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The Intrastate Crowdfunding Exemption: Gaining the Wisdom of Crowds While Avoiding its Madness

By Andrew M. Palmer*

I. Introduction

In the Netherlands in 1637, a colorful tulip's root was allegedly traded for twelve acres of land.¹ Later, in London in the early eighteenth century, a company raised one million pounds to create "a wheel for perpetual motion."² Although crowds may be delusional enough to create financial bubbles even in present day,³ there is evidence that crowds can make collective decisions that are wiser than any one individual's decision.⁴

In 2012, Congress passed the Jumpstart Our Businesses (JOBS) Act to increase the ability of small businesses to raise capital.⁵ Within the JOBS Act, Title III created an offering exemption to enable companies to raise capital through equity crowdfunding.⁶ Congress prompted the SEC to write rules to implement these exemptions, and in October 2013, the SEC released a proposed rule for comment, which was criticized for being overly burdensome.⁷ By the beginning of 2015, the SEC had made no other progress to create a rule for Title III.⁸ Title III was initially passed with much excitement, but due to the SEC's delay, states utilized the Section 3(a)(11) intrastate exemption and wrote their own intrastate crowdfunding exemptions that enabled small businesses within the respective state to take advantage of equity crowdfunding.⁹ Equity crowdfunding has been very successful in other parts of the world, and the public is excited for its potential in the United States.¹⁰

This article will examine the types of intrastate crowdfunding exemptions that have been passed to determine the best approach that protects investors while still making the process efficient for small businesses. "The mission of the [SEC] is to protect investors . . . and facilitate capital formation," and the crowdfunding exemption creates tension between these two foundational purposes.¹¹ Part II will set forth a definition of equity crowdfunding and explain Title III of the JOBS Act and the SEC's proposed

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rule. Part III will discuss three types of intrastate crowdfunding exemption statutes that have been passed by the states, along with examples of equity crowdfunding that have been implemented using the exemptions. Then in Part IV, a proposed crowdfunding exemption statute will be explained, utilizing the best features of the different types of intrastate crowdfunding exemptions.

II. Background

(a) Defining Equity Crowdfunding

Crowdfunding is achieved by a large number of individuals, sometimes hundreds or even thousands of people, contributing a small amount of capital, and funds typically are gathered through the Internet, on websites or social media.¹² In equity crowdfunding, individuals receive equity in the company in exchange for the contributed capital.¹³ This is different from rewards-based crowdfunding, which has been popularized on websites such as Kickstarter and IndieGoGo.¹⁴ In rewards-based crowdfunding, the individual receives the product created by the project funded, such as a movie or videogame, and thus, the investment is not considered a security under federal securities laws.¹⁵ Websites such as Kickstarter and IndiGoGo have been wildly successful in raising funds through rewards-based crowdfunding, with \$529 million total raised by Kickstarter for projects in 2014.¹⁶ By advertising to the masses via the Internet, some projects have raised large amounts of money that vastly exceeded the target offering, such as over \$74 million for a videogame with a \$500 thousand target offering,¹⁷ over \$18 million for a smart watch with a \$500 thousand target offering,¹⁸ and \$13.8 million for a portable cooler with a \$50 thousand target offering.¹⁹ This success of rewards-based crowdfunding has fueled the public's excitement for equity-based crowdfunding and expectations of Title III.²⁰

Currently, federal equity crowdfunding is available to accredited investors. Aside from Title III, the JOBS Act required the SEC to amend Rule 506 of Regulation D to allow general solicitation, provided all purchasers are accredited investors.²¹ By utilizing this feature of Rule 506, issuers can raise unlimited amounts of capital with accredited investors and generally solicit investments as long as purchasers are accredited investors.²² This feature of the JOBS Act has taken off and has spurred lots of investment, particularly in the real estate sector.²³ For example, Realty Mogul, a crowdfunding website, has raised \$52.6 million for 184 properties since its inception in 2013.²⁴ Moreover, another crowdfunding website, Fundrise, recently purchased \$5 million of tax-exempt bonds for financing 3 World Trade Center in Manhattan.²⁵ However, since this type of exemption can only ac-

cess accredited investors, issuers miss the opportunity to tap into the same broad market that rewards-based crowdfunding is capable of entering.²⁶

Therefore, equity crowdfunding targets both unaccredited and accredited investors, and investors receive equity in exchange for a capital contribution, typically via an Internet website.

(b) Title III of the JOBS Act and the SEC Proposed Rule

Title III of the JOBS Act added a new Section 4(a)(6) to the Securities Act, which created a federal crowdfunding exemption.²⁷ The federal crowdfunding exemption required the amount raised to not exceed \$1 million over a twelve month period, the transaction to be conducted through a registered broker or “funding portal,”²⁸ and the individual investments in a project to not exceed \$2,000 if annual income or net worth is less than \$100,000 and ten percent of annual income or net worth if annual income or net worth is greater than \$100,000, an amount not to exceed \$100,000.²⁹ Moreover, Congress authorized the SEC to create rules that exempted securities from registration requirements that were offered in reliance on a Section 4(a)(6) exemption.³⁰

Over a year later, on October 23, 2013, the SEC released a proposed rule for comment that attempted to balance the need for investor protection with the desire for efficiency that allowed small businesses to use the federal exemption.³¹ The proposed rules maintained the \$1 million limit, the investor limitations, and the funding portal, or intermediary, requirement.³² There were additional requirements for the issuer that were meant to prevent fraud, such as requiring the issuer to have a business plan, not be an investment company, and not be disqualified under bad actor provisions.³³ On the other hand, some of these fraud preventing requirements were criticized for being overly burdensome on issuers to the extent that small businesses would be deterred from using the federal exemption.³⁴ For example, if a company seeks an offering of over \$500,000, its financial statements must be audited by an independent public accountant.³⁵ Regardless of the amount offered, the issuer must also disclose “material factors that make an investment in the issuer speculative or risky . . . and provide a reasonably detailed description of [the] intended use” of the offering proceeds.³⁶ Moreover, the issuer is required to file an offering statement with the SEC,³⁷ an offering progress update when half of the target funds are received,³⁸ and an annual report comprised of similar information from the initial offering statement disclosure, including the audited financial reports if over \$500,000 is raised.³⁹ Although these requirements are important means for adequate disclosure

to potential investors, the legal and accounting costs to comply with these provisions are estimated to consume more than 15% of the offering amount.⁴⁰ Since these disclosures are not present in other private offerings that can raise more capital, issuers may be inclined to not use the federal crowdfunding exemption because of the large upfront and annual reporting costs.⁴¹

The funding portals or intermediaries are also utilized as a role to prevent fraud and protect investors. In addition to the requirement to use an intermediary, the offering has to take place “exclusively” on the intermediary’s website.⁴² Requirements were placed on the funding portal to reduce the risk of fraud, such as a “reasonable basis to believe that an issuer seeking to offer and sell securities in reliance on Section 4(a)(6)” complies with all requirements for the federal exemption.⁴³ The funding portal is also required to supply potential investors with plain language education materials that explain crowdfunding requirements and to ensure investors know the risks involved.⁴⁴ In addition, the funding portal cannot offer investment advice or solicit offers from investors.⁴⁵ The issuer can pay the funding portal for the offering services, but this information must be disclosed to investors.⁴⁶ These requirements place a burden on the funding portal to provide investors with another line of protection and hold the funding portal liable for any misstatements or fraud.⁴⁷

In addition to burdens on the issuer and the funding portal, the proposed rule included other requirements to reduce the potential for fraud. First, the proposed rules required contributed funds to be placed in an escrow account until the target amount is reached, which releases the funds to the issuer.⁴⁸ By placing these funds in an escrow account, the investor also has the ability to cancel the investment before the target amount is reached, prior to 48 hours in advance of the offering deadline, or after a material change in the offering statement.⁴⁹ If the offering is not completed by the offering deadline, then the intermediary returns the investment to the individual.⁵⁰ Second, a resale restriction of one year is placed on the security, unless transferred to certain parties.⁵¹ Third, the portals are required to have a tool on the website for allowing potential investors to comment about the investments and be able to view others’ comments.⁵² Furthermore, the portals are not allowed to participate in these conversations between potential investors because in part, a portal’s comments may be viewed as investment advice, which is prohibited.⁵³ In addition, the SEC requires the person commenting to disclose any association with the issuer, such as being an employee or being compensated by the issuer, so that any bias can be disclosed.⁵⁴ The SEC believes that the ability to comment reduces the chance of fraud because it provides “transparency and accountability.”⁵⁵

