

THE SEC’S REGULATION CROWDFUNDING: THE ISSUER’S DILEMMA

LAILA SABAGH*

TABLE OF CONTENTS

Introduction.....	112
I. The SEC.....	113
II. The JOBS Act.....	115
III. What Is Crowdfunding?	117
A. History of Crowdfunding.....	117
B. Crowdfunding Models	118
IV. Regulation Crowdfunding	120
A. Regulation Crowdfunding: Proposed Rules Versus Final Rules	121
B. Regulation Crowdfunding’s Issuer Requirements	123
V. Regulation A+.....	124
Table 1: Tier 1 v. Tier 2 Offerings.....	126
VI. Costliness of Regulation Crowdfunding	128
VII. Recommendations.....	130
A. Allowing Issuers to Test the Waters	130
1. Testing the Waters for Issuer Efficiency	131
2. Testing the Waters for SEC Modernization.....	132
B. Allowing Issuers to Raise More or Less than the Target Figure	133
C. Uniform Disclosure Forms.....	133
D. Implementing the Amendments	134
Conclusion.....	135

* J.D. Candidate, 2018, American University Washington College of Law; B.A., 2014, University of Dayton. I want to thank my husband and my family for their continuous encouragement and support. I also want to thank Professor Randall Quinn and my faculty advisor Professor Heather Hughes for their guidance and advice. Finally, I would like to thank the editors and members of the *Administrative Law Review* for their feedback and hard work.

INTRODUCTION

The Internet is an integral part of everyday life, utilized for innumerable purposes. The Internet allows us to communicate and share ideas instantly and effortlessly. The Internet is also home to many new businesses and helps grow industries by being a host for marketing, advertising, and crowdfunding.¹ The rise of Internet dependency sparked new developments in securities and investments. The SEC is the administrative agency that regulates securities to protect investors and promote economic growth.² Congress created the SEC to encourage Americans to invest in companies and businesses by regulating securities offers.³

Recently, the SEC updated its regulations to help small businesses grow in the age of the Internet. One such update is “Regulation Crowdfunding,” which allows crowdfunding of securities: “instead of raising money from a small group of sophisticated investors, crowdfunding helps firms to obtain money from large audiences (the ‘crowd’), in which each individual provides a very small amount.”⁴ The benefit of crowdfunding securities is that it allows businesses to sell equity to the general public. Therefore, instead of businesses getting large lump-sums of money from a small number of investors, businesses are now able to go to the American public to raise large amounts of money in small contributions from many people.⁵ Although crowdfunding opens a new world of business opportunity and growth, it also creates new risks.⁶ The SEC’s final rules for securities-based crowdfunding

1. See Samantha Harrington, *How to Use the Internet to Build Your Business*, FORBES (Aug. 16, 2016, 9:30 AM), <http://www.forbes.com/sites/samanthaharrington/2016/08/16/how-to-use-the-internet-to-build-your-business/#58d328e1d4a0> (discussing the ease that the Internet has brought to business owners); Newtek, *How Much Is Online Presence Helping Small Business?*, FORBES (Nov. 25, 2013 11:19 AM), <http://www.forbes.com/sites/thesba/2013/11/25/how-much-is-online-presence-helping-small-business/#6356e8e72278> (describing the business benefits of properly utilizing the Internet); see also *The Basics of Crowdfunding*, ENTREPRENEUR, <https://www.entrepreneur.com/article/228125> (last visited Aug. 16, 2016) (explaining crowdfunding, different websites, and the advantages and disadvantages of crowdfunding for small businesses).

2. See *About the SEC*, SEC, <https://www.sec.gov/about.shtml> (describing the SEC as an organization that seeks to protect investors while still promoting economic growth through investment).

3. See *id.*

4. JOAN MACLEOD HEMINWAY, SECURITIES CROWDFUNDING AND INVESTOR PROTECTION, CESIFO DICE 12 (2016).

5. See *infra* Part III.

6. See Catherine Fredman, *Fund Me or Fraud Me? Crowdfunding Scams Are on the Rise*, CONSUMER REPORTS (Oct. 5, 2015), <http://www.consumerreports.org/cro/money/crowdfunding-scam> (discussing the risk of contributing to a fraudulent crowdfunding

attempt to control and reduce risks while still providing enough leeway to promote economic growth.

The focus of this Comment is Regulation Crowdfunding's requirements for the securities issuers. Specifically, this Comment examines how these rules affect startups and small to medium-size businesses and whether the rule will actually encourage businesses to take advantage of equity crowdfunding. Part I is an introduction to the SEC, including the purpose of the agency and how it regulates securities. Part II introduces the Jumpstart Our Business Startups (JOBS) Act, and discusses the various regulations and amendments that came from it. Part III discusses the history of crowdfunding and different types of crowdfunding, including equity crowdfunding. Part IV compares the SEC's proposed and finalized rules on Regulation Crowdfunding and takes a closer look at the regulatory requirements for issuers. Part V discusses Regulation A+ and the components of the registration exception. Part VI predicts that Regulation Crowdfunding may be beneficial for small and medium-size businesses but will likely not be beneficial for most startups. It further discusses the costliness of Regulation Crowdfunding.

Part VII recommends several amendments to Regulation Crowdfunding that would allow businesses to "test the waters" before having to fulfill the disclosure requirements set forth in Regulation Crowdfunding, set and collect benchmark goals, raise capital beyond their target goal, and receive uniform disclosure forms. This Part also suggests that these amendments will allow the SEC to fulfill several of its missions and concludes that it is important to analyze Regulation Crowdfunding as compared to other equity crowdfunding options to understand the impact that the new regulation will have on the economy.

I. THE SEC

Congress created the SEC to regain public trust after the 1929 stock market crash devastated the American economy and Americans' trust in the stock market.⁷ Congress passed the Securities Act of 1933 and the Securities Exchange Act of 1934, which created securities regulations and a commission, the SEC, for oversight.⁸ Congress created the SEC to

campaign).

7. See *What We Do*, SEC, <https://www.sec.gov/about/whatwedo.shtml#create> (explaining the history and purpose of the SEC and clarifying that for the economy to recover, it was vital that the public be willing to invest in the market again).

8. See generally Securities Act of 1933, 15 U.S.C. §§ 77a, 77b(a)(1) (2012) (establishing securities regulations and defining "securities"); Securities Exchange Act of 1934, 15 U.S.C. § 78a (2012) (creating the SEC and assigning it as the agency to regulate securities

administer the newly enacted securities regulations, ensure that investors were protected, and support the markets by requiring disclosures from the companies offering securities.⁹

The SEC prides itself on its ability to keep up with the modernizing world.¹⁰ In 2015, the SEC released a proposal to update the rules and forms for companies to report to the Commission.¹¹ Before the Internet was widely used, the SEC standardized forms to easily keep databases of company reports.¹² As Internet accessibility rose, the SEC enacted changes in regulations to match the country's increased Internet use. In 2000, the SEC began accepting forms electronically and in 2007, the SEC began to publish information online so that shareholders could make more informed decisions when voting.¹³ In 2009 and 2010, the SEC made several additional changes, such as requiring more information to be submitted to the SEC for investor-use due to technology's ability to make company information more accessible for reporting. These changes allowed information reporting to be posted online and sent to investors and required companies to submit their risk and return analysis to an online database to be accessible to investors and potential investors.¹⁴

In 2015, the SEC proposed to increase certain company reporting to the SEC to once a month.¹⁵ In this proposal the SEC was clear about the purpose of the proposed changes:

- (1) increase the transparency of fund portfolios and investment practices both to the Commission and to investors, (2) take advantage of technological advances both in terms of the manner in which information is reported to the Commission and how it is provided to investors and other potential users, and (3) where appropriate, reduce

transactions); *What We Do*, *supra* note 7.

