



2014

Comments: The Securities and Exchange Commission's Proposed Regulations under the CROWDFUND Act Strike a Necessary Balance between the Burden of Disclosure Placed on Issuers of Securities and Meaningful Protection for Unsophisticated Investors

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Recommended Citation

Smith, Stuart Evan (2014) "Comments: The Securities and Exchange Commission's Proposed Regulations under the CROWDFUND Act Strike a Necessary Balance between the Burden of Disclosure Placed on Issuers of Securities and Meaningful Protection for Unsophisticated Investors," *University of Baltimore Law Review*: Vol. 44: Iss. 1, Article 6.
Available at: <http://scholarworks.law.ubalt.edu/ublr/vol44/iss1/6>

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THE SECURITIES AND EXCHANGE COMMISSION'S
PROPOSED REGULATIONS UNDER THE CROWDFUND ACT
STRIKE A NECESSARY BALANCE BETWEEN THE BURDEN
OF DISCLOSURE PLACED ON ISSUERS OF SECURITIES AND
MEANINGFUL PROTECTION FOR UNSOPHISTICATED
INVESTORS

I. INTRODUCTION

On April 5, 2012, Congress enacted the Jumpstart Our Business Startups Act (JOBS Act) with the purpose of improving job creation and economic growth.¹ A cornerstone provision of the JOBS Act was Title III, Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 (CROWDFUND Act).² The CROWDFUND Act created an exemption to the registration requirements for issuing equity securities under the Securities Act of 1933 (Securities Act).³ The reasoning behind this exemption was to relieve small businesses and startup companies from the costly and burdensome requirements associated with the issuance of security interests under the existing Securities Act.⁴ However, companies wishing to utilize the exemption to raise capital through the Internet via the CROWDFUND Act must still comply with the requirements of the exemption, which includes disclosure of information to potential investors.⁵ This required disclosure provides some protection to the investor by setting a minimum level of information relating to the company, its current financial condition, and the security offering itself.⁶

Further protection of potential investors in securities under the CROWDFUND Act comes from limitations on the amount of

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1. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified in scattered sections of 15 U.S.C.). The JOBS Act, in part, intended to make investment capital available to small businesses and start-up companies unable to obtain financing through existing channels. *See infra* note 41 and accompanying text.
 2. § 301, 126 Stat. at 315.
 3. *Id.* § 302, 126 Stat. at 315–16 (codified at 15 U.S.C. § 77d(a)(6) (2012)).
 4. *See* 15 U.S.C. § 77f (describing the registration of securities).
 5. 15 U.S.C. § 77d-1(b). Section 77d(a)(6)(D) requires companies issuing securities under the crowdfunding exemption comply with the disclosure requirements contained in § 77d-1(b). *Id.* § 77d(a)(6)(D).
 6. *See infra* Part IV.

securities an issuer may sell to any particular investor.⁷ The issuer is limited both by the net worth and annual income of the investor and the amount invested in any issuance by the issuer under the CROWDFUND Act exemption.⁸ This combination of a limitation on sales to individual investors with required issuer disclosures offers both a lower cost of disclosure to issuers and protection for the investor against losses resulting from fraud or misinformation.⁹

In addition to the disclosure requirements codified in the CROWDFUND Act, further action by the Securities and Exchange Commission (SEC) is required before the new law can take effect.¹⁰ Specifically, § 77-1(b)(1)(I) left open the option for the SEC to impose additional requirements, beyond those already contained in the law, in order to protect investors and the public.¹¹ This particular provision led to much discussion in the media as to whether the CROWDFUND Act, along with any additional requirements by the SEC, would require so much disclosure on the part of small businesses and startups that it would render the exemption ineffective.¹²

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7. 15 U.S.C. § 77d(a)(6)(B) (limiting the total value of securities sold by an issuer to an individual investor during any 12-month period); *see infra* Part III.C.
 8. § 77d(a)(6)(B).
 9. Neither protection of investors from “bad” investments nor assurance of only positive investment gains has been the goal of securities regulation. Rather, the goal has been to ensure that potential investors receive all the information needed to make a fair assessment of the investment opportunity. *See* 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, 1741 (2012).
 10. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 303(b), 126 Stat. 306, 321 (2012). Section 303(b) requires the Commission (SEC) to issue a rulemaking. *Id.*
 11. 15 U.S.C. § 77d-1(b)(1)(I).
 12. *See* Andrew A. Schwartz, *Roundtable: Keep it Light, Chairman White: SEC Rulemaking Under the CROWDFUND Act*, 66 VAND. L. REV. EN BANC 43, 45–46 (2013) [hereinafter *Roundtable*]; Charles D. Vaughn, *Crowdfunding: Is the Hype Really Justified?*, THE DAILY REPORT (Oct. 14, 2013); Carrie Rossenfeld, *Crowdfunding Has Its Pros and Cons*, GLOBEST.COM (Sept. 17, 2013, 8:53 AM), http://www.globest.com/news/12_693/losangeles/finance/Crowdfunding-Has-Its-Pros-and-Cons-337672.html; Tammy Whitehouse, *JOBS Act Inspires Criticism of Regulatory and Governance Rollback*, COMPLIANCE WEEK (Mar. 27, 2012), http://www.complianceweek.com/news/news-bulletin/jobs-act-inspires-criticism-of-regulatory-and-governance-rollback#.VAPC2_ldWS0; Yin Wilczek, *Former SEC Member Questions Viability of JOBS Act Crowdfunding*, BLOOMBERG BNA (July 2, 2013), <http://www.bna.com/former-sec-member-questions-viability-of-jobs-act-crowdfunding/>.

On October 23, 2013, the SEC released its proposed rules (SEC Rules) covering the CROWDFUND Act for public comment.¹³ This release offers the first opportunity to examine the SEC's thoughts on regulating disclosure under the exemption and any additional requirements to be imposed.¹⁴ A thorough examination of the SEC Rules relating to issuer disclosure under § 4A(b)(1),¹⁵ in relation to empirical evidence on the types of information most valued by potential investors, suggests that the burden created by the required disclosures is one for which small businesses and startups have little choice but to undertake should they desire a successful offering under the CROWDFUND Act exemption.¹⁶

The rules proposed by the SEC limit the cost and burden to small businesses and startups through the CROWDFUND Act exemption, while preserving investor protection through specific required disclosure and the additional structural limitation on investor participation.¹⁷ Part II of this Comment discusses what is meant by "crowdfunding" securities and provides background on the need and purpose behind the CROWDFUND Act, as well as some of the benefits and potential disadvantages to the practice.¹⁸ In Part III, key requirements of the exemption for crowdfunding are presented along with a discussion of empirical evidence highlighting types of information most valuable to investors when deciding whether or not to purchase securities under crowdfunding.¹⁹ Part IV examines the rules proposed by the SEC governing the issuance of securities utilizing the crowdfunding exemption within the context of required disclosure by potential investors and issuing companies.²⁰ Part V summarizes the likely impact of the SEC's proposed rules on the

13. Crowdfunding, 78 Fed. Reg. 66,428 (proposed Oct. 23, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240); see also *SEC Issues Proposal on Crowdfunding*, U.S. SECURITIES AND EXCHANGE COMMISSION (Oct. 23, 2013), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540017677#.UtA4G2R4aBU>.

14. Until the release of the proposed rules by the SEC, commentary on the likely effects of the CROWDFUND Act were based on speculation and came with the caveat that until the SEC acted no one could be sure of how burdensome the disclosure requirements might be on small businesses and startups. Rossenfeld, *supra* note 12.

15. Section 4A(b)(1) of JOBS Act, § 302, 126 Stat. at 315–16 refers to the Securities Act of 1933 (Securities Act) as amended by the CROWDFUND Act. 15 U.S.C. § 77d-1.

16. See *infra* Part III.B.

17. See *infra* Part IV.

18. See *infra* Part II.

19. See *infra* Part III.

20. See *infra* Part IV.

viability of crowdfunding under the exemption to small businesses and startup companies and examines the balance achieved between the burden of disclosure on the issuer and investor protection.²¹

II. CROWDFUNDING EQUITY SECURITIES

A. Background

The notion of crowdfunding security interests as a form of capital financing for businesses arose out of the already ubiquitous practice of crowdsourcing.²² Crowdsourcing utilizes the power of the Internet to reach out to the public at large and solicit small amounts of funding from many investors in order to raise enough capital to commence a project.²³ These projects have included activities such as the creation of a t-shirt, a novel design for a smartphone case, or a new musical album, mostly within the creative arts realm.²⁴ In exchange for monetary donations to the requesting company, the payer receives either one of the first offerings of the item, the item at a lower than retail price, or some other incentive other than any type of security interest in the company creating the project.²⁵ Websites such as Kickstarter.com and Sellaband.com facilitate the setup of these projects and provide a place for willing “investors” to search out projects they wish to fund.²⁶ Currently, crowdsourcing can be broken down into four main categories based on what the investor receives in return for his contribution: donation-based, reward-based, lending, and equity.²⁷ At the time of this writing, the Securities Act prohibits equity investment in such projects.²⁸

21. See *infra* Part V.

22. Joan MacLeod Heminway & Sheldon Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 881 (2011) (quoting Paul Belleflamme et al., *Crowdfunding: Tapping the Right Crowd* 29 J. BUS. VENTURING 585, 586 (Feb. 21, 2011)) (unpublished manuscript), available at <http://ssrn.com/abstract=1578175>; Andrew A. Schwartz, *Crowdfunding Securities*, 88 NOTRE DAME L. REV. 1457, 1459 (2013).

