THE NEW FEDERAL CROWDFUNDING EXEMPTION: PROMISE UNFULFILLED

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On April 5, 2012, President Barack Obama signed into law a new federal securities law exemption for crowdfunded securities offerings. Crowdfunding—the use of the Internet to raise small amounts of money from a large number of contributors—has become incredibly popular outside the securities context. But the use of crowdfunding to sell securities has been stymied by federal securities regulation. Securities Act registration is simply too expensive for small, crowdfunded offerings, and, until now, none of the registration exemptions fit crowdfunding well. Moreover, the web sites that facilitate crowdfunding could be considered brokers if they hosted securities offerings, imposing additional regulatory costs.

The new crowdfunding exemption attempts to resolve both of those regulatory problems—by exempting crowdfunded offerings from the registration requirement of the Securities Act and by providing that crowdfunding sites that meet certain requirements will not be treated as brokers. However, the new exemption imposes substantial regulatory costs of its own and, therefore, will not be the panacea crowdfunding supporters

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hoped for. The regulatory cost of selling securities through crowdfunding may still be too high.

This article analyzes the requirements of the new crowdfunding exemption and discusses its flaws.

I. Introduction

On April 5, 2012, President Barack Obama signed into law the Jumpstart Our Business Startups (JOBS) Act,[1] which amends federal securities law in ways intended to benefit small to medium-sized businesses. Title III of the JOBS Act, known as the CROWDFUND Act,[2] creates a new federal securities law exemption for crowdfunded securities offerings.

Crowdfunding is the use of the Internet to raise money through small donations from a large number of people—the "crowd" in crowdfunding.[3] An entrepreneur, or anyone else who needs money, publishes an appeal for funds on a publicly accessible web site, and that appeal is communicated to the general public through the site. People who want to participate can contribute any amount from a few dollars to the entire amount the person needs.[4]

Internet-based crowdfunding is a recent phenomenon. Kiva, today's leading crowdfunding site, started in 2005,[5] and the term crowdfunding first appeared in 2006.[6] But crowdfunding has become a billion-dollar industry.[7] One recent offering on the Kickstarter crowdfunding site raised over $10 million.[8]

Crowdfunding offers significant promise for small business issuers, who face a capital funding gap.[9] Traditional sources of business financing—bank lending, venture capital, and angel investors—are unavailable to many startups and other very small offerings.[10] Fundraising is even more difficult for issuers located away from the major sources of capital because small business investors tend to focus on local investments.[11] Crowdfunding connects entrepreneurs who would not otherwise get financing to a new source of capital—public investors who would not traditionally be investing in small-business startups.[12]

But crowdfunding is not an unmitigated positive. It involves a potentially dangerous combination of investment risk and relatively unsophisticated investors. Crowdfunding involves sales to the general public, not just sophisticated or accredited investors, and many members of the general public are remarkably unsophisticated financially.[13] And investing in small business, particularly at the startup stage, is inherently risky. The potential for fraud and self-dealing is high,[14] and, even in the absence of wrongdoing, small businesses are much more likely to fail than more established companies.[15] Illiquidity is also a significant concern.[16]

Until now, issuers wishing to sell securities through crowdfunding have had to deal with two formidable obstacles under federal securities law. First, absent an exemption, those offerings would have to be registered under the Securities Act of 1933.[17] Registration is simply too expensive for the small offerings to which crowdfunding appeals, and none of the traditional exemptions from the registration requirement fits crowdfunding well.[18] Second, crowdfunding web sites hosting offerings of securities could be required to register as brokers under the Securities Exchange Act or as investment advisers under the Investment Advisers Act.[19]

Because of these regulatory issues, most crowdfunding sites in the United States have stuck with fundraising techniques that do not involve securities. In some cases, contributors merely donate money and receive nothing in return.[20] Other fundraising is done through pre-purchases, where, in return for the contribution, the contributor is promised a copy of the product the entrepreneur is developing.[21] Other entrepreneurs offer various types of non-financial rewards to contributors; for example, an entrepreneur making a movie might promise to put people's names in the credits if they contribute more than a specified amount.[22] None of these types of crowdfunding involves a security, so federal securities law is not an issue.[23]