9. *See What We Do*, *supra* note 7 (explaining that the regulation of securities required the creation of a new governmental agency, the SEC, to prioritize investor protection and enforce the new laws while promoting economic growth).

10. *See* Reporting Modernization, 80 Fed. Reg. 33,590, 33,592 (June 12, 2015) (codified at 17 C.F.R. §§ 200–274) (“We have historically acted to modernize our forms and the manner in which information is filed with the Commission and disclosed to the public in order to keep up with changes in the industry and technology.”).

11. *See id.* at 33,591.

12. *See id.* at 33,592 (reducing the number of reporting forms to one form to standardize the reporting process).

13. *See id.* (discussing the changes that the SEC made to keep up with changes in technology and to make reporting and collecting data easier such as reducing paper filing, having information posted online so it is accessible to those who need it, and allowing different formatting to be submitted electronically).

14. *See id.*

15. *See id.* at 33,593.

duplicative or otherwise unnecessary reporting burdens on the industry.¹⁶

Many of the Commission's modernizations can be traced back to at least one of those three reasons provided by the SEC above.¹⁷ All three purposes serve the investors and potential investors because they improve upon the information reported and disclosed by issuers.¹⁸

II. THE JOBS ACT

One way that the SEC worked to modernize securities law was through the JOBS Act.¹⁹ The purpose of the JOBS Act was to improve the economy after the 2008 recession.²⁰ Congress signed the JOBS Act into law in 2012 with overwhelming bipartisan support, attempting to relax SEC regulations on startups and small businesses to promote economic growth and higher employment rates.²¹ The JOBS Act is a seamless representation of what the SEC sought to accomplish. Just as the purpose of the SEC was to promote growth after the economy plummeted, the purpose of the JOBS Act is also to promote economic growth.²² Additionally, the rules set forth in the JOBS Act fulfill the three purposes of the proposed modernization changes: improve transparency, take advantage of technological advances, and remove unnecessary reporting burdens.²³

Although the JOBS Act is widely associated with crowdfunding equity

16. *Id.*

17. See e.g., *id.* at 33,591-92 (fulfilling these goals by reducing paper filing, making information accessible by posting it online, and allowing electronic submissions).

18. See Securities Act of 1933, 15 U.S.C. § 77b(a)(4) (2012) (defining an "issuer" as "every person who issues or proposes to issue any security").

19. Jumpstart Our Business Startups Act (JOBS Act), Pub. L. No. 112-106, §§ 101-170, 125 Stat. 306, 306-27 (2012).

20. See Chloe Albanesius, *Obama Signs JOBS Act to Boost Startups*, PC MAG (Apr. 5, 2012, 3:09 PM), <http://www.pcmag.com/article2/0,2817,2402657,00.asp> (showing the widespread backing of the JOBS Act); Jennifer Liberto, *House Passes Bipartisan Bill Aimed at Start-ups*, CNN: MONEY (Mar. 8, 2012, 3:24 PM), <http://money.cnn.com/2012/03/08/smallbusiness/House-startup-bill/index.htm?> (illustrating the bipartisan support for the JOBS Act).

21. See J.J. Colao, *Breaking Down the JOBS Act: Inside the Bill That Would Transform American Business*, FORBES (Mar. 21, 2012, 11:08 AM), <http://www.forbes.com/sites/jjcolao/2012/03/21/jobs-act/#445f61d25a1b> (noting that the JOBS Act was passed 290 to 23 in the House of Representatives on March 8, 2012); Albanesius, *supra* note 20; Liberto, *supra* note 20.

22. See *What We Do*, *supra* note 7 [https://www.sec.gov/about/whatwedo.shtml#create](https://www.sec.gov/about/whatwedo.shtml#create;); Albanesius, *supra* note 20; Liberto, *supra* note 20.

23. See generally JOBS Act, Pub. L. No. 112-106, §§ 101-701, 126 Stat. 306, 396-27 (2012).

securities, the Act contains much more.²⁴ Title I of the JOBS Act creates a new category of businesses—the “Emerging Growth Companies”—and provides these businesses with disclosure exceptions if the businesses decide to go through an initial public offering (IPO).²⁵ Title II changes the rules about accredited investors of Regulation D Rule 506 offers.²⁶ The JOBS Act also changes the rules so that issuers do not have to register the security with the SEC as long as “the issuer . . . take[s] reasonable steps to verify that purchasers of the securities are accredited investors.”²⁷ Title III is the controversial Regulation Crowdfunding, which allows issuers to crowdfund securities and includes the rules for such offers.²⁸ Title IV is Regulation A+, which increases securities sales from \$5 million to \$50 million to both accredited and unaccredited investors.²⁹ Last, Title V increases the number of shareholders of private companies from 500 to 2,000 and allows those companies to avoid reporting to the SEC as long as they stay under 2,000 shareholders.³⁰ These changes addressed in the JOBS Act are intended to make business growth easier to boost the American economy.³¹

President Obama framed this legislation as a way to turn to the American people to help American businesses and entrepreneurs.³² He specifically

24. See Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(11) (2012) (defining “equity security” as “any stock or similar security”).

25. See *id.* § 77b(a)(19) (defining “emerging growth company” as “an issuer that had total gross annual revenues of less than \$1,000,000,000”); JOBS Act, §101, 126 Stat. 306 (defining “initial public offering” as “the date of the first sale of common equity securities of an issuer pursuant to an effective registration statement under the Securities Act of 1933.”).

26. See Securities Act of 1933, 15 U.S.C. § 77d(b) (2012) (qualifying Regulation D as an exception to SEC reporting requirements if the offer falls within one of the Regulation D rules such as Rule 506, which allows non-registration of offers so long as the company complies with the required procedures of 506 offers).

27. See *generally id.* § 77f (requiring issuers to register specific information with the SEC about the company, such as principal officers, board of directors, etc., unless the issuer qualifies for an exception); JOBS Act, § 201(a)(1) (changing the rule so that an issuer only needs to take “reasonable steps” to ensure that a purchaser is accredited).

28. See Chris Brunner & Daniel Gorfine, *The JOBS Act Isn’t All ‘Crowdfunding’*, FORBES (Oct. 8, 2013, 8:00 AM), <http://www.forbes.com/sites/realspin/2013/10/08/the-jobs-act-isnt-all-crowdfunding/#7b669762879e> (explaining the requirements of Regulation Crowdfunding such as a \$1 million annual limit, advertising limits, and funding portal platforms).

29. See Regulation A+, 15 U.S.C. § 77c(b)(2) (2012) (amending Regulation A, which is an exception for registering small securities issuers, to offer up to \$50 million worth of securities within a twelve-month period and referring to it as Regulation A+).

30. *Id.* § 78lm (amending securities registration and periodical reports requirements).

31. See Albanesius, *supra* note 20; Liberto, *supra* note 20.

32. President Obama also stressed how “American” the JOBS Act is when he said that

referenced Regulation Crowdfunding, noting that: “Because of this bill, startups and small business will now have access to a big, new pool of potential investors—namely, the American people. For the first time, ordinary Americans will be able to go online and invest in entrepreneurs that they believe in.”³³ His words emphasize the most drastic part of Regulation Crowdfunding—now, ordinary Americans are able to invest in businesses through online crowdfunding.