The SEC received over five hundred comments on the proposed rules.⁵⁶ While containing many protective measures for investors, many people harped on the SEC for its overly burdensome requirements.⁵⁷ Even the original sponsor of the bill has introduced measures that would amend the Title III requirements to increase the annual offering limit and the offering limit necessary to require audited financial statements, because in its current form, Title III “won’t work in practice.”⁵⁸ In addition to the estimated disclosure costs being more than fifteen percent of the amount raised, the costs on the intermediary will likely be passed onto to the issuer by high broker fees, which results in even higher offering costs.⁵⁹ Due to the overly burdensome proposed rule, and strict requirements even imposed by Title III, states began creating their own crowdfunding exemptions to allow small businesses within their respective state to gain the purported advantages of equity crowdfunding.⁶⁰

III. The Intrastate Crowdfunding Exemption Movement

Kansas was the first state to pass its own intrastate crowdfunding exemption in August of 2011,⁶¹ and Georgia followed later that year in passing its own intrastate crowdfunding exemption.⁶² Since then, the total number of states with intrastate crowdfunding exemptions has surpassed twenty-five with Washington D.C. also on the list, along with many other states having pending bills for an intrastate crowdfunding exemption.⁶³ These intrastate crowdfunding exemptions are able to be exempt from registration under federal securities law because they are tied to the federal intrastate offering exemption, Section 3(a)(11) of the Securities Act of 1933⁶⁴ and Rule 147, which is the safe harbor for Section 3(a)(11).⁶⁵ Different types of small business have been able use the exemption within their respective state, with industries ranging from craft breweries to a locally sourced butcher shop.⁶⁶ With national media coverage, the redevelopment of the old Detroit Tigers Stadium into a mixed-use development of apartments and retail space has plans for its equity to be funded in part by Michigan’s intrastate crowdfunding exemption.⁶⁷

Once states began passing their own crowdfunding exemptions, the SEC released guidance on the use of advertising for intrastate offering exemptions on the Internet, which could lead to people outside of the respective state receiving an offer.⁶⁸ The SEC’s initial guidance in April of 2012 placed restrictions on the advertising of the offering that limited it to only on a portal where investors were confirmed to be state residents.⁶⁹ However, later in 2014, the SEC relaxed the requirements by also allowing issuers to post the advertisement on their company’s website or social media page, as long as technological measures, such as IP restrictions, were used to limit access to only computers within the

state.⁷⁰

The states that have adopted their own exemptions are located all over the country and have all ranges of state population.⁷¹ With the many burdens of the SEC proposal, states wanted to lessen the crowdfunding requirements, but have sought different avenues for maintaining investor protection.⁷² After examination of all the state statutes, the statutes can be divided into roughly three different categories based upon the statutes' approaches: burdening the portal, increasing the issuer's disclosure, and relaxing all of the requirements.

(a) Placing a Burden on the Portal

One avenue of maintaining protection of investors while still allowing for efficient transactions is to relax the requirements on the issuer and maintain similar portal requirements to the SEC proposed rule.⁷³ This strategy has smaller hurdles for companies to meet than the SEC's proposed rule, and the portals filter the potential fraud, rather than high disclosure costs prohibiting many potentially successful companies from seeking the exemption.⁷⁴ Texas is one of the prime examples of crafting an exemption in this manner.⁷⁵ After enacting its crowdfunding exemption in November of 2014, Texas became the most populous state to enact an intrastate crowdfunding exemption, with over twenty million residents.⁷⁶

The Texas exemption does not require audited financials and lessens the burden on an issuer's disclosure from the SEC proposed rule.⁷⁷ In its disclosure statement, the issuer must disclose material information, risk factors, and current financial statements certified by the principal executive officer.⁷⁸ There is also no progress update of the sale and no annual reporting requirement after the sale.⁷⁹ Upon filing for the exemption, in addition to the disclosure statement, the issuer only has to file a standard crowdfunding exemption notice and a summary of the offering, which includes the business plan, intended use of the offering, identity of officers, and description of the securities offered.⁸⁰ Moreover, the Texas exemption has a non-accredited investor limit of only five thousand dollars and an unlimited amount that can be raised from accredited investors.⁸¹ Furthermore, the resale restriction follows the Rule 147(e) period of nine months, rather than the SEC's proposal of one year.⁸²

While the issuer burdens are less, the requirements on the portal are comparable to the SEC proposed rule. The Texas exemption requires the offering to "be made *exclusively* through an Internet website operated by a registered general dealer or registered Texas crowdfunding portal."⁸³ There are requirements for the portal's website, such as disclaimers that investments are

only for Texas residents and gathering evidence that a prospective purchaser is a Texas resident.⁸⁴ Along with the issuer, the portal has a responsibility to verify that the potential investor is a Texas resident.⁸⁵ The portal is also required to obtain an “affirmative acknowledgement” from the investor, which includes recognition of the resale restrictions of the security, the investor relying on its own examination of the security, and the State not confirming the disclosure’s accuracy.⁸⁶ Likewise, the issuer’s disclosures about the offering must be made available on the portal’s website 21 days before the offering.⁸⁷ Furthermore, the portal can only display offerings that are exempt under the Texas crowdfunding exemption, be incorporated within Texas, and sell initial offerings of Texas securities with no resales, which would imply that the portal cannot bring its services to other states for their intrastate exemptions.⁸⁸ In addition, the portal must be neutral and cannot offer advice on the investments.⁸⁹

Most importantly, Texas subjects each portal to a due diligence requirement.⁹⁰ Aside from the SEC’s proposed rule,⁹¹ this is the only approach that explicitly imposes liability on the portal as a measure to reduce the risk of fraud.⁹² Under the Texas exemption, each portal is required to “conduct a reasonable investigation of the background and regulatory history of each issuer whose securities are offered on the portal’s Internet website and of each issuer’s control persons.” The portal must reject any issuer if the portal has a “reasonable basis” to conclude that:

- (1) the issuer or any of its control persons is subject to a disqualification under § 139.25 of this title (relating to Intrastate Crowdfunding Exemption);
- (2) the issuer has engaged in, is engaging in, or the offering involves any act, practice, or course of business that will, directly or indirectly, operate as a fraud or deceit upon any person; or
- (3) it cannot adequately or effectively assess the risk of fraud by the issuer or its potential offering.⁹³

This requirement could potentially hold a portal liable for any fraud that an issuer conducts since the third requirement can act as a catch-all category, assuming there is evidence the fraud could have been found before the offering was made.⁹⁴

While the potential for the portal’s liability is broad, this threat has not deterred portals from registering with the Texas State Securities Board.⁹⁵ For example, Crudefund.com, an approved Texas portal, will offer investments in Texas oil and gas projects to Texas residents.⁹⁶ Even before receiving approval as a registered portal, Crudefund.com had received interest from nearly six hundred investors.⁹⁷ Additionally, Massventure.com,

another approved Texas portal, will offer investments in Texas real estate projects to Texas residents.⁹⁸ In keeping with the policy of the Texas exemption, the portals have pitched themselves as having educational materials for investors about the types of investments and how to invest under the exemption.⁹⁹ Given the size of the Texas population and diversity for potential investments, the Texas crowdfunding exemption may prove workable, especially considering portals are registering despite the increased liability exposure.¹⁰⁰

(b) Increasing Issuer Disclosure Requirements

In contrast to the Texas exemption example, some other states eliminated the requirement for a portal and offering through an Internet website, and shifted burdens on the issuer to maintain investor protection.¹⁰¹ The state of Washington enacted an exemption in October of 2014 that is a prime example of this approach.¹⁰² Washington does not require issuers to use a portal or Internet website, but has a specific disclosure form, the Washington Crowdfunding Form, for issuers to complete.¹⁰³ Within the Washington Crowdfunding Form, the document consists of a blank template of boxes to check for risk factors, space to fill in the business description, and tables to detail the budget of the offering proceeds, among many other items of business information within the 23-page file.¹⁰⁴ Although the Department of Financial Institutions states the Crowdfunding Form is intended for businesses to “prepare the form themselves without relying on the expertise of attorneys and accountants,” transaction costs will be raised if businesses seek the assistance of counsel in preparing this disclosure, which is especially likely considering the risk of blowing the exemption.¹⁰⁵ The issuer is also required to provide a quarterly report to investors, which is more frequent than the SEC’s annual report, and the quarterly report includes a requirement for a “brief analysis by management of the issuer of the business operations and financial condition of the issuer,” which is similar to the MD&A requirement for companies reporting under the 1934 Act framework.¹⁰⁶ Furthermore, the issuer must establish a minimum target amount, which is the amount the issuer can meet the business plan.¹⁰⁷ Additionally, the issuer must wait to offer securities under the exemption until the director of the Washington Department of Financial Institutions declares them exempt.¹⁰⁸ But the director’s declaration of the exemption is not considered a certification of the offering’s merits, which keeps transaction costs down by not creating a merit regulation.¹⁰⁹