But donations, pre-purchases, and non-financial rewards can only attract a limited number of investors. Crowdfunding can fulfill its promise as a capital-formation tool only if issuers are able to offer financial returns to investors—either interest on the funds invested or a share of the business's profits—and those types of investments would clearly be securities.[24]

The CROWDFUND Act attempts to facilitate the use of crowdfunding to sell securities by adding a new Section 4(6) offering registration exemption to the Securities Act.[25] Section 4(6) exempts offerings of $1 million or less, provided that no investor exceeds an individual investment cap based on the investor's annual income and net worth. The securities must be sold through an intermediary that meets the requirements of new section 4A(a) of the Securities Act, and the issuer must meet the requirements of new section 4A(b).[26] Resales of securities sold pursuant to the crowdfunding exemption are restricted.[27] (*For the reader's convenience, the full text of sections 4(6) and 4A appears in Appendix A*.)

The CROWDFUND Act includes a number of additional provisions. It creates a new category of regulated entity known as a "funding portal;" crowdfunding intermediaries that are not brokers must register as funding portals.[28] It preempts most state regulation of crowdfunded offerings and funding portals.[29] And it creates an important new liability provision for fraud or negligent misstatements in connection with section 4(6) offerings.[30]

In an earlier article, I explained why a crowdfunding exemption makes sense[31] and how such an exemption should be structured.[32] A reader who wants a full discussion of the policy arguments can turn to that article and to the articles others have written on the subject.[33] The key, as in all securities regulation, is to balance the capital formation benefits of crowdfunding against the cost of allowing those offerings, including possible investor losses.[34] To minimize investor losses without unduly increasing the cost to issuers, investors should be protected not through complicated, expensive mandatory disclosure requirements, but through less costly structural requirements.[35]

The new crowdfunding exemption is disappointing. It is poorly drafted, leaving many ambiguities and inconsistencies for the SEC or the courts to resolve. Its mandatory disclosure requirements are too complicated and expensive for the small offerings it is designed to facilitate. Its individual investment limits are too high, exposing investors to more risk than many of them can afford. Its regulation of crowdfunding intermediaries is haphazard, unnecessarily disadvantaging non-broker intermediaries, but failing to include a crucial investor protection provision. Its failure to include a "substantial compliance" provision to protect innocent and immaterial violations, coupled with its complicated regulatory requirements, makes inadvertent violations likely. And the new liability provision the Act adds is fairly draconian and will expose innocent but unsophisticated entrepreneurs to unexpected liabilities. Because of these and a number of other problems, the promise of crowdfunded securities offerings remains unfulfilled. The new exemption is not the regulatory panacea crowdfunding supporters hoped for, and it is unlikely to spawn a crowdfunding revolution.

Part II of this article is a brief legislative history of the crowdfunding exemption. Part III is a detailed analysis of the specific requirements of the exemption and the other provisions in the CROWDFUND Act. In Part IV, I discuss some of the new exemption's shortcomings.

II. A Brief Legislative History[36]

The crowdfunding exemption has a surprisingly short history. The first proposal to exempt crowdfunding from federal securities law came in 2010, when the Sustainable Economies Law Center petitioned the SEC to exempt offerings of $100,000 or less, provided that no single investor contributed more than $100.[37] Other exemption proposals followed,[38] but the SEC took no public action. In April, 2011, in an exchange with Congressman Darrell Issa,[39] SEC Chairman Mary Schapiro indicated that the SEC staff had been discussing crowdfunding[40] and promised to "[take] a fresh look" at ways to reduce the regulatory burdens on small business capital formation.[41] But, as it turned out, the SEC never had the opportunity to act.

In September, 2011, the White House publicly supported a crowdfunding exemption. The following sentence appeared in a ten-page "Fact Sheet and Overview" discussing President Obama's proposed job-creation measures: "The administration . . . supports establishing a 'crowdfunding' exemption from SEC registration requirements for firms raising less than $1 million (with individual investments limited to $10,000 or 10% of investors' annual income) . . . ."[42]

The first crowdfunding bill, House Resolution 2930, was introduced in Congress on September 14, 2011, by Representative Patrick McHenry, a Republican from North Carolina.[43] That proposal was endorsed by President Obama[44] and passed the House on November 3, 2011, by a bipartisan 407-17 vote.[45]

On November 2, 2011, Senator Scott Brown, a Republican from Massachusetts, introduced another crowdfunding bill, Senate Bill 1791, in the Senate.[46] On December 8, 2011, Senator Jeff Merkley, a Democrat from Oregon introduced a third crowdfunding bill, Senate Bill 1970.[47] The Senate took no immediate action on any of these bills.