III. WHAT IS CROWDFUNDING?

Crowdfunding allows businesses and entrepreneurs to raise large amounts of money in small increments from a large group of people.³⁴ Since 2012, the global crowdfunding industry has more than doubled each year. The crowdfunding industry grew faster than predicted, and in 2015 the global industry was estimated to be worth \$34.4 billion.³⁵

A. History of Crowdfunding

Although Internet crowdfunding is a relatively new phenomenon, crowdfunding is not a new concept.³⁶ For example, when the United States

the United States has “always been on the cutting edge. And the reason is that America has always had the most daring entrepreneurs in the world When their businesses take off, more people become employed because, overall, new businesses account for almost every new job that’s created in America.” *See Remarks by the President at JOBS Act Bill Signing*, WHITE HOUSE (Apr. 5, 2012), <https://www.whitehouse.gov/the-press-office/2012/04/05/remarks-president-jobs-act-bill-signing>.

33. *Id.*

34. *See* C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 Colum. Bus. L. Rev. 1, 5 (2012) (describing crowdfunding as business owners and entrepreneurs requesting funding from the public). Crowdfunding can be used in addition to or instead of traditional fundraising methods by creating campaigns. *Id.* These campaigns provide information such as: business or product descriptions, pictures, drawings, rewards for a contribution, the crowdfunding goal, how much of the goal has been achieved, and when the campaign ends. *See id.* at 10. In non-equity crowdfunding, there is no minimum or maximum contribution amount, nor a limit on the number of campaigns a contributor can support.

35. For example, the World Bank estimated that the industry would be worth \$90 billion by 2020; however, with the current growth rate, the industry will be worth much more than \$90 billion by 2017. *See* Chance Barnett, *Trends Show Crowdfunding to Surpass VC in 2016*, FORBES (June 9, 2015, 5:33 PM), <http://www.forbes.com/sites/chancebarnett/2015/06/09/trends-show-crowdfunding-to-surpass-vc-in-2016/#51bd3813444b>.

36. *See The Statue of Liberty and America’s Crowdfunding Pioneer*, BBC (Apr. 25, 2013), <http://www.bbc.com/news/magazine-21932675> (telling the history of raising funds

was erecting the Statue of Liberty, the government did not have the necessary funds to complete the Statue's pedestal.³⁷ In response, Joseph Pulitzer posted an advertisement in his newspaper and asked for donations from the public.³⁸ The government needed to raise \$100,000 (around \$2.5 million today) and was able to raise the money in five months from more than 160,000 different people.³⁹

Today, some websites specialize in hosting crowdfunding campaigns such as IndieGoGo, Kickstarter, and GoFundMe.⁴⁰ Different websites have various models, such as an all-or-nothing model, which requires campaigners to reach their crowdfunding goal before they can collect the funds, or a model that allows campaigners to collect whatever funds they were able to raise even if they fall short of their goals.⁴¹

B. Crowdfunding Models

The donation crowdfunding model, used to fund the Statue of Liberty, is only one example of several different crowdfunding models. Some of the most common models are: the donation model, the rewards and pre-purchase models, the lending model, and the equity model.⁴² One product or business can create multiple crowdfunding campaigns and utilize a variety of methods throughout different stages of the campaigns.⁴³

through crowdfunding for the Statue of Liberty).

37. *Id.*

38. *Id.*

39. *See id.* (highlighting that more than two-thirds of the money raised was one dollar or less).

40. *See Our Story*, INDIEGOGO, <https://www.indiegogo.com/about/our-story> (last visited Nov. 20, 2016) (founded in 2008); *About*, KICKSTARTER, <https://www.kickstarter.com/about> (last visited Jan. 12, 2016) (founded in 2009); *About Us*, GOFUNDME, <https://www.gofundme.com/about-us> (last visited Nov. 20, 2016) (founded in 2010). These different websites are host sites where individuals, entrepreneurs, and businesses can create and maintain their crowdfunding campaigns and allow people to directly contribute to the campaigns.

41. *Compare Pressroom*, KICKSTARTER, <https://www.kickstarter.com/press> (last visited Jan. 12, 2016) (utilizing the all-or-nothing model), *with How It Works*, INDIEGOGO, <https://www.indiegogo.com/how-it-works> (last visited Jan. 12, 2016) (allowing a take-what-you-get model).

42. *See* Bradford, *supra* note 34, at 14-15; Lindsay Sherwood Fouse, *The Crowdfunding Act: A New Frontier*, 16 DUQ. BUS. L.J. 21, 24-27 (2013) (describing different crowdfunding platforms and clarifying that different websites utilize various models; some sites restrict the campaigns to only one specific model while other websites allow the businesses or startup to determine which model they would prefer to utilize).

43. *See, e.g.,* Bradford, *supra* note 34, at 17 (noting that Kickstarter offers a variety of

With the donation model, businesses do not offer any rewards or perks to the crowdfunding contributors, and the funds are only donations to the business or startup.⁴⁴ Overall, the donation model only accounted for \$2.85 billion of the global crowdfunding industry in 2015.⁴⁵

The reward and the pre-purchase models are similar to each other because they both provide the contributor with some type of reward for their contribution.⁴⁶ In the reward model, the contributor receives a reward dependent on the level of the contribution to the campaign.⁴⁷ In the pre-purchase model, the contributor receives the item for which the entrepreneur is campaigning and, similarly to the reward model, the quantity can depend on the level of the contribution.⁴⁸ The reward model only accounted for \$2.68 billion of the global crowdfunding industry in 2015.⁴⁹

With the lending model, entrepreneurs and business owners create

rewards in addition to pre-purchase of the product, such as a dinner with the creators of the iPhone tripod); Fouse, *supra* note 42, at 24–26 (explaining that Kickstarter combines reward and pre-purchase models).

44. See Bradford, *supra* note 34, at 15 (describing that under the donation model, contributors do not receive anything in return from the business). Star Citizen is a modern, successful donation crowdfunding campaign that raised over \$117 million through different stages of crowdfunding. See ROBERT SPACE INDUSTRIES, <https://robertspaceindustries.com/about-the-game/spaceflight> (last visited Nov. 20, 2016) (“100% crowd funded, Star Citizen aims to create a living, breathing science fiction universe with unparalleled immersion . . . and you’re invited to follow every step of development!”); ROBERT SPACE INDUSTRIES, *The Stretch Goals*, <https://robertspaceindustries.com/funding-goals> (last visited Nov. 20, 2016) (listing all the crowdfunding campaigns and additional features offered for Star Citizen for reaching specific funding goals).

45. See It is unclear if this figure includes crowdfunding donations made to individuals for personal use in addition to those made to startups or if it only includes donations made to startups; Barnett, *supra* note 35.

46. See Bradford, *supra* note 34, at 16–17 (comparing the rewards and pre-purchase model and how different crowdfunding websites utilize each, and explaining that the reward does not include interest or part of the business’s earnings); Fouse, *supra* note 42, at 24–27 (explaining that contributors receive gifts for giving money to the campaign).

47. See Bradford, *supra* note 34, at 16 (explaining that the reward does not include interest or part of the business’s earnings); Fouse, *supra* note 42, at 25 (explaining that contributors receive gifts for giving money to the campaign).

48. See, e.g., Bradford, *supra* note 34, at 16–19 (explaining that under the pre-purchase model, contributors get the product that the entrepreneur is creating); Fouse, *supra* note 42, at 25 (using the example that even early composers such as Mozart and Beethoven provided fans with advance copies of their music to finance concerts).