The Washington exemption also places restrictions on the type of companies that issuers can be, such as companies with “complex capital structures,” companies engaged in “petroleum exploration or production or mining or other extractive indus-

tries,” and “real estate investment programs.”¹¹⁰ However, the exemption does permit these types of companies if approved by the director of the Washington Department of Financial Institutions to have shown adequate disclosure for investors.¹¹¹ The exemption also sets the annual offering limit at \$1 million,¹¹² and the non-accredited investor limitation is the same scaled limitation as the SEC proposal, except there is no limit for accredited investors.¹¹³ Moreover, the exemption burdens only the issuer, and not the portal, for verifying that the purchasers are Washington state residents.¹¹⁴

Although these burdens are placed on the issuers, there have been examples of different types of issuers in many of these states using the exemption. For example, in Indiana, a butcher’s shop supplying locally sourced foods was funded by \$220,000 from 24 people, and craft breweries have been funded in both Indiana and Wisconsin.¹¹⁵ Additionally, in Michigan, a craft beer and tea company was able to raise \$136,000 from 26 people.¹¹⁶ These examples show that while the burdens on issuers may be high, issuers still want to tap into the available capital from equity crowdfunding.

(c) Simplifying of All the Requirements

Some states opt to not impose burdens on either the issuer or portal, which creates a more relaxed crowdfunding exemption than the other categories.¹¹⁷ This approach has continued throughout the intrastate crowdfunding exemption movement as exemptions with this approach range from the first enacted, which was Kansas in 2011,¹¹⁸ to one of the later enactments, Tennessee in 2015.¹¹⁹ In light of the criticism of the SEC’s proposed rule for being too burdensome, this relaxed approach most reflects an opposition to the SEC’s approach to equity crowdfunding.¹²⁰ Even with the relaxed approach, these exemptions operate as an experiment of the best practices for the intrastate crowdfunding exemption by starting off with a relaxed statute and giving the state’s securities department the ability to impose additional rules as needed.¹²¹ Moreover, many of these statutes comprise minimal pages of a pdf document.¹²²

Tennessee is a prime example of this approach, as it was enacted in January of 2015.¹²³ The portion of the exemption that follows the SEC proposal is the requirement for using a state “bank or depository institution” as an escrow¹²⁴ and the bad actor disqualifiers.¹²⁵ Other than the escrow requirement and bad actor disqualifiers, the Tennessee exemption is more relaxed in many ways than the SEC proposed rules. The Tennessee statute allows for an annual offering limit of \$1 million with no requirement of audited financial statements at certain tiers of offering limits.¹²⁶

Moreover, the exemption has a non-accredited investor limit of \$10,000 with an unlimited amount to be raised from accredited investors.¹²⁷ With little restrictions on the type of issuer, the issuer cannot be an investment company under the Investment Company Act of 1940 or be subject to the reporting requirements of the Securities Exchange Act of 1934.¹²⁸ Likewise, the issuer's filing requirement is to notify the Tennessee securities commissioner that it "will offer or has sold securities" under the Tennessee crowdfunding exemption.¹²⁹ Within the filing requirement, there is no obligation for disclosing financial statements, business plan, or description of what the offering proceeds will be used for, but only giving the names and addresses of the issuer, persons selling the security on the issuer's behalf, and the escrow used.¹³⁰ Furthermore, the investors are subject to the resale restrictions from Rule 147(e) of nine months, which is less than the one year requirements from the SEC's proposed rule.¹³¹ In addition to disclosing this resale restriction to investors, the issuer only has to inform investors that the security is not registered, and there is no requirement to give investors a copy of a business plan or financial statements.¹³²

With this simplified approach, the risk of fraud by issuers and losing investors' trust in the issuers is higher than other approaches. Despite this risk, there have been companies that have been successful in offering under these simplified intrastate crowdfunding exemptions.¹³³ For example, a guitar market, Bohemian Guitars, was able to use the Georgia intrastate crowdfunding exemption to raise more than \$130,000,¹³⁴ which was more than its target goal of \$100,000.¹³⁵ Additionally in Georgia, Crowdvested.com has been a funding portal for both a residential project for a new home and a retail project for revitalization of a retail site.¹³⁶ In Kansas, Radius Brewing Company was able to raise about \$100,000 from twenty investors.¹³⁷ Although there are examples of successful business in these states, there have also been reports that companies have failed to reach their requirement target investment.¹³⁸ Companies blame this failure on a lack of knowledge that the crowdfunding exemption exists or how to proceed with the crowdfunding process.¹³⁹ To combat this issue, even though not required, portals in states with this approach have been created to provide investors with a secure place to purchase investments and have advertised their services through the media.¹⁴⁰ By advertising their services, the portals are able to promote the crowdfunding exemption, which saves marketing costs for issuers.¹⁴¹ Additionally, the portals also offer their services to help issuers comply with the crowdfunding exemptions, which can further reduce the issuer's costs for the exemption.¹⁴²

IV. The Preferred Approach

As shown from the foregoing, each approach presents many ad-

vantages and disadvantages. An approach that requires a portal along with additional requirements for the portal and reduces the disclosures for the issuer would be a preferred approach for any future intrastate crowdfunding exemptions and the finalization of the SEC's rule. This approach allows for the most investor safety while also reducing issuer costs, and the approach increases equity crowdfunding's presence and possibility as a successful capital funding method.

The requirements on the portal would increase investor safety because the portal would be a filter of potential fraud. By placing a due diligence requirement on portals, the liability exposure would deter portals from presenting offerings of suspect companies.¹⁴³ Likewise, the portals also have a public relations incentive to not present fraudulent offerings because investors would not want to invest with portals that have a history of fraudulent offerings.¹⁴⁴ Using the portal as a filter may be more effective than investors relying on the issuer's disclosures or solely the investors' collective wisdom being a filter.¹⁴⁵ The portals will likely have conducted many crowdfunding offerings, and this experience combined with the threat of liability will increase the portal's potential as an effective filter of fraudulent offerings. Furthermore, the use of portals as an effective tool for investor protection has started to be used in states that do not require portals for equity crowdfunding.¹⁴⁶ Since some intrastate equity crowdfunding exemptions are an experiment of how the exemptions should be tailored, using portals in states where they are not required further shows that portals should be mandatory for offerings under an intrastate equity crowdfunding exemptions.¹⁴⁷

In addition to investor protection, the use of portals can reduce issuer costs compared to the issuer costs associated with an approach that increases issuer disclosures.¹⁴⁸ A main source of reduced issuer costs is found in marketing costs of the offering and crowdfunding investing for investors. For example, Kickstarter is able to brand itself as a reliable platform of rewards-based crowdfunding, and the same can be done with equity crowdfunding portals.¹⁴⁹ For specialized portals, like Crudefund.com, investors can know the website to utilize for specific types of investments. The alternative is that investors have to market the offering on their own and advertise the strengths of crowdfunding to the public, which have both proved to be difficult and expensive tasks for small businesses seeking to use equity crowdfunding.¹⁵⁰ With portals marketing the ability to crowdfund on their websites, issuers reduce their total marketing costs of an offering and allow more of the capital to be used for disclosure and compliance with the crowdfunding exemption, which can further investor safety.¹⁵¹

As a practical matter, the use of portals will likely increase the ability of companies to raise capital through crowdfunding and the possibility of crowdfunding being successful. Equity crowdfunding has received much hype, but in some states, issuers have had trouble raising money through crowdfunding due to a lack of public knowledge about investing through crowdfunding.¹⁵² Since portals make more money by hosting more offerings, the portals have an incentive to promote crowdfunding that is likely greater than individuals conducting periodic offerings. This ability of portals to promote crowdfunding and be a reliable investing place has been attributed as part of the success of equity crowdfunding in Europe.¹⁵³ And by making crowdfunding more popular, the ability of the crowd's collective wisdom to be used as an effective tool for detecting fraud is greater, by both increasing the amount of offerings to compare and the amount of investors viewing the offerings.