23. Ajay K. Agrawal et al., *Some Simple Economics of Crowdfunding*, 14 INNOVATION POL'Y & ECON. 63, 65 (2014); see also Ethan Mollick, *The Dynamics of Crowdfunding: An Exploratory Study*, 29 J. BUS. VENTURING 1, 1–3 (2013) (discussing the “Pebble” smart watch project).

24. See Schwartz, *supra* note 22, at 1458–59.

25. See *id.* at 1459.

26. See KICKSTARTER, <http://www.kickstarter.com> (last visited Nov. 17, 2014); SELLABAND, <http://www.sellaband.com> (last visited Nov. 17, 2014).

27. Gerrit K.C. Ahlers et al., *Signaling in Equity Crowdfunding* 6 (Oct. 14, 2012) (unpublished manuscript), <http://ssrn.com/abstract=2161587>.

28. See C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 6. The JOBS Act and subsequent passage of the SEC’s rules

Unlike crowdsourced projects where the public funder receives an actual product in return for his investment, an investor in crowdfunded equity securities will actually acquire a security interest in the company.²⁹ This ownership interest would potentially allow the investor to receive dividends based on their security ownership and to participate in a public offering of the company, should such an event occur in the future.

The offering of a security interest, or anything that translated into a share of profits, through one of these crowdsource websites would potentially require regulation under the Securities Act if the offering met the definition of an “investment contract” under the *Howey* test.³⁰ Applying *Howey* using a five-prong analysis, commentators Heminway and Hoffman concluded that it is likely a court would find a crowdfunded security interest to be an “investment contract.”³¹

The existing regulatory framework under the Securities Act was created with investor protection as a primary policy concern.³² Under a crowdfunding investment scheme, investor protection becomes an even greater concern as the transaction involves both a high degree of investment risk³³ and a pool of unsophisticated investors.³⁴ The key to creating a viable exemption for crowdfunded securities is to keep

related to the CROWDFUND Act exemption will end this prohibition on equity-based crowdfunding; *supra* Part I.

29. Schwartz, *supra* note 22, at 1459–60. This acquired interest in the assets and profits of the issuer brings these offerings under the regulatory umbrella of the Securities Act of 1933. 15 U.S.C. § 77b(a)(1) (2012).
30. Securities Act of 1933, ch. 38, § 2(a)(1), 48 Stat. 74 (codified as amended at 15 U.S.C. § 77b(a)(1) (2012)); *see* SEC v. W.J. Howey Co., 328 U.S. 293, 298–99 (1946) (setting out the test to determine when an investment scheme is considered an “investment contract” under § 2(a)(1) of the Securities Act of 1933); Stuart R. Cohn, *The New Crowdfunding Registration Exemption: Good Idea, Bad Execution*, 64 FLA. L. REV. 1433, 1435 (2012).
31. Heminway & Hoffman, *supra* note 22, at 904. The five prongs used in the analysis are (1) contract, transaction, or scheme, (2) investment of money, (3) common enterprise, (4) expectation of profits, and (5) solely from the efforts of others. *Id.* 892–904. After examining each prong in the context of a crowdfunded security, the authors conclude that each prong is likely to be satisfied by such an offering. *Id.*
32. *See id.* at 927.
33. *See* C. Steven Bradford, *The New Federal Crowdfunding Exemption: Promise Unfulfilled*, 40 SEC. REG. L.J. 195, 196 (2012). “[I]nvesting in small business, particularly at the startup stage, is inherently risky. The potential for fraud and self-dealing is high” *Id.* There is an additional risk of a lack of liquidity as well. *Id.*
34. *See id.* The term “unsophisticated investor” applies to the general public, and assumes a low level of financial sophistication as compared to sophisticated or accredited investors. *Id.*

disclosure costs low, while protecting the unsophisticated investor.³⁵ The informational asymmetry between the issuer and the unsophisticated investor will be different, and likely greater, in the context of equity crowdfunding than in other forms of crowdfunding.³⁶

In order to best protect investors, meaningful disclosure on the part of the issuing company is required.³⁷ This is no different for the crowdfunded security than it is for other types of securities, and meaningful disclosure was a primary focus of the existing securities laws.³⁸ Because those investors choosing to invest via crowdfunding are “subject to an unusually high degree of risk,”³⁹ the need for adequate disclosure of information about the company remains of paramount importance.⁴⁰

B. Benefits of Crowdfunding and the Exemption

Why, given the added risks surrounding crowdfunded offerings, was there such a push to create a mechanism by which companies could sell equity securities to the public through crowdfunding? The short answer is job creation and economic development.⁴¹ For a company looking to finance capital to start or grow their business, crowdfunding offers several advantages over more traditional sources of funding, primarily a lower cost of acquiring capital and access to information.⁴²

The lower cost of acquiring capital through crowdfunded securities may be due, in part, to a better match between the company and those

35. See *id.* at 196–98.

36. Ahlers et al., *supra* note 27, at 6; see also Agrawal et al., *supra* note 23, at 68 (“In general, the most critical differences between equity and nonequity crowdfunding will arise due to the amplification of information asymmetries.”).

37. Hazen, *supra* note 9, at 1737.

38. See *id.* at 1741–42. Rather than focusing on the merits of investments, securities laws favor disclosure as a mechanism to ensure sufficiently informed investors. *Id.* at 1741.

39. Agrawal et al., *supra* note 23, at 68.

40. See Hazen, *supra* note 9, at 1769.

41. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012); see also 157 CONG. REC. S188,8458 (daily ed. Dec. 8, 2011) (statement of Sen. Jeff Merkley) (“Low-dollar investments from ordinary Americans may help fill the void, providing a new avenue of funding to the small businesses that are the engine of job creation. The CROWDFUND Act would provide startup companies and other small businesses with a new way to raise capital from ordinary investors in a more transparent and regulated marketplace.”).

42. Agrawal et al., *supra* note 23, at 71–72.

investors willing to back their venture.⁴³ Geographic discrepancies among small, young companies and investors become less of a barrier when the potential group of investors is enlarged to include anyone with Internet access.⁴⁴ Also potentially lowering the cost of capital is the ability to “bundle” the sale of equity securities with other types of rewards, should intermediaries support such an option.⁴⁵ Finally, disclosure of more information under the CROWDFUND Act could lead to a greater willingness to pay on the part of investors, thus reducing the cost to issuers of acquiring capital.⁴⁶

Another possible benefit to companies choosing crowdfunding may be the ability to increase their access to information about their product or business.⁴⁷ Similar to market-based research, crowdfunding may provide relevant information about the product, establish a pre-production market, and increase the likelihood of success.⁴⁸

One of the main advantages of crowdfunding is that the costs of crowdfunding will likely be lower versus traditional securities offerings or initial public offerings (IPOs).⁴⁹ Crowdfunding should allow for the cost of raising capital from the public through the sale of equity to become a viable method for startup companies and smaller businesses.⁵⁰ Though the ability to raise funds through public offerings has been available under SEC Regulation D,⁵¹ such offerings have only realistically been available to accredited investors.⁵²

43. *Id.* at 71.

44. *Id.*; *see also* Mollick, *supra* note 23, at 14 (noting that crowdfunding helps to diminish traditional geographic limitations by enabling online communities to participate in investments).

45. Agrawal et al., *supra* note 23, at 71. Other rewards which may be bundled with securities include early product access, limited-edition products, and investor recognition. *Id.*

46. *Id.* at 71; *see infra* note 120 and accompanying text.

47. Agrawal et al., *supra* note 23, at 72.

48. *Id.*

49. Schwartz, *supra* note 22, at 1467.

50. *Id.*

51. *Id.* at 1467–68. Regulation D sets forth the regulations issued by the SEC that governs the securities that do not need to be registered under the Securities Act of 1933. 17 C.F.R. §§ 230.500–508 (2013).

52. Schwartz, *supra* note 22, at 1468. SEC Regulation D, in addition to state specific Blue Sky Laws, has limited public offerings to accredited investors and allowed for only private offerings with no advertising or “general solicitation.” *Id.*

The high cost of traditional offerings stems from compliance with regulation and registration laws⁵³ and the cost of promotion.⁵⁴ These costs can be especially burdensome for small-scale issuances of securities, as the costs are not proportional to the size of the offering, but are based instead only on regulatory requirements.⁵⁵ One of the potential positive aspects of crowdfunded offerings under the proposed exemption is a lower regulatory and registration burden than the one under the Securities Exchange Act of 1934.⁵⁶ In addition, promotion of the offering within the crowdfunding context should be simpler through the use of the Internet and the availability of intermediaries at all hours.⁵⁷ Despite this expectation of lower cost, a significant burden remains⁵⁸ as disclosure of information to potential investors is required in order to take advantage of the exemption for crowdfunding.⁵⁹

C. Potential Negative Impacts of Crowdfunding on the Issuer

Although the benefits of raising capital through crowdfunding have been lauded, there exist potential negative impacts beyond mere disclosure requirements.⁶⁰ These negative impacts are more generally applicable to the funding of capital through the issuance of equity.⁶¹ While a thorough discussion of these impacts is beyond the scope of this Comment, they are briefly noted to present a more complete picture of the advantages and disadvantages of acquiring capital through the issuance of crowdfunded securities. In some instances, the negative impact may be amplified by the use of crowdfunding and the platform on which it is built.⁶²

53. *Id.* at 1470.