49. See Barnett, *supra* note 35 (including no information regarding the volume of the pre-purchase model).

campaigns to seek loans, and contributors provide the money for the loans.⁵⁰ Some loan crowdfunding websites offer interest to the contributors but others do not, such as Kiva.⁵¹ The lending model made up \$25.1 billion of the global crowdfunding industry in 2015, and, thus, accounted for an overwhelming majority of the global crowdfunding industry.⁵²

The equity model is about selling securities; it allows entrepreneurs to sell shares of their company to investors who contribute to the campaign.⁵³ In 2015 it was only \$2.56 billion of the crowdfunding industry.⁵⁴ The U.S. government did not permit equity crowdfunding until the JOBS Act, and it was especially expanded under Regulation Crowdfunding.⁵⁵

IV. REGULATION CROWDFUNDING

Regulation Crowdfunding originates in Title III of the JOBS Act.⁵⁶ The JOBS Act became effective in 2012 and sought to revitalize the American economy by reducing securities registration burdens for startups and small businesses.⁵⁷ Regulation Crowdfunding added a new part to section 4(a)(6) of the Securities Act, which “provides an exemption from the registration requirements of Securities Act Section 5 for certain crowdfunding transactions. “To qualify for the exemption under Section 4(a)(6), crowdfunding transactions by an issuer (including all entities controlled by or under common control with the issuer) must meet specified requirements”

50. See Bradford, *supra* note 34, at 20 (explaining that contributors offer loans and expect repayment from the business).

51. *Id.* at 20–21; *How Kiva Works*, KIVA, <https://www.kiva.org/about/how> (last visited Nov. 20, 2016); see Bradford, *supra* note 34, at 20 (“Kiva is, without a doubt, the leading crowdfunding site using the lending model, and probably the leading crowdfunding site of any type.”). Kiva highlights several success stories, one of which is about a business owner in Detroit who was able to take out a \$5,000 loan backed by forty-two lenders, and who was able to open a restaurant in an effort to help the city’s economy. Rachel Getz, *A Native Son Returns to Detroit with a Dream to Make a Difference*, KIVA: BLOG (June 29, 2016), <https://medium.com/@Kiva/a-native-son-returns-to-detroit-with-a-dream-to-make-a-difference-49348832a6fc#.40snp0r2d>.

52. Barnett, *supra* note 35.

53. See Bradford, *supra* note 34, at 24–25 (explaining that the equity model was uncommon in the United States because of regulatory issues raised).

54. Barnett, *supra* note 35.

55. Brunner & Gorfine *supra* note 28.

56. See *supra* Part II (discussing the JOBS Act).

57. See Albanesius, *supra* note 20; see also Liberto, *supra* note 20; Steve Vanroekel, *The JOBS Act: Encouraging Startups, Supporting Small Business*, WHITE HOUSE BLOG (Apr. 5, 2012, 4:12 PM), <https://www.whitehouse.gov/blog/2012/04/05/jobs-act-encouraging-startups-supporting-small-businesses>.

set forth in Regulation Crowdfunding.⁵⁸ The purpose of this exemption is to allow startups and small businesses to sell securities to the public through crowdfunding in order to grow their business.⁵⁹

Regulation Crowdfunding sets requirements for investors, intermediaries, and issuers, such as the requirements for issuers to report and disclose information about their businesses in order to be able to crowdfund equity.⁶⁰ These burdensome disclosure requirements have caused problems for small businesses and startups because, for these types of businesses, the costs of the compliance outweigh the benefits of the regulation.⁶¹

A. Regulation Crowdfunding: Proposed Rules Versus Final Rules

On October 23, 2013, the SEC released the proposed rules for Regulation Crowdfunding and allowed the public to submit comments until February 2014.⁶² The SEC reviewed all of the comments received, addressed some of the comments, and altered or clarified portions of the rules to come up with the final rules based on the feedback from the public.⁶³ The final rules became effective on May 16, 2016.⁶⁴

The proposed rules also required issuers to disclose the risks associated with investing in their businesses.⁶⁵ Some commenters agreed with this disclosure while others did not and preferred that the SEC provide specifics about what types of risks should be disclosed.⁶⁶ Commenters were also concerned with the costs that issuers would incur as a result of complying with this disclosure; however, the SEC chose to include the risk disclosure in the final rules because of the importance that such information provides

58. Regulation Crowdfunding, 80 Fed. Reg. 71,387, 71,389 (Nov. 16, 2015) (codified in scattered sections of 17 C.F.R.).

59. *See id.* at 71,390-71,391.

60. *See id.*

61. *See infra* Section VI.

62. *See generally* Regulation Crowdfunding, 78 Fed. Reg. 66,427, 66,428 (proposed Nov. 5, 2013); APA, 5 U.S.C. § 553(a), (c) (2012) (requiring that before administrative agencies create final rules, they must publish proposed rules in the Federal Register and the public must be given an opportunity to submit comments and participate in the rulemaking process).

63. Regulation Crowdfunding, 17 C.F.R. §§ 227.100-503 (2016).

64. Regulation Crowdfunding, 80 Fed. Reg. at 71,388.

65. *See* Regulation Crowdfunding, 78 Fed. Reg. at 66,442 (setting forth a rule requiring equity crowdfunding businesses to disclose risk factors associated with potential investments).

66. *See* Regulation Crowdfunding, 80 Fed. Reg. at 71,404-05 (discussing several comments received about the proposed risk factor disclosure).

investors.⁶⁷ The SEC chose to not provide specific information that should be disclosed because of the different types of businesses and different stages of business that would be required to comply with the requirement.⁶⁸

Additionally, the SEC allowed a similar exception for issuers with offerings between \$100,000 and \$500,000 and for issuers with offerings of more than \$500,000 that are utilizing Regulation Crowdfunding for the first time.⁶⁹ The exception for first-time Regulation Crowdfunding issuers with offerings of \$500,000 or more is based on comments concerned with the costliness of an audit.⁷⁰ These alterations to the rules are important because they will significantly cut the compliance costs for the applicable issuers.⁷¹ The SEC also recognized that the cost of an audit would be high without any guarantee that the crowdfunding campaign would result in any capital raised and, therefore, the costs did not justify the benefits.⁷²

The proposed rules required issuers to publish reports on the status of their campaigns.⁷³ According to the SEC, many commenters did not agree with the requirement because of the cost and time that such disclosures would entail; however, the SEC did not do away with this part of the proposed rule and, instead, the final rule was altered so that it would not be burdensome on the issuers.⁷⁴ The final rule allows intermediaries to publish monthly updates on the intermediaries' website, but if the intermediaries do not publish the updates, then the issuers are still required to make that disclosure.⁷⁵

Most of the concerns highlighted by commenters and addressed by the SEC were concerns related to the costs that would be incurred by the issuers. The commenters were likely the same people who are interested in utilizing Regulation Crowdfunding in one way or another and, thus, were interested in keeping costs low for issuers.⁷⁶ On the other hand, the SEC wants to make

67. *See id.*

68. *See id.* (deciding to retain the proposed rule in order to keep the rules flexible enough to be utilized by different types of issuers).

69. *See id.*

70. *See id.* at 71,413–14 (“We are adding this accommodation for first-time issuers in response to commenters’ concerns about the expense of obtaining audited financial statements.”).

71. *See id.*

72. *See id.* at 71,413.

73. *See id.* at 71,417.