A statute that follows this approach should also take on some aspects of the other approaches and the SEC proposal, such as a higher annual offering limit with audit requirements¹⁵⁴ and a scaled investment limit based on the investor's net worth and annual income.¹⁵⁵ The need for a higher offering limit is shown from the sponsor of Title III of the JOBS Act wanting to increase the limit of the federal crowdfunding exemption.¹⁵⁶ By scaling the investment limit and increasing the annual offering limit to more appealing levels for issuers, the success of crowdfunding is likely increased, while also maintaining investor protection. A proposed exemption that follows this approach is set forth in the appendix to this article.

V. Conclusion

The intrastate equity crowdfunding exemption movement is an exciting trend and increases the potential for small and local businesses to raise capital. By adopting their own exemptions, states can continue to tailor the exemptions to best combat the competing issues of protecting investors while also reducing issuer costs. In its proposed state, the SEC's rule does not effectively meet these demands and should be changed to follow the trend of the intrastate crowdfunding exemption. Within the three approaches in the intrastate crowdfunding exemption movement, an approach that places responsibility on the portal while decreasing the burdens on the issuer will likely produce the most workable option for the equity crowdfunding movement. By following this approach, crowdfunding can harness the crowds' wisdom, and Charles Mackay's tales can be avoided.¹⁵⁷

Appendix: Proposed Intrastate Crowdfunding Exemption¹

- a) **Coordination with Federal Securities Laws:** Securities offered in reliance on the exemption provided by this section must also meet the requirements of the federal exemption for intrastate offerings in § 3(a)(11) of the Securities Act of 1933 [15 U.S.C. § 77c(a)(11)], or Securities and Exchange Commission Rule 147 [17 CFR § 230.147].
- b) **Issuer:**
 - (1) The issuer is a [state] entity that has filed a certificate of formation with the [state] Secretary of State and is authorized to do business in [state] and:
 - (A) At least 80% of the issuer's gross revenues during its most recent fiscal year prior to the offering are derived from the operation of a business in [state];
 - (B) At least 80% of the issuer's assets at the end of its most recent semiannual period prior to the offering are located in [state];
 - (C) The issuer will use at least 80% of the net proceeds of this offering in connection with the operation of its business within [state]; and
 - (D) The issuer's principal office is located in [state].
 - (2) The issuer is not, either before or because of the offering:
 - (A) An investment company as defined by 15 U.S.C. § 80a-3, a hedge fund, commodity pool, or similar investment vehicle; or
 - (B) Subject to the reporting requirements of the Securities Exchange Act of 1934, § 13 or § 15(d), 15 U.S.C. § 78m and § 78o(d).
- c) **Offering:** The offering must be made exclusively through an Internet website operated by a registered [state] crowdfunding portal. The sum of all cash and consideration received for all sales of the securities in reliance on this exemption shall not exceed:
 - (1) One million dollars (\$1,000,000) in a 12-month period, if the issuer has not undergone and made available to each prospective investor and the [state] securities administrator the documentation resulting from a financial audit with respect to its most recently completed fiscal year and meeting generally accepted accounting principles; or
 - (2) Two million dollars (\$2,000,000) in a 12-month period,

if the issuer has undergone and made available to each prospective investor and the [state] securities administrator the documentation resulting from a financial audit with respect to its most recently completed fiscal year and meeting generally accepted accounting principles.

This amount is reduced by the aggregate amount received for all sales of securities by the issuer in another offering that does not take place prior to the six month period immediately preceding or after the six month period immediately following any offers or sales made in reliance upon this section.

- d) **Individual investments:** The aggregate amount of securities sold to any investor by an issuer in reliance on this exemption shall not exceed the greater of:
- (1) \$2,000, or 5 percent of the annual income or net worth of the investor, whichever is greater, if both annual income and net worth (excluding primary residence) are each less than \$100,000; and
 - (2) 10 percent of annual income or net worth of the investor, whichever is greater (not to exceed an amount sold of \$100,000), if both the annual income and net worth (excluding primary residence) of the investor are each equal to or more than \$100,000;

The issuer and [state] crowdfunding portal must have a reasonable basis for believing that the purchaser of a security under this section is a [state] resident and that the annual income and net worth are accurate.

- e) **Escrow:** All payments for purchases of securities offered under this section are directed to and deposited in an escrow account with a bank or other depository institution located in [state] and organized and subject to regulation under the laws of the United States or under the laws of [state], and will be held in escrow until the aggregate capital raised from all purchasers is equal to or greater than the minimum target offering amount specified in the disclosure statement as necessary to implement the business plan. Investors will receive a return of all their subscription funds if the target offering amount is not raised by the time stated in the disclosure statement.
- f) **Communications:**
- (1) All communications between the issuer, prospective purchasers, or investors taking place during the offer of securities pursuant to this section must occur through the Internet website of the [state] crowdfunding portal. During the time the offering appears on the

Internet website, the website must provide channels through which potential purchasers and investors can communicate with one another and with representatives of the issuer about the offering. These communications must be visible to all those with access to the offering materials on the Internet website.

- (2) Notwithstanding the foregoing, the issuer may distribute a notice within [state] limited to a statement that the issuer is conducting an offering, the name of the registered portal through which the offering is being conducted, and a link directing the potential investor to the portal's Internet website. The notice must contain a disclaimer that reflects that the offering is limited to [state] residents and offers and sales of the securities appearing on the Internet website are limited to persons that are [state] residents.

g) **Intrastate Crowdfunding Portal:**

- (1) A [state] crowdfunding portal:
 - (A) must be an entity incorporated or organized under the laws of [state], authorized to do business in [state], and engaged exclusively in intrastate offers and sales of securities in [state];
 - (B) must limit its activities to operating an Internet website utilized to offer and sell securities pursuant to this exemption; and
 - (C) does not operate or facilitate a secondary market in securities.
- (2) The Internet website operated by a [state] crowdfunding portal must meet the following requirements:
 - (A) the website must contain a disclaimer that reflects that access to securities offerings on the website is limited to [state] residents and offers and sales of the securities appearing on the website are limited to persons that are [state] residents;
 - (B) an affirmative representation by a visitor to the Internet website that the visitor is a resident of [state] is required before the visitor can view securities-related offering materials on the website;
 - (C) evidence of residency within [state] is required before a sale may be made to a prospective purchaser. An affirmative representation made by a prospective purchaser that the prospective purchaser is a [state] resident and proof of at least one of the following would be considered

sufficient evidence that the individual is a resident of this state:

- (i) a valid [state] driver license or official personal identification card issued by the State of [state];
 - (ii) a current [state] voter registration; or
 - (iii) general property tax records showing the individual owns and occupies property in this state as his or her principal residence.
- (D) prior to offering an investment opportunity to residents of [state] and throughout the term of the offering, the registered portal shall give the [state] Securities Commissioner access to the Internet website.
- (E) prior to permitting an investment in any securities listed on the Internet website, the portal shall obtain an affirmative acknowledgment from the investor of the following:
- (i) There is no ready market for the sale of the securities acquired from this offering, and selling or otherwise disposing of this investment may be difficult or impossible for an investor. The resale of this security is subject to the resale requirements of section (j) of this exemption. An investor may be required to hold and bear the financial risks of this investment indefinitely;
 - (ii) The securities have not been registered under federal or state securities laws and, therefore, cannot be resold unless the securities are registered or qualify for an exemption from registration under federal and state law;
 - (iii) In making an investment decision, investors must rely on their own examination of the issuer and the terms of the offering, including the merits and risks involved; and
 - (iv) No federal or state securities commission or regulatory authority has confirmed the accuracy or determined the adequacy of the disclosure statement or any other information on this Internet website.
- (F) Information about the issuer and the offering posted on the Internet website operated by the

registered portal consists of a copy of the disclosure statement required by subsection (h) of this section.