After a brief lull, legislative activity accelerated in March. On March 8, 2012, the House passed the Jumpstart Our Business Startups (JOBS) Act, which incorporated Congressman McHenry's original crowdfunding bill with some minor changes, by a 390-23 vote.[48] On March 13, 2012, Senators Merkley and Brown, along with Senators Mary Landrieu and Michael Bennet, introduced a compromise crowdfunding bill, Senate Bill 2190.[49] When the JOBS Act came to the Senate floor, Senators Merkley, Brown and Bennet introduced an amendment, Senate Amendment 1884, to replace Representative McHenry's crowdfunding provisions.[50] The Senate agreed to the amendment by a 64-35 vote and passed the JOBS Act by a 73-26 vote.[51] The House accepted the amendment on March 27, 2012 by a 380-41 vote[52] and President Obama signed the amended JOBS Act, which became Public Law 112-106, on April 5, 2012.[53]

III. A Tour through the New Crowdfunding Exemption

A. Basic Structure[54]

The basic crowdfunding exemption is in new section 4(6) of the Securities Act, but that section draws heavily on new section 4A. Section 4(6) contains four requirements: (1) a limit on the amount of the offering; (2) a limit on the amount that each investor may invest; (3) a requirement that the offering be conducted through an intermediary that complies with section 4A(a) of the Act; and (4) a requirement that the issuer comply with section 4A(b) of the Act.[55] In addition to the basic exemption, the CROWDFUND Act adds several other important provisions: (1) disqualification provisions precluding certain issuers and intermediaries from participating in section 4(6) offerings; (2) a restriction on the resale of crowdfunded securities; (3) provisions preempting state securities law; and (4) a new liability section for people involved in section 4(6) offerings. All of these requirements are discussed below.

B. Offering Amount

The maximum amount that an issuer may sell in any 12-month period is $1 million.[56] It is a little unclear if that limit includes *all* securities sold by the issuer, or just securities sold pursuant to the section 4(6) exemption. The Act says that the aggregate amount sold "to all investors" by the issuer may not exceed $1 million, but it only expressly includes sales in the past 12 months in reliance on the section 4(6) exemption,[57] so sales pursuant to other exemptions arguably do not count against the $1 million cap.[58] Sales pursuant to other exemptions would, however, raise offering integration issues.[59]

The offering limit only looks backwards in time, so subsequent sales pursuant to other exemptions do not affect the section 4(6) dollar limit. Those subsequent sales could raise potential integration issues,[60] but, absent integration, they would not retroactively reduce the section 4(6) limit.

C. Requirements Imposed on Investors

The new crowdfunding exemption imposes three limits on investors: (1) a limit on the amount each investor may invest in a single crowdfunded offering; (2) a limit on the aggregate amount each investor may invest in all crowdfunded offerings; and (3) an investor-education requirement. The two investment limits depend on the investor's annual income and net worth and, in some cases, the statutory limit is unclear.

1. The Single-Issuer Investment Limit

The limit on the amount an investor may invest with a single issuer depends on the investor's net worth and annual income, with both calculated in accordance with SEC rules concerning such calculations for accredited investors.[61]

- *Both net worth and annual income less than $100,000*. If the investor's annual income and the investor's net worth are both less than $100,000,[62] the limit is the greatest of three numbers: $2,000, five percent of the investor's annual income, or five percent of the investor's net worth.[63]

- *Both net worth and annual income equal to or greater than $100,000*. If the investor's net worth and annual income are *both* equal to or greater than $100,000, the statute says the limit is "10 percent of the annual income or net worth," subject to a maximum of $100,000.[64] The statute does not say whether the limit is the greater or the lesser of the two 10% figures.[65] Assume, for example, that the investor's annual income is $150,000 and the investor's net worth is $200,000. Is the cap $15,000 or $20,000? The language is ambiguous, but the best interpretation is probably the lesser of the two amounts. The statute requires that the aggregate amount sold "*not exceed* . . . (ii) 10 percent of the annual income *or* net worth of such investor, . . ."[66] If the amount invested exceeds either one of the two, this requirement would not be met.