74. *See id.*

75. *See id.*

76. *See* T.W. Kennedy, CyberIssues, LLC, Comment Letter on Proposed Regulation Crowdfunding Rules (Oct. 1, 2015), <https://www.sec.gov/comments/s7-09-13/s70913-542.htm>; Kiran Lingam, General Counsel, SeedInvest, Comment Letter on Proposed Regulation

the regulation efficient so that it is utilized; but the SEC is also concerned with protecting investors.⁷⁷ The disclosure requirements are meant to help investors make informed decisions, but the requirements are expensive and may deter startups and small businesses from utilizing Regulation Crowdfunding.⁷⁸

B. Regulation Crowdfunding's Issuer Requirements

Businesses that wish to utilize the crowdfunding exception of Regulation Crowdfunding are required to file specific information with the SEC and also disclose specific information to investors and intermediaries who facilitate the offerings.⁷⁹ Some of the required issuer disclosures are information about the crowdfunding goal, deadline to reach the goal, how the money raised will be utilized, business's financial condition, financial statements, and in some circumstances, tax returns.⁸⁰ A company offering less than \$1 million but more than \$500,000 for the first time is required to disclose reviewed financial statements, or if available, independently audited financial statements.⁸¹ Additionally, these businesses are required to file annual reports with the SEC and provide the reports to investors.⁸² Further, the issuers would be required to have an SEC-approved funding portal to host their equity crowdfunding campaigns.⁸³

Moreover, issuers that utilize Regulation Crowdfunding can only collect the capital contributed if the issuers are able to reach the campaign goals.⁸⁴ If not enough money is contributed and the amount crowdfunded is less than the goals, then the issuers cannot collect any of the money contributed. The

Crowdfunding Rules (Mar. 2, 2015), <https://www.sec.gov/comments/s7-09-13/s70913-533.pdf>; Mandy Calara, Founder, CrowdFranchise, Comment Letter on Proposed Regulation Crowdfunding Rules (Nov. 5, 2015), <https://www.sec.gov/comments/s7-09-13/s70913-520.pdf>; Alon-Hillel-Tuch and Jed Cohen, RocketHub, Comment Letter on Proposed Regulation Crowdfunding Rules (Feb. 3, 2014), <https://www.sec.gov/comments/s7-09-13/s70913-206.pdf>.

77. See *What We Do*, *supra* note 7.

78. See *infra* Section VI (concluding that the costs of Regulation Crowdfunding are burdensome for many of the businesses targeted by the regulation).

79. See generally Regulation Crowdfunding, 17 C.F.R. § 227.201 (2016).

80. *Id.*

81. *Id.* § 227.201(i)(3).

82. See *id.* § 227.201–202.

83. See *id.* § 227.204 (requiring that businesses only advertise and host their equity crowdfunding campaigns on intermediary websites approved by the Financial Industry Regulatory Authority (FINRA)).

84. See *id.* § 227.304.

reason for this rule is that issuers are required to disclose exactly how they will utilize the money raised.⁸⁵ If the issuer is not able to collect the capital they sought, then they cannot utilize the money raised for the purpose that they campaigned for because it is not enough to fulfill that purpose.⁸⁶ For example, if an issuer creates a campaign to raise \$150,000 in order to buy a piece of manufacturing equipment but is only able to raise \$100,000 before the campaign expires, then they will not be able to purchase the piece of equipment. Since the contributors invested based on the issuer being able to purchase the equipment and the issuer cannot actually purchase it, the money must go back to the contributors.⁸⁷ This means that if issuers are unable to reach their crowdfunding goals, then they have lost the money that was used to comply with the regulation in order to utilize equity crowdfunding but were not able to make any type of financial gain.

Moreover, Regulation Crowdfunding also limits issuers' campaign advertisements on non-intermediary platforms.⁸⁸ The issuers must direct potential investors to the intermediary websites, where the advertisements are posted.⁸⁹ The advertisements are only allowed to have certain information and issuers are required to make certain disclosures within the advertisements.⁹⁰ To promote investor knowledge and maintain the regulated advertisements, issuers cannot advertise the offering on any platform other than the intermediaries' platforms.⁹¹

V. REGULATION A+

The JOBS Act also amended the Regulation A exception because it was under utilized by businesses.⁹² The amended version of Regulation A is

85. *See id.*

86. *See id.* (utilizing the all-or-nothing rule regarding collecting contributions after an equity crowdfunding campaign).

87. *See id.*

88. *See id.* § 227.204 (requiring issuers to only post limited information about their campaign on platforms other than the intermediary platform).

89. *See id.*

90. *See id.* (limiting advertisements on non-intermediary websites so that they can only include information indicating that there is an offering; the name of the intermediary; a link to the intermediary's website; the terms of the offering, which includes the amount of securities offered, the price, and the nature of the securities; the end of the offering period; the issuer's name, address, phone number, and website; the e-mail address of a representative; and a brief description of the business).

91. *See id.*

92. *See* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-839, SECURITIES REGULATION: FACTORS THAT MAY AFFECT TRENDS IN REGULATION A OFFERINGS (2012) (associating the decreased utilization of Regulation A to high costs of Blue Sky Law compliance, offerings

often referred to as Regulation A+.⁹³ Regulation A+ is described as a mini-IPO⁹⁴ and can be used by businesses that seek to reach similar goals as provided by Regulation Crowdfunding.⁹⁵

Similar to Regulation Crowdfunding, Regulation A+ allows the American public to invest in private companies.⁹⁶ The businesses that decide to sell equity through Regulation A+ must fulfill several compliance requirements, depending on which of the two tiers the businesses decide to utilize, such as Blue Sky Laws, audited financial statements, and several disclosure forms.⁹⁷ The lower-end of the estimated Regulation A+ compliance cost is around \$50,000.⁹⁸ Even so, Regulation A+ allows businesses to raise up to \$50 million within a twelve-month period.⁹⁹ This is a huge advantage compared

ceilings, and lengthy processes); *see also* *Helping Small Businesses and Protecting Investors*, SEC, <https://www.sec.gov/news/statement/helping-small-businesses-and-protecting-investors.html> (last visited Oct. 8, 2016) (describing the Regulation A amendments as a way to encourage businesses to take advantage of the exception).

93. *See SEC Adopts Rules to Facilitate Smaller Companies' Access to Capital*, SEC (Mar. 25, 2015), <https://www.sec.gov/news/pressrelease/2015-49.html> (last visited Oct. 8, 2016) (clarifying that Regulation A+ is the commonly used name for the amended Regulation A).

94. *See* Regulation A+, 80 Fed. Reg. 21,806, 21,807 (Apr. 20, 2015) (finalizing the rules for equity crowdfunding per Regulation A+); *What is Regulation A*, SEEDINVEST, <https://www.seedinvest.com/how-it-works/regulation-a> (last visited Oct. 8, 2016) (describing how Regulation A can be used by businesses that seek to crowdfund equity); *see* *Lindeen v. SEC*, 825 F.3d 646, 648 (D.C. Cir. 2016) (confirming the SEC's authority to amend the rules to achieve Regulation A+).

95. *Compare* Regulation Crowdfunding, 80 Fed. Reg. at 71,289–90 (allowing individuals to invest in companies through equity crowdfunding), *with* Regulation A+, 80 Fed. Reg. at 21,812–15 (allowing individuals to invest in businesses).

96. *See* Regulation A+, 17 C.F.R. § 230.251 (summarizing the amendments in Regulation A+).

97. *See Lindeen*, 825 F.3d at 649 (defining “blue sky laws” as “state imposed comprehensive securities regulation regimes”); *see also* *Blue Sky Laws*, SEC, <https://www.sec.gov/answers/bluesky.htm> (last visited Oct. 8, 2016) (defining “blue sky laws” as state securities laws to protect investors); Kendall Almerico, *Raising Millions with Equity Crowdfunding Will Cost You, but How Much?*, ENTREPRENEUR (May 20, 2015), <https://www.entrepreneur.com/article/246063>.

98. *See id.* (breaking down the potential costs associated with Regulation A+ offerings); *see also* Tanya Prive, *Regulation A+: Now Everyone Can Invest in Your Startup*, FORBES (June 19, 2015, 3:49 PM), <http://www.forbes.com/sites/tanyaprive/2015/06/19/regulation-a-now-everyone-can-invest-in-your-startup/2/#588245ad3e76> (setting the range for compliance costs to be between \$50,000 to \$100,000).