- (3) The information on the Internet website required by paragraph (3) of this subsection must be made available to the Commissioner and potential investors for a minimum of 21 days before any securities are sold in the offering.
- (4) Prior to offering securities to residents of [state], the [state] crowdfunding portal shall conduct a reasonable investigation of the background and regulatory history of each issuer whose securities are offered on the portal's Internet website and of each of the issuer's control persons. "Control persons" for purposes of this subsection means the issuer's officers; directors; or other persons having the power, directly or indirectly, to direct the management or policies of the issuer, whether by contract or otherwise; and persons holding more than 20% of the outstanding equity of the issuer. The portal must deny an issuer access to its Internet website if the portal has a reasonable basis for believing that:
 - (A) the issuer or any of its control persons is subject to a disqualification under paragraph (l) of this exemption;
 - (B) the issuer has engaged in, is engaging in, or the offering involves any act, practice, or course of business that will, directly or indirectly, operate as a fraud or deceit upon any person; or
 - (C) it cannot adequately or effectively assess the risk of fraud by the issuer or its potential offering.
- (5) A [state] crowdfunding portal shall not:
 - (A) offer investment advice or recommendations;
 - (B) compensate employees, agents, or other persons not registered with the Securities Commissioner for soliciting offers or sales of securities displayed or referenced on its platform or portal;
 - (C) hold, manage, possess or otherwise handle investor funds or securities;
 - (D) be affiliated with or under common control with an issuer whose securities appear on the Internet website;
 - (E) hold a financial interest in any issuer offering securities on the portal's Internet website; or
 - (F) receive a financial interest in an issuer as

compensation for services provided to or on behalf of an issuer.

- h) **Disclosure statement:** A disclosure statement must be made readily available and accessible to each prospective purchaser at the time the offer of securities is made to the prospective purchaser on the Internet website. The disclosure statement must contain all of the following:
- (1) Material information and risk factors. All information material to the offering, including, where appropriate, a discussion of significant factors that make the offering speculative or risky. Guidance on the categories of information to include can be found by reviewing the small business offering information provided by the [state] Securities Commission on its Internet website. Topics to be addressed include, but are not limited to:
 - (A) general description of the issuer's business;
 - (B) history of the issuer's operations and organization;
 - (C) management of the company and principal stockholders;
 - (D) how the proceeds from the offering will be used;
 - (E) financial information about the issuer;
 - (F) description of the securities being offered; and
 - (G) litigation and legal proceedings.
 - (2) Disclosures. The issuer shall inform all prospective purchasers and investors of the following:
 - (A) There is no ready market for the sale of the securities acquired from this offering; it may be difficult or impossible for an investor to sell or otherwise dispose of this investment. An investor may be required to hold and bear the financial risks of this investment indefinitely;
 - (B) The securities have not been registered under federal or state securities laws and, therefore, cannot be resold unless the securities are registered or qualify for an exemption from registration under federal and state law.
 - (C) In making an investment decision, investors must rely on their own examination of the issuer and the terms of the offering, including the merits and risks involved; and
 - (D) No federal or state securities commission or regulatory authority has confirmed the accuracy or determined the adequacy of the disclosure statement or any other information on this Internet website.

- (3) Financial statements. Issuers must provide current financial statements certified by the principal executive officer to be true and complete in all material respects. If the issuer has audited or reviewed financial statements, prepared within the last three years, such financial statements must also be provided to investors.
- (4) Summary of the Offering. Issuers must provide a summary of the offering, including:
 - (A) a description of the entity, its form of business; principal office, history, business plan, and the intended use of the offering proceeds, including compensation paid to any owner, executive officer, director, or manager;
 - (B) the identity of the executive officers, directors, and managers, including their titles and their prior experience and the identity of all persons owning more than 20% of the ownership interests of any class of securities of the company; and
 - (C) a description of the securities being offered and of any outstanding securities of the company, the amount of the offering, and the percentage ownership of the company represented by the offered securities.
- i) **Notice filing:** Before using any publicly available Internet website in an offering of securities in reliance on this section, the issuer shall file with the Securities Commissioner:
 - (1) Crowdfunding Exemption Notice; and
 - (2) The disclosure statement, required by subsection (h) of this section.
- j) **Resales of securities:** The issuer and all its officers, directors, and employees shall make the disclosures required by SEC Rule 147(e) and (f), 17 C.F.R. § 230.147(e) and (f). The issuer must place a legend on the certificate or other document evidencing that the securities have not been registered and setting forth the limitations on resale contained in SEC Rule 147(e), including that for a period of nine months from the date of last sale by the issuer of the securities in the offering, all resales by any person, shall be made only to [state] residents.
- k) **Commissions and remuneration:** A commission or other remuneration shall not be paid or given, directly or indirectly, for the offer or sale of the securities unless the person receiving such compensation is registered in [state] as a [state] crowdfunding portal.
- l) **Disqualifications:**

- (1) For purposes of this subsection, “control person” means an officer; director; other person having the power, directly or indirectly, to direct the management or policies of the issuer, whether by contract or otherwise; or a person that owns 20% or more of any class of the outstanding securities of the issuer.
- (2) This exemption is not available if the issuer, the issuer’s predecessors, any affiliated issuer, or any control person of the issuer:
 - (A) within the last five years, has filed a registration statement which is the subject of a currently effective registration stop order entered by any state securities administrator or the United States Securities and Exchange Commission;
 - (B) within the last five years, has been convicted of any criminal offense in connection with the offer, purchase, or sale of any security, or involving fraud or deceit;
 - (C) is currently subject to any state or federal administrative enforcement order or judgment, entered within the last five years, finding fraud or deceit in connection with the purchase or sale of any security; or
 - (D) is currently subject to any order, judgment, or decree of any court of competent jurisdiction, entered within the last five years, temporarily, preliminarily, or permanently restraining or enjoining such party from engaging in or continuing to engage in any conduct or practice involving fraud or deceit in connection with the purchase or sale of any security.
- (3) Paragraph (2) of this subsection shall not apply if:
 - (A) the party subject to the disqualification is licensed or registered to conduct securities-related business in the state in which the order, judgment, or decree creating the disqualification was entered against such party;
 - (B) before the first offer under this exemption, the state securities administrator, or the court or regulatory authority that entered the order, judgment, or decree, waives the disqualification; or
 - (C) the issuer establishes it did not know and exercising reasonable care, based on a factual inquiry, could not have known that a disqualification existed under this subsection.

- (4) This exemption is not available to an issuer if:
- (A) a control person of the issuer is also a control person of another issuer that has made a securities offering in [state] within the previous 12-month period;
 - (B) a control person of the issuer is also a control person of another issuer that is concurrently conducting a securities offering in [state]; or
- (C) the proceeds of the offering will be combined with the proceeds of a securities offering by another issuer as part of a single plan of financing.

NOTES:

¹Charles MacKay, *Extraordinary Popular Delusions and the Madness of Crowds* 63 (1841). The “tulipmania” was so severe that “[p]eople of all grades converted their property into cash, and invested it in flowers.” *See id.* at 65.

²*See id.* at 42.

³*See* Marshall Goldsmith, *The Madness of Crowds, Past and Present*, *BloombergBusiness* (Dec. 16, 2008), <http://www.bloomberg.com/bw/stories/2008-12-16/the-madness-of-crowds-past-and-presentbusinessweek-business-news-stock-market-and-financial-advice>.

⁴*See* James Surowiecki, *The Wisdom of Crowds* xiii (2004). At a county fair in 1907, the average of the crowd’s guesses of an ox’s weight was equal to the ox’s actual weight. *See id.*

⁵*See* Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 125 Stat. 306 (2012).

⁶*See id.*

⁷*See* Proposed Regulation Crowdfunding, Crowdfunding, SEC Release No. 33-9470 (Oct. 23, 2013), available at <http://www.sec.gov/rules/proposed/2013/33-9470.pdf> [hereinafter *SEC Proposed Regulation*].

⁸*See* JD Alois, Mary Jo White: “This Year we will be Focused on Implementing the Final Two Major Mandates of the JOBS Act,” *Crowdfund Insider* (Feb. 20, 2015, 11:33 A.M.), <http://www.crowdfundinsider.com/2015/02/63085-mary-jo-white-this-year-we-will-be-focused-on-implementing-the-final-two-major-mandates-of-the-jobs-act/>.

⁹Ruth Simon & Angus Loten, ‘Crowdfunding’ gets State-Level Test Run, *Wall St. J.*, Dec. 5, 2013, at B5.