54. *Id.* at 1468.

55. *Id.* at 1470. For example, preparation of a registration statement—required regardless of the size of the issuance—can require as much as 1200 hours of work. *Id.* at 1469.

56. *See* 17 C.F.R. § 240.6a-1 (2013). Whether or not these costs are in fact lower under the exemption hinges on the proposed SEC rules. *See infra* Part IV.

57. Schwartz, *supra* note 22, at 1471.

58. *Id.* at 1472.

59. *See* 15 U.S.C. § 77d-1(b)(1) (2012); Schwartz, *supra* note 22, at 1472; *see also infra* Part IV.

60. *See* Schwartz, *supra* note 22, at 1477–80.

61. *See id.* at 1483–87 (explaining that the sale of equity creates fiduciary duties, exposes directors and officers to the risk of personal liability, and empowers purchasers with certain statutory rights).

62. *See id.* at 1478–79 (noting that Internet-facilitated communications increase the risk and likelihood of proxy contests). Crowdfunding relies on the Internet and its ability to connect those with a common interest yet separated by physical location. *Id.* at 1471. Regarding some negative impacts, as viewed by the issuer of the security,

One disadvantage that may be heightened through crowdfunding is the hostile takeover,⁶³ as proxy fights will be cheaper and easier to coordinate over the Internet.⁶⁴ Another is the tender offer, where a person, group, or competitor becomes the majority shareholder by purchasing the shares of other shareholders.⁶⁵

In addition to increased potential for takeovers, several other disadvantages exist from issuing equity through crowdfunding.⁶⁶ These potentially negative consequences include shareholder derivative suits,⁶⁷ demand by investors for company books and records,⁶⁸ disgruntled shareholders and lack of a secondary market,⁶⁹ and voting rights for shareholders.⁷⁰

The disadvantages noted above involve complex considerations for any company deciding whether to issue equity shares, through either crowdfunding or any other registered or exempt offering. A more thorough discussion is beyond the scope of this Comment. Part III discusses the exemption for crowdfunding and examines the types of information most valued by investors when making an investment decision.

associated with funding capital through sale of equity, the ability for equity holders to communicate and coalesce via the Internet increases the risk to the issuer. *Id.* at 1486–87.

63. A takeover is “[t]he acquisition of ownership or control of a corporation . . . typically accomplished by a purchase of shares or assets, a tender offer, or a merger.” BLACK’S LAW DICTIONARY 1591 (9th ed. 2009). A taker over is considered hostile when it is “resisted by the target corporation.” *Id.*

64. Schwartz, *supra* note 22, at 1477–78. These proxy battles are not governed by federal laws, as those laws cover only registered securities. *Id.* at 1478.

65. *Id.* at 1479. Though coercive takeovers have since been regulated, and two-tier tender offers effectively banned, those prohibitions apply only to registered securities. *Id.* at 1480.

66. *Id.* 1483–84.

67. *Id.* 1483. The potential for derivative suits may necessitate the added cost of directors’ and officers’ insurance to cover liability. *Id.* at 1483–84.

68. *Id.* at 1486–87. Shareholder demands for access to company books and records have the possibility of leaking confidential corporate information. *Id.* at 1485–86.

69. *Id.* at 1486–87. “[D]isgruntled shareholders are more likely to petition management for change in the context of crowdfunded securities than has traditionally been the case for public companies.” *Id.* at 1487. Furthermore, shareholders are restricted from selling their shares on any secondary market for a period of one year after purchase unless the transfer of securities satisfies one of the four exceptions under this provision. 15 U.S.C. § 77d-1(e) (2012).

70. Schwartz, *supra* note 22, at 1487.

III. EXEMPTING CROWDFUNDED EQUITY SECURITIES

One of the intended benefits resulting from crowdfunding is a decreased cost to issuing equity.⁷¹ Without the exemption for crowd-funded securities, offering anything that translated into a share of profits would potentially require regulation under the Securities Act of 1933 (Securities Act) if the offering met the definition of a security under the *Howey* test.⁷² Traditional securities, under which crowd-funded securities would fall if not exempted, face a system of heavy and burdensome regulation.⁷³ In addition, companies selling securities under the Securities Act are required to register and comply with the regulatory process, or face liability for fraud or false and misleading information.⁷⁴ The expenses associated with such a registration—which include accounting, legal, and other fees—make this prohibitively expensive for small businesses.⁷⁵ The typical filing of a registration with the SEC, even for a small offering, can be as much as \$100,000.⁷⁶

Small businesses, however, existed prior to the Internet and the arrival of crowdfunding.⁷⁷ While Regulation D of the SEC contains exemptions for small businesses from the prohibitive registration costs of the current system,⁷⁸ an exemption under Regulation D would not be feasible within the crowdfunding context.⁷⁹ Exempted offerings under Rules 504, 505, and 506 of Regulation D contain several provisions restricting their applicability to crowd-funded securities.⁸⁰ The provisions include a ban on general solicitation, a

71. *See supra* Part II.B.

72. *See Cohn, supra* note 30, at 1435; *see also supra* note 31 and accompanying text.

73. Heminway & Hoffman, *supra* note 22, at 908.

74. *Id.* See § 77k of the Securities Act, which provides a purchaser with a cause of action against the seller in the case of misleading or omitted statements of material fact in any part of the registration. 15 U.S.C. § 77k(a) (2012).

75. Heminway & Hoffman, *supra* note 22, at 909–10.

76. *Id.* at 909. The initial registration with the SEC includes underwriting, fees to the SEC, legal and accounting fees, cost of printing, and various other fees. *Id.* at 908.

77. *See id.* at 880–81.

78. Hazen, *supra* note 9, at 1744–46.

79. Heminway & Hoffman, *supra* note 22, at 913.

80. *See* 17 C.F.R. §§ 230.504–.506 (2013). Regulation D refers to § 77a *et seq.* of the Securities Act of 1933, which exempts certain transactions. 15 U.S.C. § 77d (2012); 17 C.F.R. § 230.500(a) (2013). Rule 504 prohibits exemptions where transactions are based on solicitation. 15 U.S.C. § 77d(a)(4); 17 C.F.R. § 230.504. Rule 505 exempts transactions with only accredited investors, and only if there is no advertising or public solicitation. 15 U.S.C. § 77d(a)(5); 17 C.F.R. § 230.505. Under Rule 506, all transactions would be subject to the full disclosure requirements under § 77d-1b. 15 U.S.C. § 77d(a)(6); 17 C.F.R. § 230.506.

maximum of thirty-five purchasers, and a requirement that disclosure of specific financial and non-financial information be made to non-accredited investors.⁸¹ Certainly the unsophisticated investor whom the small business wishes to target its crowdfunding efforts is not an accredited investor,⁸² and thus the exemption from the burdensome registration and disclosure process is unattainable.

A. Key Requirements of the Exemption

A primary purpose behind creating the exemption for crowdfunding was to allow for small, otherwise insignificant investment in small companies.⁸³ Notwithstanding, meaningful disclosure must be a part of the exemption—this includes risks, obligations, benefits, financial history, and information about the business that are necessary for investors to evaluate the merits of investment.⁸⁴ As Hazen stated, “the impersonal nature of the Internet would seem to call for more, rather than less, investor protection.”⁸⁵ These investors are likely unsophisticated and are strangers to the business with no additional information to that which is available over the Internet.⁸⁶ In this regard, “social media technologies increase rather than decrease the potential for fraud” and further highlights the need for adequate disclosure.⁸⁷

The question moving forward is, to what extent does the exemption for crowdfunding increase the viability of small businesses raising capital through the sale of security interests? Do the disclosure requirements differ substantially from those under the traditional offerings?

81. Heminway & Hoffman, *supra* note 22, at 918; *see also* Hazen *supra* note 9, at 1748–49; *supra* note 80.

82. An “accredited investor” is one who meets the definition under Rule 501(a) of Regulation D. 17 C.F.R. 230.501(a) (2013). For natural persons, Rule 501(a) specifies an accredited investor as a person: (1) “whose individual net worth, or joint net worth with that person’s spouse, exceeds \$1,000,000,” excluding the value of the person’s primary residence; or (2) “who had an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person’s spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.” 17 C.F.R. § 230.501(a)(5)–(6).

83. Cohn, *supra* note 30, at 1434.

84. Hazen, *supra* note 9, at 1753.

85. *Id.* at 1766.

86. *Id.*

87. *Id.* at 1769.

The proposed requirements under the CROWDFUND Act and comments regarding those proposals highlight the existing tension between investor protection and the cost of raising capital through crowdfunding.⁸⁸ Efforts to protect the investor may leave the small business facing costs for registration and meeting ongoing regulatory requirements that effectively erase any benefit from being able to issue the securities.⁸⁹ The recently released regulations proposed by the SEC covering the crowdfunding exemption offer one indication of just how costly compliance with the exemption may ultimately be.⁹⁰

Prior to the release of the SEC's proposed rules, some authors expressed a desire for the SEC to keep the exemption for crowdfunding simple and streamlined to allow it to achieve the goal of providing a low cost alternative for raising small capital.⁹¹ With the release of the proposed rules, it appears the SEC was listening.