99. *See* Almerico, *supra* note 97.

to the \$1 million limit imposed by Regulation Crowdfunding.¹⁰⁰

Regulation A+ is appealing to businesses because the regulation created two tiers of regulations based on the needs of the companies.¹⁰¹ Tier 1 allows issuers to collect up to \$20 million and Tier 2 allows issuers to collect up to \$50 million.¹⁰² If businesses seek to raise up to \$20 million, then they can decide whether they should utilize Tier 1 or Tier 2.¹⁰³ There are several differences between Tier 1 and Tier 2 offerings. One of the biggest differences is the limitation on individual contributions in Tier 2 offerings.¹⁰⁴ Non-accredited investors are limited to “(a) 10% of the greater of annual income or net worth (for natural persons); or (b) 10% of the greater of annual revenue or net assets at fiscal year end (for non-natural persons).”¹⁰⁵ However, the advantage of Tier 2 offerings is that the offerings are not subject to Blue Sky Laws.¹⁰⁶ Table 1 shows the major difference between Regulation A+’s Tier 1 and Tier 2 offerings.¹⁰⁷

*Table 1: Tier 1 v. Tier 2 Offerings*¹⁰⁸

	Reg A – Tier 1	Reg A – Tier 2
Maximum Offering	\$20,000,000	\$50,000,000
Investor Types	All, including non-accredited investors	All, including non-accredited investors
Individual Investment Limits	None	Unaccredited investors: The greater of 10% of their income or 10% of their net worth; Entities: 10% of revenue or net assets; Accredited Investors: Unlimited

100. *See infra* Section IV (discussing the requirements and limitations of Regulation Crowdfunding compared to Regulation A+).

101. Regulation A+, 17 C.F.R. § 230 (2016) (differentiating between Tier-one and Tier-two regulations).

102. *Id.*

103. *See id.* (clarifying that businesses can choose either of the two tiers if they seek to raise \$20 million or less).

104. *See id.*

105. *Id.*

106. *See id.*

107. *Raising Capital Using Regulation A+ Mini-IPO*, SEEDINVEST, <https://www.seedinvest.com/blog/raising-capital/raising-capital-reg-a-mini-ipo> (last visited Oct. 8, 2016).

108. *See id.* This table is replicated from the SeedInvest website.

General Solicitation	Unrestricted	Unrestricted
Offering Documents	SEC Review and State Review	SEC Review
State Pre-emption	No; Coordinated State Review	Yes
Financial Disclosures	Reviewed Financials (certain states might require audits)	Audited Financials
Ongoing Disclosures	No Ongoing Public Financial Reporting	Annual and Semi-Annual Public Reporting including Audits
Ability to Terminate Ongoing Reporting Requirements	N/A	Less than 300 holders of Regulation A+ stock
Transfer Restrictions	None	None

Another advantage of Regulation A+, using both Tier 1 and Tier 2, is that businesses can “test the waters” to determine if they will be able to raise sufficient funds.¹⁰⁹ This means that the businesses can gauge how much interest the American public has in contributing to their campaigns. Based on this information, the company can decide whether or not to continue with the campaign or determine if there should be adjustments.¹¹⁰

Since Regulation A+ became effective in March 2015, many businesses have already proven that it can be an extremely successful mechanism for raising capital.¹¹¹ For example, 8tracks, an Internet radio company, launched a Regulation A+, equity-crowdfunding campaign on SeedInvest, a Financial

109. See Regulation A+, 17 C.F.R. § 230.

110. See *id.* (describing the solicitation of interest option in Regulation A+).

111. See Alexandra Wilson, *Why Millennial Music Platform 8tracks Launched \$11M Equity Crowdfunding*, FORBES (June 15, 2016, 11:29 AM), <http://www.forbes.com/sites/alexandrawilson/2016/06/15/millennial-music-platform-8tracks-launches-11m-equity-crowdfunding/#63283efd5c57> (writing about the \$30 million worth of interest shown through 8tracks’ “testing the waters” campaign); Amy Feldman, *Elio Motors, First Equity-Crowdfunded IPO, Soars Past \$1B Valuation Days After Listing Shares*, FORBES (Mar. 1, 2016, 1:00 AM), <http://www.forbes.com/sites/amyfeldman/2016/03/01/elio-motors-first-equity-crowdfunded-company-soars-past-1b-valuation-days-after-listing-shares/#3cb778a41cf5> (describing the affects of Elio Motors Regulation A+ crowdfunding campaign that raised \$17 million from 6,600 investors).

Industry Regulatory Authority approved intermediary platform.¹¹² Before launching the campaign, 8track tested the waters on SeedInvest to gauge the interest that a crowdfunding campaign could attract. 8track found that around 30,000 supporters indicated that they were willing to invest \$1,000 each in exchange for company equity.¹¹³ Currently, 8tracks has a Regulation A+, equity crowdfunding campaign on SeedInvest where they are crowdfunding \$11,000,000 of the company's shares.¹¹⁴ As with 8track's experience, Regulation A+ has been an effective way to raise capital.

VI. COSTLINESS OF REGULATION CROWDFUNDING

A by-product of Regulation Crowdfunding's disclosure requirements on issuers is that these startups and small to medium-size businesses will be required to spend a significant amount of money to take advantage of the new exception.¹¹⁵ The SEC included the estimated cost for these issuers' compliance in its final rules.¹¹⁶ For a business to raise between \$500,000 and \$1,000,000 by utilizing Regulation Crowdfunding, the business or startup will likely spend "between \$44,000 and \$94,000 upfront, and \$3,000 to \$13,000 each following year to fulfill annual SEC reporting requirements."¹¹⁷ These estimates are problematic when the receipts of small businesses, one of the major targets of the regulation, are taken into consideration.¹¹⁸

The SEC predicts that intermediary fees will vary depending on the amount of money raised.¹¹⁹ The SEC also provided estimated costs for

112. *See 8tracks Campaign*, SEEDINVEST, <https://www.seedinvest.com/8tracks/series.a> (last visited Jan. 12, 2016).

113. *See* Romain Dillet, *8tracks Is Raising a \$30 Million Dollar Crowdfunding Round*, TECHCRUNCH (Mar. 22, 2016), <https://techcrunch.com/2016/03/22/8tracks-is-raising-a-30-million-crowdfunding-round/> (reporting on 8tracks recent Regulation A+ crowdfunding campaign).

114. *See 8tracks Campaign*, *supra* note 112.

115. *See* Bob Marvin, *Regulation Crowdfunding Is Live: What Businesses and Investors Need to Know*, PC MAG (May 19, 2016), http://www.pcmag.com/article/344544/regulation-crowdfunding-is-live-what-businesses-and-investo#disqus_thread.

116. *See id.* (reporting on the specific compliance costs provided by the SEC).

117. *Id.*

118. *See 2014 Small Nonemployer Statistics*, U.S. CENSUS BUREAU, <http://censtats.census.gov/cgi-bin/nonemployer/nondet.pl> (last visited Oct. 9, 2016) (reporting that there are about 23,800,000 nonemployer businesses—businesses with no paid employees—in the United States, and about 22,700,000 of them had less than \$250,000 in receipts in 2014).

