampson/scaling-diversity-in-vent_b_10824240.html; Joyce Rosenberg, *Why Equity Crowdfunding Is Not Living Up to the Hype*, INC. (May 9, 2018), <https://www.inc.com/associated-press/equity-crowdfunding-investing-business-not-working-hype-investors-regulations-sec.html>.

passage of the JOBS Act promoted the idea that the way forward out of the recession is for entrepreneurs to either start a high-growth business or to invest in a high-growth business. The changes to the securities laws arguably have the potential to disrupt traditional financing constructs and traditional methods of capital raising by promoting economic participation by everyone, not just the wealthy accredited investor.

The change to the securities laws, allowing for investment in startup enterprises and investment by unaccredited investors, is a monumental advancement for entrepreneurship in the U.S. The purpose and goals of crowdfunding have been lauded for their aspirations, but as a fundraising mechanism, it only works in a limited sphere. Crowdfunding as it currently stands is unlikely to overcome the existing challenges to capital raising that entrepreneurs face within the entrepreneurial ecosystem. The legislation could do more to account for how entrepreneurs have access to capital and markets. It remains to be seen whether entrepreneurs will benefit from the change. Crowdfunding is not a panacea to the many fundraising challenges facing small businesses. After the historic change to the securities laws, it seems as though crowdfunding is not merely a passing trend. Historically, however, the U.S. has a history of creating wealth-building policies that benefit the wealthy. As an unintended consequence of investor protection, tax policies and financial policies have also evolved to favor the wealthy.¹⁵⁶ With respect to crowdfunding, every effort should be made to avoid that phenomenon.

156. Rodrigues, *supra* note 49, at 3417 (Describing the disparity in investment access, Professor Rodrigues writes that “in the name of investor protection, investments have been harmed by being sidelined.”).