B. Disclosure Information Relevant to Investors – Empirical Evidence

Given the desire to create a workable exemption for crowdfunding that both protects the investor from unscrupulous and fraudulent issuers and imposes a reasonable burden of disclosure on the issuer,⁹² it becomes important to investigate which pieces of information are most relevant to the investment decision.⁹³ Are the disclosure requirements under the CROWDFUND Act exemption in accord with what the unsophisticated investor would or should want to know in order to make an informed investment decision? If so, are the proposed regulations issued by the SEC likely to increase or decrease the burden of disclosure on small business wishing to utilize the exemption? Two recent empirical studies have examined the factors influencing investment decisions within the crowdfunding context.

In *Signaling in Equity Crowdfunding*, Ahlers and authors investigate which signals by small start-up companies lead investors to purchase equity securities through crowdfunding.⁹⁴ The authors

88. *Id.* at 1767.

89. *See id.* at 1738.

90. Crowdfunding, 78 Fed. Reg. 66,428, 66,509 (proposed Oct. 23, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240) (“[T]he average cost of achieving initial regulatory compliance for an initial public offering is \$2.5 million, followed by an ongoing compliance cost, once public, of \$1.5 million per year.”).

91. *Roundtable*, *supra* note 12, at 52.

92. *See supra* Parts II.A, III.A.

93. *See Ahlers et al.*, *supra* note 27, at 1–2.

94. *Id.* at 3.

acknowledge that both “the mechanisms and dynamics of crowdfunding . . . are not yet well understood.”⁹⁵ However, by looking at data based on existing investment decisions within a crowdfunded context, the authors are able to make some conclusions regarding the influence of several types of disclosed information.⁹⁶

Outside of the United States, equity crowdfunding has become increasingly important as an alternative means for raising capital for small businesses or start-ups.⁹⁷ The volume of equity crowdfunding has doubled every year since 2009, and in 2011, start-ups around the world raised an estimated \$88 million in funding.⁹⁸ This funding came from small investors who typically do not have the ability to thoroughly research potential investment decisions.⁹⁹ In order to successfully raise capital, small businesses and start-ups must “signal,” or disclose, to investors that they have a value worthy of investment.¹⁰⁰ The signaling by these companies is equivalent to the disclosure required under the CROWDFUND Act exemption.¹⁰¹ Disclosure has, at its core, the goal of ensuring that investors are well informed about the company in which they may choose to purchase securities and, as such, presents a signal of their value.¹⁰²

95. *Id.* at 1.

96. *Id.* at 3.

97. *Id.* at 1. As crowdfunding within the United States has only recently become feasible through the JOBS Act, markets outside the United States are used to examine equity funding through crowdfunded means. *See id.* at 1–3.

98. *Id.*

99. *Id.* This reference to small investors equates to the unsophisticated investor referenced elsewhere in this Comment and the literature.

100. *Id.*

101. *Compare* Ahlers et al., *supra* note 27, at 1–3 (finding start-ups that signal, or disclose, the following information attract higher numbers of investors: financial forecasts and disclaimers, a long history of being in business prior to seeking equity crowdfunding, a high number of board members, a high number of board members that hold an MBA degree, better networks, and an intention to seek an exit by either an IPO or trade sale rather than by other modes of exit), *with infra* Part IV (noting that the CROWDFUND Act exemption requires disclosure of the following information: a list of executive officers, a description of the business in the form of a business plan, information about the company’s use of proceeds and existing capital, and a financial statement including a narrative discussion of the company’s financial situation).

102. *See* Ahlers et al., *supra* note 27, at 1 (explaining that in order for start-ups to successfully raise funds through crowdfunding, they must clearly disclose their value to small investors, who often comprise the main source of support for many start-ups); Ross S. Weinstein, Note, *Crowdfunding in the U.S. & Abroad: What to Expect When You’re Expecting*, 46 CORNELL INT’L L.J. 427, 434–35 (2013) (disclosing information provides investors with a straightforward way to assess the value of their potential investment, determine the risks involved, and avoid fraud).

Additionally, the type of signaling most effective for the small investor is likely different than that for angel investors or venture capitalists.¹⁰³

An analysis of which signals are important to small investors was performed using data on offerings from the Australian Small Scale Offerings Boards (ASSOB).¹⁰⁴ From these offerings, six types of data were collected: basic information, financial statements, external certifications, board experience, history of investment, and the speed of investment.¹⁰⁵ Using this data, the authors estimated several models for predicting whether an investor would invest in the security being offered.¹⁰⁶ The estimation of the model produced coefficients indicating the relative effect of each type of data on the decision to invest.¹⁰⁷

Based upon the ASSOB data, start-ups with a larger number of board members, higher levels of education,¹⁰⁸ and better networks were more likely to have successful offerings.¹⁰⁹ In addition, companies signaling their intention to offer an IPO in the future or seek acquisition by another company, as opposed to other exit strategies, had an increased likelihood of attracting investors.¹¹⁰ Companies who did not provide financial forecasts were less likely to attract investment and tended to raise less overall capital over an extended period of time.¹¹¹ Finally, companies that had been in business for some time prior to entering the equity crowdfunding market were more likely to reach their capital goals.¹¹² This suggests that new small businesses and recent start-ups could, regardless of disclosure, face a difficult time generating capital through equity crowdfunding.

Overall, the study based on the ASSOB data indicates that “financial roadmaps (such as preplanned IPO or acquisition exit

103. See Ahlers et al., *supra* note 27, at 2. Angel investors and venture capitalists are experienced, seasoned investors who are deemed sophisticated and therefore less likely to fall prey to offerings based on fraud or misrepresentation. See *id.*

104. *Id.* at 3. The authors looked at data from 104 offerings from the Australian Small Scale Offerings Board (“ASSOB”) between October 2006 and October 2011. *Id.*

105. *Id.* at 13.

106. *Id.* at 39.

107. *Id.* at 39–40.

108. Education levels were “measured by the percentage of board members holding an MBA degree.” *Id.* at 3.

109. *Id.*

110. *Id.* Other exit strategies included leveraged buyouts and reverse takeovers, or no indicated exit strategy. *Id.* at 43.

111. *Id.* at 3.

112. *Id.*

strategies) and risk factors (such as amount of equity offered and whether financial forecasts are provided),” and board experience are important pieces of information to potential investors.¹¹³ Disclosure of these items by the issuer would seem to be necessary regardless of any burden imposed by their requirement under the exemption.

In *The Dynamics of Crowdfunding: An Exploratory Study*, Ethan Mollick predicts the effects of various types of information on investment decisions for crowdfunded equity securities.¹¹⁴ Acknowledging the importance of crowdfunding and its emergence as a growing area for entrepreneurs, Mollick sought to explore the potential for this newly viable method for capital funding.¹¹⁵ He suggests that crowdfunded projects “mostly succeed by narrow margins, or else fail by large amounts.”¹¹⁶ Success for the issuer of crowdfunded equity seems to be connected to project quality, because these higher quality projects are more likely to result in greater funding.¹¹⁷ Additionally, and in conjunction with the Internet-based form of crowdfunding, companies with a larger number of friends and social network presence are more likely to have successful offerings.¹¹⁸

Mollick defines crowdfunding as “an open call, essentially through the Internet, for the provision of financial resources either in form of donation or in exchange for some form of reward and/or voting rights in order to support initiatives for specific purposes.”¹¹⁹ Whether crowdfunding becomes an alternative for more traditional methods of financing remains to be seen; however, it may in the very least provide a vehicle by which to follow the more established funding routes.¹²⁰

As crowdfunding within the United States was not permitted, and remains so until the SEC regulations are finalized, Mollick used

113. *Id.* at 30.

114. *See* Mollick, *supra* note 23, at 1–2.

115. *Id.* at 1.

116. *Id.* at 2.

117. *Id.*

118. *Id.*

119. *Id.* (quoting Armin Schwienbacher & Benjamin Larralde, *Crowdfunding of Small Entrepreneurial Ventures*, in *THE OXFORD HANDBOOK OF ENTREPRENEURIAL FINANCE* 369, 371 (Douglas Cumming ed., 2012)).

120. *See id.* at 3. Mollick gives, as an example, the recent successful Kickstarter campaign by the makers of the “Pebble” smart watch that led to the receipt of venture capital after being initially rejected. *Id.*

crowdsourcing data extracted from the Kickstarter website.¹²¹ Though not able to offer equity securities through crowdfunding, Kickstarter uses a patronage and reward model to allow companies to generate capital to fund their projects.¹²² In addition, Kickstarter provided the inspiration for the recent JOBS Act legislation and the creation of the CROWDFUND Act exemption.¹²³ In this regard, Kickstarter provides a useful model for demonstrating what information is most relevant in the crowdfunding context.¹²⁴

As noted in the previous article, signaling within the crowdfunding context represents a critical exchange of information between the issuer and investor.¹²⁵ “Since investments are uncertain, investors often need to act on partial information about particular ventures.”¹²⁶ Thus, potential signals of quality may be especially important for start-up ventures and small businesses, where information about the company may be obscure or unreliable.¹²⁷ Quality, as signaled to investors, was measured by the preparedness of the Kickstarter project pitches.¹²⁸ Project pitches included videos relating to the projects and project updates with textual descriptions.¹²⁹ In measuring preparedness based on the project pitches, Mollick also considered spelling errors within the text.¹³⁰ A quality project pitch, both in terms of professional looking videos with relevant updates and grammatical correctness, provides a signal to the potential investor that the issuer is concerned with quality and likely represents a better investment than one who does not.¹³¹

Along with quality, in an era of Internet based funding, the size of the social network associated with the company seeking funds also

121. *Id.* at 4. Kickstarter was the largest, and most dominant, crowdfunding site at the time the paper was written. *Id.*

122. *Id.*

123. *Id.*

124. *Id.*

125. *See supra* note 100 and accompanying text.