119. *See* Regulation Crowdfunding, 80 Fed. Reg. 71,387, 71,497 (Nov. 16, 2015) ("We [the SEC] project (as a percentage of offering proceeds) 5% to 15% for offerings of \$100,000 or less, 5% to 10% for offerings between \$100,000 and \$500,000, and 5% to 7.5% for offerings above \$500,000.").

disclosure requirements, including preparing and filing disclosure forms and internal costs of observance with those requirements, and cost estimates for compliance. The estimate for an offering of \$100,000 is about \$2,500, and for an offering that is more than \$500,000 the estimate is between \$6,000 and \$20,000.¹²⁰

Another large cost for issuers will be for the independent accounting review or audit. This cost will only be for issuers that have offerings between \$100,000 and \$500,000, if they do not have financial statements available, and for offers of more than \$500,000.¹²¹ The SEC's estimate for an audit is between \$2,500 and \$30,000 and the estimate for a review is between \$1,500 and \$18,000.¹²² The cost of an intermediary will also be a major expense for issuers. For offerings of \$100,000 or less, the estimated cost is between \$2,500 and \$7,500.¹²³ For offerings more than \$100,000 but less than \$500,000, the estimated cost is between \$15,000 and \$30,000.¹²⁴ For offerings of more than \$500,000, the cost is between \$37,500 and \$56,250.¹²⁵

Additionally, since Regulation Crowdfunding uses an all-or-nothing approach (i.e., for issuers to keep the money they raised, they must raise all of the money that they sought to reach within the crowdfunding campaign), issuers take on a big risk when they utilize the crowdfunding exception. The issuers must comply with the SEC's requirements before they are able to begin the crowdfunding campaign. This leaves them vulnerable to losing substantial amounts of money as a result of falling short on the initial crowdfunding goal.¹²⁶

Due to the high costs associated with Regulation Crowdfunding compliance, businesses that seek to utilize securities crowdfunding need access to capital. Because the costs of compliance are associated with a range of offerings, it would be most beneficial for issuers to set their offerings at the upper end of the offering range.¹²⁷ However, because of the all-or-nothing rule it would also be risky for issuers to create offerings that are too high because then they risk not being able to retain any of the money raised during the campaigns.

Additionally, it is unlikely that startups will have the necessary funds for regulatory compliance. Small to medium-size businesses are, potentially,

120. *Id.* at 71,498.

121. *Id.* at 71,498-99.

122. *Id.* at 71,499.

123. *Id.* (comparing the costs of utilizing the required FINRA-approved, intermediary websites).

124. *Id.*

125. *Id.*

126. *See id.* at 71,552.

127. *Id.* at 71,497.

more likely to have the funds and network necessary to make use of and benefit from this new regulation and may already have some of the financial statements required for disclosure and reporting. Although Regulation Crowdfunding seeks to help startups and small businesses raise capital in order to grow, the regulation also creates a lot of obstacles for these businesses to utilize this crowdfunding exception.

VII. RECOMMENDATIONS

A. Allowing Issuers to Test the Waters

Although it may not be fruitful for a startup to hold off raising funds, small to medium-size businesses may find it more advantageous to utilize Regulation A+, if they are eligible, instead of Regulation Crowdfunding. One of the major advantages of Regulation A+ is the ability for businesses to test the waters before launching their crowdfunding campaigns.¹²⁸ This allows businesses to ensure that they can raise the capital they need before the businesses are required to file information about their offerings with the SEC.¹²⁹

Although Regulation A+ can be utilized by both startups and small to medium-size businesses, it is often not considered an efficient exception for startup businesses.¹³⁰ Many startups are not in positions to go public.¹³¹ Accordingly, startups seeking to raise capital through crowdfunding are better served if they utilize Regulation Crowdfunding because it does not require startups to comply with Blue Sky Laws.¹³²

However, Regulation A+ has a large advantage because businesses that use the exception are able to test the waters before having to endure the disclosure costs associated with the exception.¹³³ The purpose of this solicitation of interest is to reduce the risks of utilizing Regulation A+ because the SEC recognized that there are substantial financial risks with attempting to take advantage of Regulation A+, especially because more of

128. See Regulation A+, 17 C.F.R. § 230.255 (2016); see also *supra* Part V (describing the different components of Regulation A+).

129. See Regulation A+, 17 C.F.R. § 230.255.

130. See generally Sally Outlaw, *Regulation A+ Is Not the Savior of Cash-Seeking Startups*, Entrepreneur (Apr. 30, 2015), <https://www.entrepreneur.com/article/245540> (stating that Regulation A+ can be too burdensome for startups because of the costs and requirements of going public).

131. See *id.*

132. See generally Regulation Crowdfunding, 17 C.F.R. § 227 (2016) (establishing equity crowdfunding regulations).

133. See *supra* Part V (discussing Regulation A+ requirements).

the businesses that seek to use the exception have limited financial means and access to capital.¹³⁴

Similar to small and medium-size businesses that use Regulation A+, startups also take on large financial risks when utilizing Regulation Crowdfunding.¹³⁵ However, unlike Regulation A+, startups that use Regulation Crowdfunding are not able to test the waters before deciding if the benefits of beginning an equity crowdfunding campaign are worth the risks.

1. Testing the Waters for Issuer Efficiency

To make Regulation Crowdfunding more efficient and widely utilized, the SEC should amend the regulation to allow businesses to test the waters. By amending the rule to allow businesses to test the waters, businesses, and especially startups, will be able to determine whether or not they should proceed with an equity crowdfunding campaign before they are forced to endure the burdensome costs of complying with the regulation's requirements. This means that businesses that may not have considered crowdfunding will test the waters and may find that they could successfully utilize Regulation Crowdfunding. Accordingly, more businesses could take advantage of the new regulation because there is more reassurance that they will not face such a large financial risk.

In Regulation A+, testing the waters was adopted as a way for the SEC to "reduce compliance burdens and entirely eliminate the filing requirement for issuers that, after testing the waters, decide not to proceed with an offering."¹³⁶ Since Regulation A+ and Regulation Crowdfunding target startups and small-to-medium size companies, it is crucial that the regulations take the characteristics of such businesses into consideration. Testing the waters is one area where Regulation A+ properly applied rules to cater to the needs—specifically the need to be efficient with limited capital—of those businesses. Startups only have access to a very limited amount of funding, even less than those small-to-medium size businesses that utilize Regulation A+. By amending Regulation Crowdfunding to allow business to test the waters, and taking the financial status of startups into consideration, the SEC would effectively invite all startups to test the waters to determine whether they would benefit from the equity crowdfunding regulation without taking on any direct risks. This also means that startups that were risk-averse and would not have otherwise attempted to create an equity crowdfunding

134. See Regulation A+, 17 C.F.R. § 230.255.

135. See *supra* Part VI (discussing the costliness of Regulation Crowdfunding).

136. See Regulation A+, 80 Fed. Reg. 21,806, 21,843 (Apr. 20, 2015).

campaign, may find that they have sufficient public interest to do so and, therefore, will take advantage of the regulation.

2. Testing the Waters for SEC Modernization

Additionally, allowing businesses to test the waters furthers the SEC's goal to continue to modernize disclosure, forms, and processes.¹³⁷ Today, technology allows businesses to test the waters without any burden or risk on investors. As it is applied to Regulation A+, when testing the waters, businesses must make it clear that they are only gauging the interest of the public in their business or product.¹³⁸ This means that the testing-the-waters phase is a well-defined phase that will not affect investors or potential investors. Additionally, in the event that a business moves past the testing the waters phase, those potential investors who demonstrated interest are not bound to contribute to the campaign.¹³⁹

Further, businesses constantly use the Internet to determine if there is enough interest in their product or concept in order to gauge how successful the venture will be. Businesses are less willing to take financial gambles when there are simple options available to mitigate such risks. By allowing businesses to take advantage of these technological tools that are already accessible to them, the SEC will allow businesses to make educated decisions about the future of their company. Further, since the testing the waters phase is done online it goes hand-in-hand with Regulation Crowdfunding, which is also based online.

By amending Regulation Crowdfunding to allow for testing the waters, the SEC will not only become successful in fulfilling its mission to protect investors, but also promote economic growth through investments. Since testing the waters will not affect the disclosure requirements already set out in the current regulation, investors will not be faced with higher risks when investing. Moreover, testing the waters will lead to economic growth because more businesses, especially startups, will have newfound opportunities to create equity campaigns per Regulation Crowdfunding. This is because businesses that would not have been willing to blindly comply with the burdens of the regulation will instead be able to find out if their campaign will be successful without having to take on any of the financial burdens of complying with Regulation Crowdfunding first. This means that more

137. See Reporting Modernization, 80 Fed. Reg. 33,589, 33,592 (June 12, 2015) (codified at 17 C.F.R. §§ 200–274) (“We have historically acted to modernize our forms and the manner in which information is filed with the Commission and disclosed to the public in order to keep up with changes in the industry and technology.”).