¹⁰*See* Samantha Hurst, Update: London’s Camden Town Brewery Continues to Find Success on Crowdcube, *Crowdfund Insider* (Feb. 23, 2015, 4:12 P.M.), <http://www.crowdfundinsider.com/2015/02/63222-update-londons-camden-town-brewery-continues-to-find-success-on-crowdcube/>. In February 2015, a popular London craft brewery raised over £855,000 from nearly 860 investors over a period of three weeks. *See id.*

¹¹*The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. Securities and Exchange Commission, <http://www.sec.gov/about/whatwedo.shtml#VPeptC6M4uM> (last

visited Mar. 4, 2015).

¹²See *Crowdfunding*, Investopedia (last visited Mar. 4, 2015), <http://www.investopedia.com/terms/c/crowdfunding.asp>. See also CROWDFUNDING, Black's Law Dictionary (10th ed. 2014).

¹³See *SEC Proposed Regulation*, *supra* note 7, at 6-8.

¹⁴See *id.*

¹⁵See *id.*

¹⁶See Gregory T. Huang, Boston's Top-Funded Kickstarter Tech Projects of the Past Year, Xconomy (Feb. 11, 2015, 2:18 P.M.), <http://www.xconomy.com/boston/2015/02/11/bostons-top-funded-kickstarter-tech-projects-of-the-past-year/>.

¹⁷*The Stretch Goals*, Robert Space Industries, <https://www.robertsspaceindustries.com/funding-goals> (last visited Mar. 15, 2015).

¹⁸*Pebble Time*, Kickstarter.com, https://www.kickstarter.com/projects/597507018/pebble-time-awesome-smartwatch-no-compromises?ref=most_funded (last visited Mar. 16, 2015).

¹⁹Anthony Volastro & Eric Rosenbaum, A New King of Kickstarter is Crowned, CNBC (Aug. 27, 2014, 5:49 A.M.), <http://www.cnbc.com/id/101948741>.

²⁰See Editorial, How to Harm Investors, N.Y. Times, Mar. 30, 2014, at SR 10. Facebook paid \$2 billion to acquire Oculus VR, a company initially funded by \$2.4 million from 9,500 donations on Kickstarter. See *id.* Instead of a massive payout from investing in a successful start-up company, investors had simply received a t-shirt or product, and this result sparked interest in crowdfunding as a way for the average individual to discover a successful investment. See *id.*

²¹See 17 C.F.R. § 230.506 (2015). See also Joe Gose, *Real Estate Crowdfunding Grows up Fast for Investors*, Investor's Business Daily, Feb. 13, 2015, at A10. As defined in Rule 501(a) of Reg. D, accredited investors are individuals with annual income of \$200,000 (\$300,000 if married) from the most two recent years or net worth, excluding value of primary residence, of \$1,000,000. See 17 C.F.R. § 230.501(a) (2015). The definition for accredited investors also includes institutional investors with total assets in excess of \$5 million. See *id.*

²²See *id.*

²³See Ruth Simon and Eliot Brown, A Fundraising Creation Gets Real, Wall St. J., Jun. 12, 2014, at C1.

²⁴See *id.*

²⁵See *id.*

²⁶The SEC estimates that only 8.7 million households are accredited investors. See Joe Gose, *New Rules Shake Up Real Estate Investing*, Investor's Business Daily, Nov. 8, 2013, at A10.

²⁷See *SEC Proposed Regulation*, *supra* note 7, at 9.

²⁸"A funding portal is defined as a crowdfunding intermediary that does not: (i) offer investment advice or recommendations; (ii) solicit purchases, sales, or offers to buy securities offered or displayed on its website or portal; (iii) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (iv) hold, manage, possess, or otherwise handle investor funds or securities; or (v) engage in such other activities as the SEC, by rule, determines appropriate." Frequently Asked Questions About Crowdfunding Intermediaries, U.S. Securi-

ties and Exchange Commission (last visited Apr. 20, 2015), <https://www.sec.gov/divisions/marketreg/tmjjobsact-crowdfundingintermediariesfaq.htm>.

²⁹See *SEC Proposed Regulation*, *supra* note 7, at 10.

³⁰See *id.* at 11.

³¹See *id.* at 11-14.

³²See *id.* at § 100(a)(1-3). If registered as a “funding portal,” the portal is exempt from the broker requirements of Section 15(a)(1). See *id.*

³³See *id.* § 100(b).

³⁴See Ruth Simon and Angus Loten, Frustrations Rise over Crowdfunding Rules, *Wall St. J.*, May 1, 2014, at B3.

³⁵See *id.* § 201(t)(3).

³⁶See *id.* § 201(f)(i). The instructions to paragraph (i) require the issuer to “provide a reasonably detailed description of such intended use.” See *id.* at 478.

³⁷See *id.* § 203(a)(1).

³⁸See *id.* § 203(a)(3).

³⁹See *id.* § 202.

⁴⁰Steven Davidoff Solomon, S.E.C.’s Delay on Crowdfunding May Just Save It, *N.Y. Times* (Nov. 18, 2014, 2:56 P.M.), http://dealbook.nytimes.com/2014/11/18/s-e-c-s-delay-on-crowdfunding-may-just-save-it-2/?_r=0.

⁴¹See Andrew Ackerman, SEC Urged to Scale Back ‘Crowdfunding’ Rules, *Wall Street Journal* (Feb. 27, 2014, 3:14 P.M.), <http://www.wsj.com/articles/SB10001424052702304071004579409323759964120>.

⁴²See *SEC Proposed Regulation*, *supra* note 7, § 100(a)(3)(d).

⁴³See *id.* § 301.

⁴⁴See *id.* § 302(b).

⁴⁵See *id.* § 300(b)(2).

⁴⁶See *id.* § 302(d). Additionally, this compensation cannot be special or additional to payment for normal offering services. See *id.* § 402(b)(2)(iii).

⁴⁷See *id.* § 301(c)(2). This section requires the funding portal to “[d]eny access to its platform to an issuer if the intermediary . . . believes that the issuer or the offering presents the potential for fraud or otherwise raises concerns regarding investor protection.” *Id.*

⁴⁸See *id.* § 303(e).

⁴⁹See *id.* § 304.

⁵⁰See *id.* § 304(d).

⁵¹See *id.* § 501(a). The exempt transactions are “(1) [t]o the issuer of the securities; (2) [t]o an accredited investor; (3) [a]s part of an offering registered with the Commission; or (4) [t]o a member of the family of the purchaser or the equivalent, to a trust controlled by the purchaser, to a trust created for the benefit of a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance.” See *id.* § 501(a).

⁵²See *SEC Proposed Regulation*, *supra* note 7, § 303(c).

⁵³See *id.* See also *id.* at 177.

⁵⁴See *id.* § 303(c).

⁵⁵See *id.* at 175-77

⁵⁶See *Comments on Proposed Rule: Crowdfunding*, <http://www.sec.gov/comments/s7-09-13/s70913.shtml#comments> (last visited Mar. 4, 2015).

⁵⁷See Solomon, *supra* note 40.

⁵⁸See Simon & Loten, *supra* note 34.

⁵⁹See *SEC Proposed Regulation*, *supra* note 7, at 145.

⁶⁰See Simon & Loten, *supra* note 9.

⁶¹See Kan. Admin. Regs. § 81-5-21 (2015).

⁶²See Ga. Comp. R. & Regs. § 590-4-2-.08 (2015).

⁶³See NASAA, *Intrastate Crowdfunding Legislation*, NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION, <http://nasaa.cdn.s3.amazonaws.com/wpcontent/uploads/2014/12/NASAA-Crowdfunding-Index-9-16-2015.pdf>.

⁶⁴15 U.S.C.A. § 77c(a)(11) (2014). Section 3(a)(11) states that “[a]ny security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory.” Maine is the one exception as it is the only state to tie its intrastate crowdfunding exemption to Rule 504 of Regulation D. See Me. Rev. Stat. Ann. tit. 32, § 16304, sub-§ 6-A (2015).

⁶⁵17 C.F.R. § 230.147 (2015). To comply with Rule 147, the issuer needs to be organized within the state, have its principal office is within the state, derive at least 80% of gross income from within the state, have at least 80% of assets within state, intend to use and use at least 80% of net proceeds for business within state, and offer and sell to only state residents. See *id.* Additionally, all resales within nine months after the issue can only be made to state residents. See *id.*

⁶⁶See Solomon, *supra* note 40.