126. Mollick, *supra* note 23, at 7.

127. *Id.*

128. *Id.* at 8. Preparedness equates to the degree to which the project founders adhered to the standards for successful pitches. *Id.*

129. *Id.*

130. *Id.*

131. *Id.*

influences success.¹³² Network size was measured based on the number of Facebook friends of the project founders.¹³³

Estimating the relevance of signals of quality and their effect on successful funding, Mollick concludes that investors do assess the potential of the founders seeking crowdfunding of their projects.¹³⁴ In addition, the importance of geography as it relates to the location of the company and the investor (funder) is reduced.¹³⁵ Despite being only a small business or start-up, the fact that the company is not located near the investor does not reduce the likelihood of investment, as it might under a more traditional funding methodology.¹³⁶

Mollick uncovers several clear lessons for companies considering crowdfunding their projects. Quality is key, and ways in which to signal high quality to the potential funder should be considered.¹³⁷ The company should also set appropriate goals that allow for delivering the product on time and careful planning both in setting these goals and in executing them.¹³⁸ Though these results are directly applicable within the Kickstarter project context of a company raising funds to make a product, they are also relevant in examining disclosure within the equity crowdfunding context.

Signaling within the Kickstarter framework is analogous to disclosure under an equity crowdfunding scenario, as it provides relevant investment information to the potential investor. The results of Mollick's study may be applied to what is disclosed by issuers of crowdfunded equity securities. Disclosure of goal setting and plans for product creation within the more traditional crowdfunding model are no different than a sound business model and path for growth which would be outlined in disclosure documents by a company offering the sale of securities.

132. *Id.*; see also Alhers et al., *supra* note 27, at 3 (noting that companies in business for some time prior to seeking crowdfunding were more likely to be successful at raising funds, and success may have been due, in part, to having an existing social network).

133. Mollick, *supra* note 23, at 8. Within the estimation of the econometric model, network size was calculated as the log of the number of Facebook friends. *Id.*

134. *Id.* at 14.

135. *Id.*

136. See *id.*

137. *Id.*

138. *Id.*

C. Capping Investor Exposure Under the CROWDFUND Act

In addition to the required issuer disclosure under the CROWDFUND Act, “the Act [also] includes a structural protection for investors that limits their potential losses.”¹³⁹ This protection takes the form of limiting the total aggregate amount of securities an issuer can sell to a given investor in a twelve-month period.¹⁴⁰ The aggregate amount allowed for investment is based on a tiered system taking into account the annual income and net worth of the individual investor.¹⁴¹ This tiered system effectively sets the upper limit that any individual may invest in crowdfunded securities during any twelve-month period at \$5,000.¹⁴² Thus, the very structure of the CROWDFUND Act exemption attempts to limit the potential losses to an investor by capping the aggregate amount invested.¹⁴³

One issue raised by this structural protection has been how to monitor the aggregate amount invested.¹⁴⁴ While the CROWDFUND Act does not specify any method for ensuring compliance with this provision, it is likely that the private sector will create a solution.¹⁴⁵ However, until such a system has been adopted, it will fall upon the issuer to make certain that the individual investors to whom they issue securities have not exceeded their aggregate amount.¹⁴⁶

139. *Roundtable*, *supra* note 12, at 50; see 15 U.S.C. § 77d(a)(6)(B) (2012).

140. § 77d(a)(6)(B).

141. The relevant aggregate amount allowed is determined as

(B) the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, does not exceed—

(i) the greater of \$2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than \$100,000; and

(ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of \$100,000, if either the annual income or net worth of the investor is equal to or more than \$100,000[.]

Id.

142. *Roundtable*, *supra* note 12, at 50–51.

143. *Id.*

144. Hazen, *supra* note 9, at 1751.

145. Thaya Brook Knight et al., Comment, *A Very Quiet Revolution: A Primer on Securities Crowdfunding and Title III of the JOBS Act*, 2 MICH. J. PRIVATE EQUITY & VENTURE CAP. L. 135, 143 (2012).

146. *Id.*

Perhaps more importantly, concern for whether or not this structural requirement will in fact protect the unsophisticated investor from fraudulent offerings has been raised.¹⁴⁷ The assumption that, by merely limiting investors to small amounts, fraud will be deterred is misplaced.¹⁴⁸ “Even limiting the exemption to relatively small amounts such as \$250 or \$500 does not mean that there is an insufficient investor-protection stake such that scrutiny is not warranted.”¹⁴⁹

However, others have acknowledged the need for balance between the burden of disclosure on issuers and the protection of investors.¹⁵⁰ “To minimize investor losses without unduly increasing the cost to issuers, investors should be protected not through complicated, expensive mandatory disclosure requirements, but through less costly structural requirements.”¹⁵¹ The cost, however, of implementing and monitoring this tiered system may be large.¹⁵² Despite this potential cost, it is also important to consider the benefits stemming from this approach in the context of the entire exemption.¹⁵³

Thus, the capping of aggregate investment by any individual investor provides a structural balance to the disclosure required by the issuer. This provision, as with the exemption itself, is subject to regulatory guidance by the SEC.¹⁵⁴ Whether or not the necessary balance exists is dependent on how the SEC handles compliance.

IV. THE SEC PROPOSED REGULATIONS

On October 23, 2013, the SEC released for public comment the proposed regulations for exempting crowdfunded securities offerings under the JOBS Act revision to the Securities Act of 1933.¹⁵⁵ In releasing the proposed regulations, the potential impact of the disclosure requirements on small businesses may be evaluated.¹⁵⁶

147. Hazen, *supra* note 9, at 1765–66.

148. *Id.*

149. *Id.* at 1765.

150. Bradford, *supra* note 33, at 198; *see also* Heminway & Hoffman, *supra* note 22, at 953.

151. Bradford, *supra* note 33, at 198.

152. Heminway & Hoffman, *supra* note 22, at 953.

153. *Id.*

154. *See supra* note 11 and accompanying text.

155. Crowdfunding, 78 Fed. Reg. 66,428 (proposed Oct. 23, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240, & 249).

156. *See* John S. Wroldsen, *The Crowdfund Act's Strange Bedfellows: Democracy and Start-Up Company Investing*, 62 U. KAN. L. REV. 357, 372 (2013) (“The Crowdfund

The proposed regulations cover the entirety of the new exemption,¹⁵⁷ which includes the creation of and regulations for intermediaries to act as brokers or exchanges between the issuing companies and the investors. However, the following discussion focuses on the disclosure requirements for the issuing company and the costs of compliance as a potential deterrent from utilizing the exemption.

Disclosure requirements for businesses wishing to issue securities under the exemption for crowdfunding amends the Securities Act of 1933 by adding § 4A, which corresponds to § 302 of the JOBS Act.¹⁵⁸ Specifications for issuer disclosure are contained in § 4A(b)(1).¹⁵⁹ Some of the items required for disclosure are the name, address, and website of the issuer; a description of the business; the financial condition of the business; the purpose or intended use of the requested funds; and a description of the ownership and capital structure of the business.¹⁶⁰ Additionally, under § 4A(b)(1)(I), the

Act's ongoing disclosure requirement breaks new ground in regulating the relationship between investors and managers of small companies.”).

157. Crowdfunding, 78 Fed. Reg. 66,428, 66,431–37.

158. *See id.* at 66,428. The SEC is “proposing new rules and forms to implement Securities Act Sections 4(a)(6) and 4A and Exchange Act Sections 3(h) and 12(g)(6).” *Id.* at 66,430.

159. *See* 15 U.S.C. § 77d-1(b)(1) (2012); Crowdfunding, 78 Fed. Reg. at 66,437–38.

160. Crowdfunding, 78 Fed. Reg. at 66,437–38. The full list of disclosed items as presented includes:

- The name, legal status, physical address and Web site address of the issuer;
- The names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;
- a description of the business of the issuer and the anticipated business plan of the issuer;
- a description of the financial condition of the issuer;
- a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;
- the target offering amount, the deadline to reach the target offering amount and regular updates regarding the progress of the issuer in meeting the target offering amount;
- the price to the public of the securities or the method for determining the price; and
- a description of the ownership and capital structure of the issuer.

Id. at 66,438 (footnotes omitted).

SEC may require additional disclosures in order to protect investors and the public interest.¹⁶¹

The SEC acknowledged community concern with respect to the disclosure and its burden, stating that “[c]ommenters expressed concerns about the extent of the disclosure requirements and stated that overly burdensome rules would make offers and sales in reliance on Section 4(a)(6) prohibitively expensive. We recognize these concerns and have considered them in determining the disclosure requirements that we should propose in this release.”¹⁶² Public concern over the potential burden resulted in the SEC declining to recommend a specific format for the disclosure materials, opting instead to let each company determine the appropriate format.¹⁶³ In addition, there is no requirement for duplicative disclosures where information overlaps.¹⁶⁴

The information required to be disclosed by companies wishing to utilize the CROWDFUND Act exemption fall into three broad categories: business and ownership information; company finances and the offering itself; and updates and ongoing reporting.¹⁶⁵ Within each of these groupings, the SEC has specifically addressed aspects of disclosure with the intent of easing the burden of meeting the requirements for small businesses.¹⁶⁶ Though the burden remains sizable for any small operation wishing to request capital via crowdfunding, especially with regard to company finances and the offering itself, it does not approach the cost associated with a traditional registered offering.¹⁶⁷

161. *Id.*; see also 15 U.S.C. § 77d-1(b)(1)(I) (2012).