138. See Regulation A+, 17 C.F.R. § 230.255.

139. See *id.*

businesses could successfully utilize Regulation Crowdfunding, thus improving the economy.

B. Allowing Issuers to Raise More or Less than the Target Figure

Currently, Regulation Crowdfunding only allows issuers to set one target figure per crowdfunding campaign.¹⁴⁰ Further, if the issuer is not able to crowdfund their complete target then the issuer is unable to keep any of the funds collected during the campaign.¹⁴¹ There are two major disadvantages to this all-or-nothing rule: it may discourage issuers from setting high campaign targets because of the risk of financial loss in the event that the target is not reached, or it may completely deter issuers from utilizing the regulation because of that risk.

In order to mitigate those disadvantages, Regulation Crowdfunding should allow issuers flexibility in setting campaign targets. First, issuers should be able to set several benchmark goals within one campaign and collect the contributions from the highest benchmark met. Similar to the current disclosure requirements for one target goal, with each benchmark goal, issuers will be required to disclose how the money will be utilized and how much equity is being offered. The advantage of allowing issuers to set benchmark goals is that they will not be confronted with the risk of total loss in the face of the high cost of disclosure compliance.

Second, issuers should also be allowed to collect funds beyond the target goal without specifying a maximum amount that will be accepted so long as it is within the regulation's annual cap. In order to do so, issuers should be required to disclose the excess amounts they will collect, the total securities offered if the excess amount are collected, and how the excess funds will be utilized by the business.¹⁴² In addition to allowing benchmark goals, this amendment will also encourage more businesses to take advantage of the regulation because, not only is there less risk of loss, but there is also more opportunity for success and growth.

C. Uniform Disclosure Forms

Presumably, many of the issuers who will utilize Regulation Crowdfunding will not have had exposure to SEC disclosure requirements. In order to

140. See *supra* text accompanying note 126.

141. *Id.*

142. For more on allowing issuers to collect beyond their target, see generally The American Bar Association Business Law Section, Comment Letter on Proposed Regulation Crowdfunding Rules (Mar. 20, 2013), <https://www.sec.gov/comments/jobs-title-iii/jobstitleiii-227.pdf>.

make it easier for startup issuers, the SEC should create uniform disclosure forms for Regulation Crowdfunding issuers. Uniform disclosure forms would make disclosure requirements much easier for the issuers. The forms should include spaces where the issuer is only required to input their startup's specific information. Additionally, the disclosure forms could also provide definitions of terms that may be confusing and new to the type of issuers who will utilize Regulation Crowdfunding.¹⁴³

Not only will this change make it easier for issuers, but it will also help the SEC improve its internal inefficiencies. Per the Modernization Reporting, the SEC is seeking to update its disclosure process in order to make it more efficient for both issuers and for the SEC.¹⁴⁴ By creating a uniform disclosure form, the SEC will have an easier time sorting through the disclosure forms because it will be clear what information is contained on the form. Additionally, there will be less back and forth between the SEC and the issuers about information that was incorrectly disclosed due to lack of understanding.

D. Implementing the Amendments

In order to implement these amendments the SEC is required to comply with the APA rules.¹⁴⁵ The APA's definition of "rulemaking" includes amendments to rules.¹⁴⁶ This means that the SEC will have to go through the entire rulemaking process in order to amend Regulation Crowdfunding. The SEC will be required to draft proposed rules and provide "general notice of proposed rule[s]" in the Federal Register.¹⁴⁷ The proposed rules must include the time, place, and nature of the amendments; the legal policy where the rule is proposed; and the rules that are being proposed.¹⁴⁸ The public will have the opportunity to review the proposal and submit comments to the SEC.¹⁴⁹ Once the comment period is over, the SEC will be able to make changes to the rules and publish the final rules no less than thirty days before the implementation of the final rules.¹⁵⁰

Since 2010, the SEC has proposed an average of nineteen rules per year.¹⁵¹

143. *See generally id.* (providing more information on uniform disclosure forms).

144. *See* Reporting Modernization, 80 Fed. Reg. 33,589, 33,592 (June 12, 2015) (codified at 17 C.F.R. §§ 200-274).

145. APA, 5 U.S.C. § 553 (2012).

146. *See id.* § 551(5).

147. *Id.* § 553(b).

148. *See id.*

149. *See id.* § 553(c).

150. *See id.* § 553(d).

151. *See Rulemaking Index*, SEC, <https://www.sec.gov/rules/rulemaking-index.shtml> (last

Since 2010, at least twenty-four of the total proposed rules have been amendments to existing rules.¹⁵² Some rules can take only a few months between the release of the proposed rules and the final rules; however, others can take several years and go through multiple stages of proposals and public comments.¹⁵³ Even if the SEC itself chooses not to make amendments to a rule, the SEC allows the public to petition for rulemaking.¹⁵⁴

CONCLUSION

Regulation Crowdfunding is a change in securities law at a level that has never been seen before. Holding true to its purpose, the SEC's Regulation Crowdfunding rules are meant to be a balance between protecting investors and encouraging economic growth through securities.¹⁵⁵ However, crowdfunding, even if it is not securities, can be risky because contributors or investors can easily be deceived by fraudulent campaigns.¹⁵⁶ In such a heavily regulated segment of the financial market, like securities, it is vital that fraud is minimized through regulation. The SEC attempted to do this through Regulation Crowdfunding by creating numerous disclosure requirements for startups and small to medium-size businesses that seek to crowdfund equity.¹⁵⁷

Unfortunately, the effect of Regulation Crowdfunding is that many startups and businesses will not be able to afford to comply with the disclosure requirements.¹⁵⁸ With the costs that are associated with the regulation's disclosure and sign-up requirements, even those businesses that may have the capital to utilize Regulation Crowdfunding, such as small to medium-size businesses, could find that Regulation A+ is a better, more worthwhile, and cost-effective option.¹⁵⁹

visited Jan. 12, 2016) (listing all proposed and final rules by the SEC).

152. *See id.*

153. *See id.*

154. *See* APA § 553(e); 17 C.F.R. § 201.192(a) ("Such petition shall include a statement setting forth the text or the substance of any proposed rule or amendment desired or specifying the rule the repeal of which is desired, and stating the nature of his or her interest and his or her reasons for seeking the issuance, amendment or repeal of the rule.").

155. *See What We Do*, *supra* note 7.

156. *See* Fredman, *supra* note 6 (highlighting the increase in reports about crowdfunding campaigns scamming contributors and then using the money for personal gains instead of the advertised use).

157. *See generally* Regulation Crowdfunding, 17 C.F.R. § 227 (2016) (creating disclosure requirements, such as audits, reports, risks, etc., for businesses that seek to utilize Regulation Crowdfunding).

158. *See supra* Part VI.

159. *See id.*

The current conversation surrounding Regulation Crowdfunding is focused primarily on startups, yet it does not mitigate the financial risks that these startups may face when they utilize the new regulation.¹⁶⁰ By amending Regulation Crowdfunding to allow startups and other businesses to test the waters, collect benchmark goals, raise more than their target goals, and utilize uniform disclosure forms, the SEC could be able to diminish those risks and thus encourage businesses to utilize the regulation. In order to truly understand the potential effect that Regulation Crowdfunding may have on the economy, it will be vital to analyze the other options available to those businesses through the JOBS Act. In the meantime, we will have to wait for more businesses to utilize Regulation Crowdfunding to see the impact it will have on the economy.

160. *See id.*