⁶⁷See Max Taves, *Deal of the Week: Detroit Tiger Stadium Redo Will Turn to ‘Crowdfunding’*, Wall St. J., Feb. 11, 2015, at C6.

⁶⁸Under Question 141.03, Section 3(a)(11) and Rule 147 do allow general solicitation and advertising, but offers can be made “only to persons within the state or territory of which the issuer is a resident.” *Compliance and Disclosure Interpretations: Securities Act Rules*, U.S. Securities and Exchange Commission, <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#141-03> (last visited Mar. 5, 2015).

⁶⁹See Joe Wallin, *The SEC Needs to Fix its Intrastate Crowdfunding Guidance*, Joe Wallin (Jul. 12, 2014), <http://joewallin.com/2014/07/12/sec-needs-fix-intrastate-crowdfunding-guidance/>.

⁷⁰See *Compliance and Disclosure Interpretations: Securities Act Rules*, U.S. Securities and Exchange Commission, <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm#141-03> (last visited Mar. 5, 2015). See also Joe Wallin, *Intrastate Crowdfunding Advertising*, Joe Wallin (Oct. 5, 2014), <http://joewallin.com/2014/07/12/sec-needs-fix-intrastate-crowdfunding-guidance/>.

⁷¹See NASAA, *supra* note 63.

⁷²See Solomon, *supra* note 40.

⁷³See *id.*

⁷⁴See Ackerman, *supra* note 41.

⁷⁵See 7 Tex. Admin. Code §§ 115.19; 139.25 (2014). The states that follow this approach are Iowa, *see* Iowa Code § 502.202(24) (2015); Minnesota, *see* Minn. Stat. § 80A.461 (2015); and Mississippi, *see* Miss. Code Ann. § 1-14-2.04 (West 2015). Other states that have portal requirements are Florida, *see* Fla. Stat. § 517.0611 (2015); Indiana, *see* Ind. Code Ann. § 23-19-2-2(27) (West 2015); Kentucky, *see* Ky. Rev. Stat. Ann. §§ 292.410-15 (2015); Nebraska, *see* Neb. Rev. Stat. § 8-1111(24) (2015); and Wisconsin, *see* Wis. Stat. Ann. §§ 551.202, 205 (West 2015), but these states do not relax their requirements on the issuer. *See infra* note 102.

⁷⁶CrowdPay.com Unveils Crowdfunding Escrow and Payment Service APIs for Texas Crowdfunding Portals (TCPs) to Meet Texas State Securities Board (TSSB) Filing Requirements, Marketwired (Feb. 13, 2015, 4:38 A.M.).

⁷⁷See 7 Tex. Admin. Code § 139.25(d), (i) (2014).

⁷⁸See *id.* § 139.25(i). This is in stark contrast to the requirements in the proposed rule. *See SEC Proposed Regulation, supra* note 7, § 201.

⁷⁹See *id.* § 139.25.

⁸⁰See *id.* § 139.25(h)(2)(B), (j).

⁸¹See *id.* § 139.25(e).

⁸²See *id.* § 139.25(k).

⁸³*Id.* § 139.25(d) [emphasis added].

⁸⁴See *id.* § 115.19(b).

⁸⁵See *id.* § 115.19(b)(5); 139.25(e),(h)(1).

⁸⁶See *id.* § 115.19(b)(5)

⁸⁷See *id.* § 139.25(h)(2-3).

⁸⁸See *id.* § 115.19(a).

⁸⁹See *id.* § 115.19(c).

⁹⁰See *id.* § 115.19(d).

⁹¹See *SEC Proposed Regulation, supra* note 7, § 301

⁹²See discussion *infra* Part III.B-C.

⁹³*Id.* § 115.19(d). The disqualifications provisions are listed in 7 Tex. Admin. Code § 139.25(m):

- (1) For purposes of this subsection, “control person” means an officer; director; other person having the power, directly or indirectly, to direct the management or policies of the issuer, whether by contract or otherwise; or a person that owns 20% or more of any class of the outstanding securities of the issuer.
- (2) This exemption is not available if the issuer, the issuer’s predecessors, any affiliated issuer, or any control person of the issuer:
 - (A) within the last five years, has filed a registration statement which is the subject of a currently effective registration stop order entered by any state securities administrator or the United States Securities and Exchange Commission;
 - (B) within the last five years, has been convicted of any criminal offense in connection with the offer, purchase, or sale of any security, or involving fraud or deceit;
 - (C) is currently subject to any state or federal administrative enforcement order or judgment, entered within the last five years, finding

fraud or deceit in connection with the purchase or sale of any security; or

- (D) is currently subject to any order, judgment, or decree of any court of competent jurisdiction, entered within the last five years, temporarily, preliminarily, or permanently restraining or enjoining such party from engaging in or continuing to engage in any conduct or practice involving fraud or deceit in connection with the purchase or sale of any security.
- (3) Paragraph (2) of this subsection shall not apply if:
 - (A) the party subject to the disqualification is licensed or registered to conduct securities-related business in the state in which the order, judgment, or decree creating the disqualification was entered against such party;
 - (B) before the first offer under this exemption, the state securities administrator, or the court or regulatory authority that entered the order, judgment, or decree, waives the disqualification; or
 - (C) the issuer establishes it did not know and exercising reasonable care, based on a factual inquiry, could not have known that a disqualification existed under this subsection.
- (4) This exemption is not available to an issuer if:
 - (A) a control person of the issuer is also a control person of another issuer that has made a securities offering in Texas within the previous 12-month period;
 - (B) a control person of the issuer is also a control person of another issuer that is concurrently conducting a securities offering in Texas; or
 - (C) the proceeds of the offering will be combined with the proceeds of a securities offering by another issuer as part of a single plan of financing.

⁹⁴See *id.*

⁹⁵See Dan Zehr, State Securities Board Oks First Texas Crowdfunding Portals, *Austin American-Statesman* (Feb. 13, 2015, 3:44 P.M.), <http://www.mysstatesman.com/news/business/state-securities-board-oks-first-texas-crowdfunding/nkBHk/>.

⁹⁶See Danielle Abril, Exclusive: Addison Oil and Gas Crowdfunding Platform Approved by State, *Dallas Business Journal* (Feb. 18, 2015, 1:18 P.M.), <http://www.bizjournals.com/dallas/blog/techflash/2015/02/exclusiveaddisonoil-and-gas-crowdfunding-platform.html>.

⁹⁷See *id.*

⁹⁸See Zehr, *supra* note 95. See also *Crowdfunding 101*, <http://www.massventure.com/crowdfunding-101/> (last visited Mar. 5, 2015).

⁹⁹See Abril, *supra* note 96; *truCrowd registered as a Texas Crowdfunding Portal*, *Marketwired* (Feb. 23, 2015, 4:02 A.M.). See also *Resource Center*, <http://www.crudefund.com/resources> (last visited Mar. 5, 2015).

¹⁰⁰See Zehr, *supra* note 95.

¹⁰¹See, e.g., Wash. Admin. Code § 460-99C (2014).

¹⁰²Although not exactly mirroring Washington's exemption, other states that similarly follow this approach include Arizona, see *Ariz. Rev. Stat. Ann.* § 44-1844(D) (2015); Florida, see *Fla. Stat.* § 517.0611 (2015); Idaho, see *Idaho Code Ann.* §§ 30-14-203, 301 (West 2015); Illinois, see 815 *Ill. Comp. Stat.* 5/4

(2015); Indiana, *see* Ind. Code Ann. § 23-19-2-2(27) (West 2015); Kentucky, *see* Ky. Rev. Stat. Ann. §§ 292.410-15 (2015); Maine, *see* Me. Rev. Stat. Ann. 32, § 16304, sub-§ 6-A (2014); Massachusetts, *see* 950 Mass. Code Regs. 14.402(B)(13)(o)(6) (2015); Michigan, *see* Mich. Comp. Laws Ann. § 451.2202A (West 2015), as amended by Public Act 264; Oregon, *see* Or. Admin. R. 441-035-0070 (2015); Vermont, *see* 4-4 Vt. Code R. § 7 (2015); and Wisconsin, *see* Wis. Stat. Ann. §§ 551.202, 205 (2015). The District of Columbia also follows this approach. *See* D.C. Mun. Regs. 26-B, §§ 250 to 256 (2015).