162. Crowdfunding, 78 Fed. Reg. at 66,438 (footnote omitted).

163. *Id.*

We expect, however, that an issuer, along with the intermediary, would determine the format that best conveys the required disclosures and any other information the issuer determines is material to investors. We recognize that there are numerous ways to achieve that goal and, as such, we are not proposing to mandate a specific disclosure format.

Id. (footnote omitted).

164. *Id.*

165. *Id.*

166. *See id.*

167. See *supra* notes 75–76 and accompanying text for a discussion of the costs related to a traditional, non-exempt offering.

A. Business and Ownership Information

Business and ownership interest information consider three aspects of disclosure relating to the issuing company: officers, beneficial owners, and the company.¹⁶⁸

1. Officers

One important piece of information for disclosure concerns the officers of the business issuing the securities. The SEC has proposed to define officers as they are defined under the Securities Act Rule 405 and Exchange Act Rule 3b-2.¹⁶⁹ Under these definitions, an issuer would be required to disclose information regarding its president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer and any person routinely performing corresponding functions with respect to any organization, whether incorporated or unincorporated, to the extent it has individuals serving in these capacities.¹⁷⁰

Disclosure of information relating to officers of the company would be for the previous three years, not the five years required under other types of offerings.¹⁷¹ The SEC contends that this requirement of three years will be less burdensome and believes the firms undertaking crowdfunding will be smaller startups.¹⁷² However, the question remains whether a two-year difference in the outlying years provides much relief to small companies trying to raise capital in their first few years of operation. In practice, the difference between three years and five years would likely have only a minimal impact on the reporting burden.¹⁷³

2. Beneficial Owners in Excess of 20 percent of Shares of Issuer

Another important piece of information to be disclosed to prospective investors is that of beneficial owners.¹⁷⁴ Beneficial

168. Crowdfunding, 78 Fed. Reg. at 66,438–39.

169. *Id.* at 66,438. An officer is defined as “a president, vice president, secretary, treasurer or principal financial officer, comptroller or principal accounting officer, and any person routinely performing corresponding functions with respect to any organization whether incorporated or unincorporated.” 17 C.F.R. § 230.405 (2013). The Exchange Act Rule 3b-2 defines officers equivalently. *Id.* § 240.3b-2 (2013).

170. Crowdfunding, 78 Fed. Reg. at 66,438–39.

171. *Id.* at 66,439. Other offerings specifically referred to are registered offerings and offerings that are exempt under Regulation A. *Id.*

172. *Id.*

173. See Heminway & Hoffman, *supra* note 22, at 940–41 (discussing inevitable costs associated with the proposed rules arising from legal transition costs).

174. Crowdfunding, 78 Fed. Reg. at 66,439.

owners are those who own existing shares in the company prior to the current offering.¹⁷⁵ Under § 4A(b)(1)(B), the issuer must disclose “the names of each person holding more than 20 percent of the shares of the issuer.”¹⁷⁶ Determination of these individuals is proposed as “the names of persons, as of the most recent practicable date, who are the beneficial owners of 20 percent or more of the issuer’s outstanding voting equity securities, calculated on the basis of voting power. We refer to this group of persons as ‘20 Percent Beneficial Owners.’”¹⁷⁷

According to the SEC, fixing the date as the most recent practicable date¹⁷⁸ would ensure that companies issuing shares under the exemption would not encounter a greater burden than companies issuing standard registered offerings.¹⁷⁹ Utilization of the most recent practicable date does ensure some uniformity with the existing standard for registered offerings.¹⁸⁰ However, the shift from reporting beneficial owners at the five-percent level to the twenty-percent level appears to offer the most relief to the small business. It is more likely that there are fewer beneficial owners at the higher percentage associated with the crowdfunding exemption.

3. Description of the Business

The final disclosure relating to the overall business, located in § 4A(b)(1)(C), is a description of the business itself in the form of a “business plan.”¹⁸¹ This information is of great value to potential investors, whose interest in what the company plans to do and how it operates aids in the investment decision. Empirical evidence discussed in Part III.B established that one of the essential factors to a successful offering relates to information about the issuer.¹⁸² However, small companies, and especially startups, would be wary of sharing too much information for fear they might lose their

175. *Id.*

176. *Id.*

177. *Id.*

178. The use of the term “practicable date” mirrors similar usage under item 403 of Regulation S-K, which applies to registered offerings. 17 C.F.R. § 229.403 (2013).

179. Crowdfunding, 78 Fed. Reg. at 66,439. Standard registered offerings regulated under Regulation S-K require the furnishing of information as of the most recent practicable date of ownership interests of more than five percent of any class of voting securities. § 229.403.

180. Crowdfunding, 78 Fed. Reg. at 66,439.

181. 15 U.S.C. § 77d-1(b)(1)(C)(2012); Crowdfunding, 78 Fed. Reg. at 66,440.

182. *See supra* Part III.B.

proprietary property.¹⁸³ In response to these concerns, the SEC proposed that the required “business plan” need not include internal management documents or marketing documents used for solicitation.¹⁸⁴

B. Company Finances and the Offering

While information relating to the offering itself is an important disclosure to investors, information about the company’s finances and capital structure is equally important in ensuring that the investor has all of the relevant information to make an informed investment decision.¹⁸⁵

1. Use of Proceeds

One important piece of information relevant to the investor regarding the offering is the intended use of the proceeds raised through the offering.¹⁸⁶ Whether the funds are needed in order to pay off existing debt or other obligations versus investment in research and development can influence a potential investor’s decision.¹⁸⁷ Capital funds raised through the offering may be used to acquire assets or other businesses, compensate intermediaries or employees, or repurchase some of the issuer’s outstanding securities.¹⁸⁸

How much information, and how detailed, relating to the use of the funds raised through the offering is left to the discretion of the issuer.¹⁸⁹ Rather than mandate a set form or minimal amount of required disclosure, the SEC requires only that some disclosure of the intended use of the proceeds be made.¹⁹⁰ While this does not free the issuer from the burden of making such disclosure, it does offer some flexibility in how much needs to be released and thus also in the size of the burden.¹⁹¹ In many cases, a simple statement that the funds raised are for product development or talent acquisition may

183. See Schwartz, *supra* note 22, at 1485–86.

184. Crowdfunding, 78 Fed. Reg. at 66,440.

185. See *id.* at 66,437–38, 66,440.

186. 15 U.S.C. § 77d-1(b)(1)(E) (2012).

187. See Crowdfunding, 78 Fed. Reg. at 66,440.

188. *Id.*

189. *Id.*

190. *Id.*

191. See *id.*

suffice.¹⁹² However, this lack of a formal requirement may leave the issuer vulnerable to an action by investors should problems arise.¹⁹³

2. Target Offering Amount

In addition to disclosing the intended use of the funds raised through the securities offering, the issuer must also disclose information relating to the target amount of funds desired.¹⁹⁴ The target amount is important both for investor's desire to know how much the company is trying to raise and to the likelihood of the offering being finalized; since the entire offering through the crowdfunding mechanism will only occur if the target amount is realized.¹⁹⁵ Should the company fail to raise the targeted amount, the entire transaction is canceled and all investor purchases for that offering are returned.¹⁹⁶

In order to ensure that investors are fully informed, the SEC proposes that both the target amount of the offering as well as the maximum offering amount that the issuer will be accept be disclosed.¹⁹⁷ Thus, if the issuer has set their target amount at \$150,000, but is willing to sell securities up to \$500,000, the issuer must disclose both amounts. This is important, as an investor who believes he will have a certain percentage of shares based on the target amount may find his percentage reduced, possibly significantly, if enough investors are interested and the company is willing to sell more shares than targeted.¹⁹⁸ To this point, the SEC is also requiring the issuer to disclose their process for allocating shares in the event of an oversubscribed offering.¹⁹⁹

Since there exists a possibility that the entire transaction may be canceled should the target amount not be met, the SEC proposes that a clear disclosure of the investors' right to cancel must be made.²⁰⁰ As well, disclosure of the investors' need to reconfirm their

192. *See id.*

193. Under § 77d-1(c)(2), an issuer is liable for material misstatements and omissions. 15 U.S.C. § 77d-1(c)(2) (2012).

194. *Id.* § 77d-1(b)(1)(F).

195. Crowdfunding, 78 Fed. Reg. at 66,440–41.

196. *Id.* at 66,441.

197. *Id.* at 66,440–41.

198. John S. Wroldsen, *The Social Network and the Crowdfund Act: Zuckerberg, Saverin, and Venture Capitalists' Dilution of the Crowd*, 15 VAND. J. ENT. & TECH. L. 583, 616 (2013).

199. Crowdfunding, 78 Fed. Reg. at 66,441.

200. *Id.*

commitment in certain situations is required.²⁰¹ Finally, the issuer must also disclose that, should the target amount not be reached, no securities will be sold and all commitments are canceled.²⁰² While at first glance it may appear to require much from the issuer, the reality may be that once a standard is developed, the majority of issuing companies can simply use a generic set of statements. The burden of these disclosures is alleviated through the use of boilerplate descriptions of the processes, tailored to each specific offering. In its discussion of the proposed regulations, the SEC included a brief outline suggesting some items for inclusion in these disclosures.²⁰³

3. Offering Price

As the offering is for a security interest in the issuing company, the price of the security must be disclosed to the investor.²⁰⁴ However, the price of the security may be based upon the number of shares sold or some other method.²⁰⁵ Therefore, the SEC has proposed that the issuer must disclose either the offering price or the method for

201. *Id.*

202. *Id.*

203. *Id.*

As such, we propose to require issuers to describe the process to cancel an investment commitment or to complete the transaction once the target amount is met, including a statement that:

- Investors may cancel an investment commitment until 48 hours prior to the deadline identified in the issuer's offering materials;
- the intermediary will notify investors when the target offering amount has been met;
- if an issuer reaches the target offering amount prior to the deadline identified in its offering materials, it may close the offering early if it provides notice about the new offering deadline at least five business days prior to that new deadline (absent another material change that would require an extension of the offering and reconfirmation of the investment commitment); and
- if an investor does not cancel an investment commitment before the 48-hour period prior to the offering deadline, the funds will be released to the issuer upon closing of the offering and the investor will receive securities in exchange for his or her investment.

Id. (footnotes omitted).

204. 15 U.S.C. § 77d-1(b)(1)(G) (2012).

205. *See* Crowdfunding, 78 Fed. Reg. at 66,457.

determining the price.²⁰⁶ Should the issuer disclose the method to be used in determining the offering price, rather than the price itself, the investor must then receive the final offering price in writing and all required disclosures prior to the sale.²⁰⁷

4. Ownership and Capital Structure

As discussed previously, the current ownership structure within the issuing company and the capital structure of the company are important considerations for the investor.²⁰⁸ Section 4A(b)(1)(H) specifies disclosures by the issuer relating to the terms of the securities issued; the effects of rights of existing shareholders on the securities offered; information about existing shareholders owning twenty percent or more of any class of the issuer's securities; how the offered securities are valued; and the risks associated with the securities offered.²⁰⁹ In addition to what is already required under the

206. *Id.* at 66,441.

207. *Id.*

208. *See supra* Part III.B.

209. Crowdfunding, 78 Fed. Reg. at 66,441. Section 77d-1(b)(1)(H) of the JOBS Act specifically states:

[A] description of the ownership and capital structure of the issuer, including—

(i) terms of the securities of the issuer being offered and each other class of security of the issuer, including how such terms may be modified, and a summary of the differences between such securities, including how the rights of the securities being offered may be materially limited, diluted, or qualified by the rights of any other class of security of the issuer;

(ii) a description of how the exercise of the rights held by the principal shareholders of the issuer could negatively impact the purchasers of the securities being offered;

(iii) the name and ownership level of each existing shareholder who owns more than 20 percent of any class of the securities of the issuer;

(iv) how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions; and

(v) the risks to purchasers of the securities relating to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related parties[.]

15 U.S.C. § 77d-1(b)(1)(H) (2012).

regulation, the SEC proposes requiring *additional* disclosures including the number of securities being offered or those outstanding; whether or not the offered or existing securities have voting rights; any limitations on voting rights; and a discussion of any restrictions on transferring the securities.²¹⁰ The SEC notes that “[a]lthough Section 4A(b)(1)(H) does not specifically call for this disclosure, we believe that such disclosure would be necessary to provide investors with a more complete picture of the issuer’s capital structure than would be obtained solely pursuant to the statutory requirements.”²¹¹ By adding these additional requirements, the SEC is “not proposing to prescribe content or format for this information, but rather to set forth principles of disclosure.”²¹²

In an effort to ensure that investors are provided a “complete picture” of the issuer’s existing capital, the SEC is also proposing additional requirements beyond those statutorily proscribed.²¹³ According to the SEC, disclosure of the name, Commission file number and Central Registration Depository number (CRD number) (where applicable) of the intermediary through whom the offering is being conducted should be required.²¹⁴ The SEC believes disclosure of these identifiers will aid investors in gathering information about the offering as well as background information on the intermediary.²¹⁵

The amount of compensation paid to the intermediary for conducting the offering should be disclosed including any referral or other expenses connected with the offering.²¹⁶ This would inform the investor as to what portion of the proceeds from the offering will go to covering the cost of the offering, as well as provide a mechanism for monitoring these costs.²¹⁷

Finally, to aid the investor generally, the SEC also proposes:

- disclosure of certain legends to be included in the offering statement,²¹⁸
- disclosure of the current number of employees of the issuer;

210. Crowdfunding, 78 Fed. Reg. at 66,441–42.

211. *Id.* at 66,442.

212. *Id.* at 66,444.

213. *Id.* at 66,442.

214. *Id.*

215. *Id.* Issuance of the CRD number comes from the Financial Industry Regulatory Authority, Inc. (FINRA) and not the SEC. *Id.* at 66,442 n.133.

216. *Id.* at 66,442.

217. *Id.*

218. These legends will aid the investor in better understanding “the general risks of investing in a crowdfunding transaction.” *Id.*

- a discussion of the material factors that make an investment in the issuer speculative or risky;
- a description of the material terms of any indebtedness of the issuer, including the amount, interest rate, maturity date and any other material terms;
- disclosure of exempt offerings conducted within the past three years; and
- disclosure of certain related-party transactions.²¹⁹

All of these additional proposed required disclosures fall under the SEC's authority provided by § 4A(b)(1)(I).²²⁰

5. Financial Statements

Under the crowdfunding exemption, issuers would be required to disclose company finances for the previous twelve-month period.²²¹ The amount of disclosure necessary follows a tiered approach based on the aggregate target offering amounts of the present offering and all other offerings in the prior twelve months.²²² In clarifying how to

219. *Id.* (footnotes omitted).

220. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 302(b)(1)(I), 126 Stat. 306, 318 (2012) (codified at 15 U.S.C. § 77d-1(b)(1)(I) (2012)). "Section 4A(b)(1)(I) provides us with discretion to require crowdfunding issuers to provide additional information for the protection of investors and in the public interest." 78 Fed. Reg. at 66,442 n.132.

221. 15 U.S.C. § 77d-1(b)(1)(D) (2012).

222. The tiered approach is specified as

(D) [A] description of the financial condition of the issuer, including, for offerings that, together with all other offerings of the issuer under section 77d(6) of this title within the preceding 12-month period, have, in the aggregate, target offering amounts of—

(i) \$100,000 or less—

(I) the income tax returns filed by the issuer for the most recently completed year (if any); and

(II) financial statements of the issuer, which shall be certified by the principal executive officer of the issuer to be true and complete in all material respects;

(ii) more than \$100,000, but not more than \$500,000, financial statements reviewed by a public accountant who is independent of the issuer, using professional standards and procedures for such review or standards and procedures established by the Commission, by rule, for such purpose; and

calculate cumulative current and prior offering amounts, the SEC suggests the aggregate offering amount would only include those securities offered *and sold*.²²³ This attempts to keep down the cost to issuers whose prior crowdfunded offerings were unsuccessful, but prevents potential abuse in the form of structuring large offerings as a series of smaller offerings.²²⁴

Specifically regarding the issuer's financial statements as required under § 4A(b)(1)(D), the SEC proposes

a complete set of their financial statements (a balance sheet, income statement, statement of cash flows and statement of changes in owners' equity), prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP"), covering the shorter of the two most recently completed fiscal years or the period since inception of the business.²²⁵

The SEC views the two-year requirement as a compromise, citing one year as insufficient and three years as too burdensome on small issuers.²²⁶ Tax returns remain required under the proposed regulations, with privacy concerns addressed through redaction of personally identifiable information (e.g., social security numbers) by the issuer.²²⁷

For those issuers requiring review by a public accountant,²²⁸ the qualification of the independent public accountant should comply with Rule 2-01 of Regulation S-X.²²⁹ This requirement will provide investors with confidence as to the reliability of the statements.²³⁰ The SEC refuses to increase the threshold for requiring audited financial statements to offerings greater than \$500,000, as Congress specifically chose the existing \$100,000 to \$500,000 range.²³¹ "If we

(iii) more than \$500,000 (or such other amount as the Commission may establish, by rule), audited financial statements[.]

Id. (footnote omitted).

223. Crowdfunding, 78 Fed. Reg. at 66,445.

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.* at 66,446.

228. Review by a public accountant would be applicable to offerings of greater than \$100,000 but less than \$500,000. 15 U.S.C. § 77d-1(b)(1)(D)(ii) (2012).

229. Crowdfunding, 78 Fed. Reg. at 66,446. See Regulation S-X for specific requirements for qualification of accountants. 17 C.F.R. § 210.2-01 (2013).

230. Crowdfunding, 78 Fed. Reg. at 66,446.

231. *Id.* at 66,446-47.

were to raise the threshold to \$1 million, as suggested by some commenters, it would eliminate the requirement for issuers ever to provide audited financial statements because the maximum offering amount under Section 4(a)(6) is \$1 million.²³²

In addition to the numerical and accounting financial requirements, the SEC also proposes requiring the inclusion of a narrative discussion of the company's financial situation.²³³ The purpose of this narrative is to reveal any prior operating history of the company not included in the other financial statements.²³⁴ If no prior history exists, then the issuer should describe financial milestones as well as operational, liquidity, or other challenges.²³⁵

C. Updates and Ongoing Reporting

Disclosure by the issuer is not confined to static information provided at the outset of the offering but also includes periodic updates and possible amendments to the offering.²³⁶ These requirements produce an additional burden on the issuer wishing to utilize the exemption for crowdfunding.²³⁷ Under § 4A(b)(1)(F), the issuer must file updates as to their progress in meeting the targeted offering amount.²³⁸ The SEC has proposed that the filing of the update occur no later than five (5) days after particular intervals have been met (e.g. 50 percent and 100 percent of target).²³⁹ And, if the issuer is accepting a sale of securities in excess of their target amount, the issuer must file an update no later than five (5) days after the offering deadline that discloses the total amount of securities sold.²⁴⁰ One result of these update filings is to create a central repository for this information within the SEC.²⁴¹ While the burden associated with these updates depends on the issuer and the specifics of each offering, the knowledge that such requirements exists may well affect a small business's decision to engage in crowdfunding as a means for raising capital.