¹⁰³*Crowdfunding in Washington*, Washington State Department of Financial Institutions, <http://www.dfi.wa.gov/small-business/crowdfunding> (last visited Mar. 5, 2015).

¹⁰⁴*See* Washington Crowdfunding Form, available at <http://www.dfi.wa.gov/sites/default/files/forms/crowdfunding-form.docm> (last visited Apr. 20, 2015).

¹⁰⁵*See* *Crowdfunding in Washington*, Washington State Department of Financial Institutions, <http://www.dfi.wa.gov/small-business/crowdfunding> (last visited Mar. 5, 2015). The Department of Financial Institutions states that “while company personnel can prepare the information requested on the Washington Crowdfunding Form and file the appropriate documents with the Division, it is often beneficial for the company to seek the assistance of counsel experienced in securities law issues.” *Id.*

¹⁰⁶*See* Wash. Admin. Code § 460-99C-180 (2014). The MD&A requires companies to provide readers with “information necessary to an understanding of [a company’s] financial condition, changes in financial condition and results of operations.” 17 C.F.R. 229.303(a) (2014). The MD&A requirements are set forth in Item 303 of Regulation S-K (Management’s Discussion & Analysis of Financial Condition and Results of Operations). 17 C.F.R. 229.303 (2014).

¹⁰⁷*See* Wash. Admin. Code § 460-99C-110 (2014).

¹⁰⁸*See id.* § 460-99C-060.

¹⁰⁹*See id.*

¹¹⁰*Id.* § 460-99C-030. Within these issuer restrictions, two are of the industry that portals approved by the Texas State Securities Board will service, real estate and oil and gas. *See* Abril, *supra* note 94. Thus, if these Texas portals were operating in Washington, they would not be able to list issuers in these industries in Washington unless each issuer was given written permission by the director of the Washington Department of Financial Institutions. *See* Wash. Admin. Code § 460-99C-030 (2014).

¹¹¹*See id.* Looking at other exemptions, the Massachusetts exemption also does not allow oil and gas companies, but there is no provision that allows the Securities Division to make an exception to the rule. *See* 950 Mass. Code Regs. 14.402(B)(13)(o)(6) (2015).

¹¹²*See* Wash. Admin. Code § 460-99C-030(3) (2014). Looking at other exemptions, the Massachusetts and Michigan exemption allows investors to raise up to \$2 million, but required audited financial statements if the issuer seeks over \$1 million. *See* 950 Mass Code Regs. 14.402(B)(13)(o)(4) (2015).

¹¹³*See* Wash. Admin. Code § 460-99C-150 (2014).

¹¹⁴*See* § 460-99C-140, 210.

¹¹⁵*See* Solomon, *supra* note 40.

¹¹⁶*See* Gary Anglebrandt, Beer and Tea Business Taps New Way to Find Investors Amid the Crowd, Crain’s Detroit Business (Jan. 15, 2015, 12:43 P.M.), <http://www.crainsdetroit.com/article/20150111/NEWS/301119980>.

¹¹⁷See, e.g., Tenn. Code Ann. § 48-1-103(a)(13) (West 2014). In addition to Tennessee, states that have enacted relaxed exemptions with little requirements include Alabama, *see* Ala. Code § 8-6-11 (2015); Colorado, *see* Colo. Rev. Stat. Ann. § 11-51-304(6) (West 2015); Georgia, *see* Ga. Comp. R. & Regs. § 590-4-2-.08 (2015); Kansas, *see* Kan. Admin. Regs. § 81-5-21 (2015); Maryland, *see* Md. Code Ann., Corps. & Ass'ns § 11-601(16) (West 2015); Montana, *see* Mont. Code Ann. § 30-10-105(22) (2015); South Carolina, *see* S.C. Code Ann. Regs. 13-206 (2015); and Virginia, *see* Va. Code Ann. § 13.1-514(21) (2015).

¹¹⁸See Kan. Admin. Regs. § 81-5-21 (2015).

¹¹⁹See Tenn. Code Ann. § 48-1-103(a)(13) (2014).

¹²⁰See Solomon, *supra* note 40.

¹²¹See Tenn. Code Ann. § 48-1-103(a)(13) (2014).

¹²²The Tennessee exemption is 2 pages of a pdf document (*available at* <http://www.tn.gov/sos/acts/108/pub/pc0943.pdf>) as compared to the Washington exemption being 16 pages long in a pdf document (*available at* www.dfi.wa.gov/documents/rulemaking/securities/crowdfunding/crowdfunding-final-rule.pdf).

¹²³See Tenn. Code Ann. § 48-1-103 (2014).

¹²⁴*Id.* § 48-1-103(a)(13)(A)(iv).

¹²⁵*Id.* § 48-1-103(a)(13)(C).

¹²⁶See *id.* § 48-1-103(a)(13)(A)(iii). Additionally, this annual offering limit does not include amounts sold to certain individuals, such as officers, directors, or persons owning 10% or more of outstanding shares. See *id.* at § 48-1-103(a)(13)(B)(ii).

¹²⁷See *id.* § 48-1-103(a)(13)(A)(iii).

¹²⁸See *id.* § 48-1-103(a)(13)(A)(vi).

¹²⁹See *id.* § 48-1-103(a)(13)(A)(v).

¹³⁰See *id.*

¹³¹See *id.* § 48-1-103(a)(13)(A)(vii).

¹³²See *id.* § 48-1-103(a)(13)(A)(vii).

¹³³See Jamie McGee, New Crowdfunding Law Offers Hope, Not Magic, *Tennessean* (Dec. 6, 2014, 6:53 A.M.), <http://www.tennessean.com/story/money/2014/12/05/equity-crowdfunding-exemption-tennessee-jobs-act-sparkmarket/19972955/>.

¹³⁴See *id.*

¹³⁵Sparkling Interest in Equity Crowdfunding, *Venture Atlanta* (Sep. 25, 2014), <http://ventureatlanta.org/2014/09/sparking-interest-in-equity-crowdfunding/> [hereinafter *Sparkling Interest in Equity Crowdfunding*].

¹³⁶*Our Projects*, *Crowdvested.com*, <http://www.crowdvested.com/#ourprojects> (last visited Mar. 6, 2015).

¹³⁷See Simon & Loten, *supra* note 9.

¹³⁸See *id.* See also McGee, *supra* note 133.

¹³⁹Simon & Loten, *supra* note 9.

¹⁴⁰See *Sparkling Interest in Equity Crowdfunding*, *supra* note 135.

¹⁴¹See *id.*

¹⁴²See *id.*

¹⁴³See *SEC Proposed Regulation*, *supra* note 7, at 137.

¹⁴⁴See *id.* at 143.

¹⁴⁵See *id.* at 141-42.

¹⁴⁶See *Sparking Interest in Equity Crowdfunding*, *supra* note 135.

¹⁴⁷See *id.*

¹⁴⁸See *SEC Proposed Regulation*, *supra* note 7, at 143.

¹⁴⁹See Jenni Bergal, States Clear Way for Crowdfunding, The PEW Charitable Trusts (Aug. 21, 2014), <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2014/08/21/states-clear-way-for-crowdfunding>.

¹⁵⁰See Patricia Clark, Kansas and Georgia beat the SEC on Crowdfunding Rules. Now Others Are Trying, BloombergBusiness (Jun. 20, 2013), <http://www.bloomberg.com/bw/articles/2013-06-20/kansas-and-georgia-beat-the-sec-on-crowdfunding-rules-dot-now-others-are-trying>.

¹⁵¹See *id.*

¹⁵²See *id.* See also Jason Wiens, State Equity Crowdfunding Policies Hold Promise, Forbes (May 28, 2014, 10:18 A.M.), <http://www.forbes.com/sites/kauffman/2014/05/28/state-equity-crowdfunding-policies-hold-promise/>.

¹⁵³See Ackerman, *supra* note 41.

¹⁵⁴See Mich. Comp. Laws Ann. § 451.2202A (2015).

¹⁵⁵See *SEC Proposed Regulation*, *supra* note 7, § 100(a)(1-3).

¹⁵⁶See Simon & Loten, *supra* note 34.

¹⁵⁷See MacKay, *supra* note 1.

¹Since the preferred approach requires a portal, this proposed rule follows the Texas statute.