232. *Id.* at 66,447 (footnote omitted).

233. *Id.* at 66,444.

234. *See id.*

235. *Id.*

236. 15 U.S.C. § 77d-1(b)(1)(F) (2012).

237. Other burdens include disclosure of business and ownership information, company finances, and information relating to the offering. *See* discussion *supra* Part IV.A–B.

238. Crowdfunding, 78 Fed. Reg. at 66,449; *see also* 15 U.S.C. § 77d-1(b)(1)(F) (2012).

239. Crowdfunding, 78 Fed. Reg. at 66,449.

240. *Id.*

241. *Id.*

1. Amended Offering Statement

The SEC proposes to require that an issuer must file an amended offering statement whenever there is “any material change in the offer terms or disclosure previously provided to investors.”²⁴² This conforms to the desire to protect investors and make certain that they have all of the relevant information needed to properly evaluate the investment opportunity. A material change is one where “there is a substantial likelihood that a reasonable investor would consider it important in deciding whether or not to purchase the securities.”²⁴³ Changes considered material include the issuer’s financial condition, the intended use of the proceeds from the offering, and how the final price is determined in cases where only the method was initially disclosed.²⁴⁴

2. Ongoing Reports

Section 4A(b)(4) requires that the issuer file annual reports on operations and financial statements with the SEC and provide them to investors.²⁴⁵ Under the proposed rules, the issuer relying on the crowdfunding exemption would be required to file within “120 days after the end of the most recent fiscal year covered by the report.”²⁴⁶ As for providing operations and financial reports to investors, the SEC proposes that the publication of an annual report on the company website would be sufficient, as it “believe[s] that investors in this type of Internet-based offering would be familiar with obtaining information on the Internet and that providing the information in this manner would be cost-effective for issuers.”²⁴⁷

The requirement for filing the annual report, which does create a burden particularly for a small company that previously had no public shareholders, would continue until one of three conditions is met.²⁴⁸

242. *Id.* at 66,450.

243. *Id.*

244. *Id.*

245. *Id.*; *see also* 15 U.S.C. § 77d-1(b)(4) (2012).

246. Crowdfunding, 78 Fed. Reg. at 66,451.

247. *Id.*

248. *Id.* The three conditions are that

(1) [t]he issuer becomes a reporting company required to file reports under Exchange Act Sections 13(a) or 15(d); (2) the issuer or another party purchases or repurchases all of the securities issued pursuant to Securities Act Section 4(a)(6), including any payment in full of debt securities or any complete redemption of redeemable securities; or (3) the issuer liquidates or dissolves its business in accordance with state law.

Annual report filing would cease when the issuer becomes a reporting company,²⁴⁹ the issuer or another buys all of the securities sold under the exemption, or the issuer dissolves or liquidates.²⁵⁰

D. Individual Investor Investment Cap

In addressing the investment cap provided under § 4(a)(6)(B), the SEC acknowledged two practical aspects of the limitation.²⁵¹ The first involves the calculation of the investment limit and concerns that under some scenarios an investor may be subject to two limits.²⁵² Because paragraph (i) and paragraph (ii) apply to “either” income or net worth, there is potential for an investor to be subject to both paragraphs.²⁵³ “[I]n [a] situation in which annual income is less than \$100,000 and net worth is equal to or more than \$100,000 (or vice versa), the language of the statute may be read to cause both paragraphs to apply.”²⁵⁴

In order to clarify the calculation of the investment limit, and avoid the scenario above, the SEC proposes to utilize the “greater of” the investor’s annual income and net worth.²⁵⁵ “[I]f *both* annual income *and* net worth are less than \$100,000,” then the investor’s limit would be \$2,000 or five percent of annual income or net worth, whichever is greater.²⁵⁶ Where both annual income and net worth exceed \$100,000, the limit would be the greater of ten percent of the annual income or net worth, not to exceed a limit of \$100,000.²⁵⁷ Here, the SEC is enabling the appropriate application of the structural protection of investors.²⁵⁸

The second practical aspect of the investment limitation addressed by the SEC in their proposal was that of monitoring investor

Id.

249. A reporting company is one which is required to file reports under the Exchange Act §§ 13(a) or 15(d). *Id.* Section 13(a) covers issuers of securities registered on a national exchange under 15 U.S.C. § 78l. *Id.* at 66,554; 15 U.S.C. § 78m (2012). Section 15(d) covers registered brokers and dealers of securities. Crowdfunding, 78 Fed. Reg. at 66,554; § 78o.

250. Crowdfunding, 78 Fed. Reg. at 66,451.

251. *Id.* at 66,433.

252. *Id.*

253. *Id.*; see 15 U.S.C. § 77d(a)(6)(B) (2012).

254. Crowdfunding, 78 Fed. Reg. at 66,433.

255. *Id.*

256. *Id.* (emphasis in original).

257. *Id.*

258. See *supra* Part III.C.

conformance with the limitation.²⁵⁹ Echoing the concerns raised by commenters regarding enforcement of the investment limitation,²⁶⁰ the SEC proposes to place the burden of monitoring on the intermediaries.²⁶¹ The SEC would “allow an issuer to rely on efforts that an intermediary takes in order to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investor limits”²⁶² This reliance, however, is subject to the issuer not having knowledge that the investor has already exceeded their limit or would do so under the transaction with the issuer.²⁶³ Having made this proposal, the SEC has asked specifically for comments on whether or not allowing reliance on the intermediary is appropriate.²⁶⁴

Given the high number of transactions that intermediaries will handle in their role, it makes sense that they would ensure investor compliance with the limitation. If the intermediaries hold investor financial information, it would be appropriate for these intermediaries to develop a system by which investor compliance can be ascertained. Burdening the individual issuers with the task of making sure that each investor has not exceeded their investment limitation, and will not with the current transaction, will likely raise costs to the issuer. These increased costs from monitoring could outweigh the benefit of raising capital through crowdfunding. As such, the balance between investor protection and reasonable burdens on the issuer would be upset.

V. CONCLUSION

One of the purposes behind the JOBS Act, and the creation of an exemption for crowdfunding, was to institute a less costly means by which small businesses and startup companies could raise capital through issuing equity securities to the public.²⁶⁵ Decreased costs are associated with being exempt from the registration requirements that accompany traditional offerings of equity to the public, which entail substantial disclosure of information to investors.²⁶⁶ However, concern for investor protection and the potential for increased risk associated with the Internet require that disclosure of information to

259. See Crowdfunding, 78 Fed. Reg. at 66,434.

260. See *supra* text accompanying notes 144–146.

261. Crowdfunding, 78 Fed. Reg. at 66,434.

262. *Id.*

263. *Id.*

264. *Id.* at 66,434–35.

265. See *supra* Part I.

266. See *supra* Part II.B.

investors remains meaningful.²⁶⁷ In addition, investors are protected by a limitation on the aggregate amount they may invest in crowdfunded securities.²⁶⁸

The rules proposed by the SEC regarding disclosure by issuers under the CROWDFUND Act attempt to strike a balance between the burdensome disclosures for registered securities and a desire to protect the public investor.²⁶⁹ Examining the information desired by investors, and relevant to their investment decision, reveals that the disclosures required under the CROWDFUND Act and those added by the SEC pertain to the very information investors seek.²⁷⁰ As such, despite the burdens associated with disclosing information about the company—its officers, shareholders, financial information, and periodic updates—a company wishing to raise capital through the selling of equity securities will certainly find a lower cost in utilizing the exemption for crowdfunding than in pursuing a more traditional public offering.²⁷¹ Disclosure requirements, as determined under the SEC proposed rules, pose a lesser burden on the issuer, in part, due to the structural component of the limitation on aggregate investor purchases.²⁷² As such, the cap on investors offsets the reduction in required disclosure.²⁷³

There will always be costs for a company when trying to raise capital, and disclosure of information is essential to securing investor commitments.²⁷⁴ Through the CROWDFUND Act, and the rules proposed by the SEC, small businesses and startup companies will have a viable mechanism for raising capital from public offerings of equity via crowdfunding.²⁷⁵

267. *See supra* Part III.A.

268. *See supra* Part III.C.

269. *See supra* Part III.C.

270. *Compare supra* Part III.B (discussing the information sought by investors), *with* Part IV.A–C (explaining the disclosures required under the SEC’s proposed rules).

271. This stems from an exemption from additional requirements associated with a registered offering under the Securities Act. *See supra* Part II.B.

272. *See supra* Part III.C.

273. *See supra* Part III.C.

274. Any attempt to raise capital requires some fees and charges simply to handle basic accounting and legal necessities. Some information, however minimal, must be disclosed to investors in order to lead to a successful attempt at raising capital. *See supra* Part III.B.

275. *See supra* Parts II.B., IV.

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* J.D. Candidate, May 2015, University of Baltimore School of Law. I would like to thank Professor Barbara White for the pivotal role she played in guiding the development and writing of this Comment.