- *One equal to or greater than $100,000; one less than $100,000*. The statute is also ambiguous about what happens when one of the two figures—either net worth or annual income—is equal to or greater than $100,000 and the other is less than $100,000. Subsection 4(6)(B)(i), the lower limit, would apply in this case. It applies "if either the annual income or net worth of the investor is less than $100,000."[67] However, subsection 4(6)(B)(ii), the higher limit, would also apply. It applies "if either the annual income or net worth of the investor is equal to or more than $100,000."[68] Thus, if net worth is greater than $100,000 and annual income is less than $100,000, or vice versa, both limits apply. Unless the SEC or Congress clarifies this ambiguity, the only safe action is to limit investors to the lower amount.

This investment limit apparently only includes an investor's purchases pursuant to the section 4(6) exemption, although the Act is a little unclear. Section 4(6)(B) says that "the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction" may not exceed the limit.[69] When an issuer sells securities to an investor pursuant to the section 4(6) exemption and also sells securities to that same investor pursuant to some other exemption, does the "aggregate amount sold to any investor by the issuer" means the aggregate amount of *all* sales to that purchaser, or only the aggregate amount of the section 4(6) sales?

Read in context, this language may mean only the amount sold pursuant to the exemption. The subsequent reference to purchases in the prior 12 months "in reliance on the exemption" supports this reading. But that clause says only that the sales to be counted *include* those earlier section 4(6) purchases, not that section 4(6) purchases are the only ones to be considered. However, the aggregate investment limit discussed below clearly includes only section 4(6) sales,[70] so the single-issuer limit should probably be interpreted similarly.[71]

2. The Aggregate Investment Limit

The second investment limit is applied on an aggregate basis, considering all of an investor's crowdfunding purchases, not just those from a single issuer. This limit is not in section 4(6), but in section 4A(a), which requires crowdfunding intermediaries to "make such efforts as the Commission determines appropriate, by rule, to ensure that no investor in a 12-month period has purchased securities offered pursuant to section 4(6) that, *in the aggregate, from all issuers*, exceed the investment limits" discussed above.[72] The dollar limit is the same as the single-issuer limit, but the aggregate limit includes the aggregate amount the investor buys from *all* issuers in any 12-month period. Section 4A(a) says that no investor may "[purchase] securities *offered pursuant to section 4(6)*" that exceed the limit, so only purchases pursuant to section 4(6) are counted.

An investor's violation of this aggregate limit would affect the exemption differently than an investor's violation of the single-issuer limit. If an issuer sells more to an investor than the single-issuer limit allows, the exemption would be lost; section 4(6)(B) conditions the exemption on the amount sold to the investor not exceeding the limit.[73] The exemption is not conditioned on the investor's satisfaction of the aggregate limit, only on the intermediary taking the SEC-mandated steps to enforce the limit. If the crowdfunding intermediary made the requisite effort to enforce the aggregate limit, but an investor nevertheless exceeded it, the requirements of section 4A(a) would be met and the exemption would survive.

It is unclear what the SEC will require intermediaries to do to enforce this aggregate limit. The intermediary's records will show how much each investor has purchased through its site, but investors might also have purchased in section 4(6) offerings on other sites. The intermediary could ask the investor how much he has invested on other crowdfunding sites, but the answer might be intentionally or unintentionally incorrect. The only totally effective solution would be to establish a central recordkeeping system and require intermediaries to report every section 4(6) purchase. But a system like that would be expensive. Self-reporting by investors may be the only cost-effective method.

3. Investor Understanding/Education Requirements

To participate in a section 4(6) offering, investors must also review investor-education information, although exactly what that information will be is left to the SEC.[74] Investors must also answer questions demonstrating an understanding of

- the risk of investments in startups and other small businesses;
- the risk of illiquidity; and
- any other matters the SEC deems appropriate.[75]

Finally, investors must positively affirm that they understand they are risking their entire investment and that they can bear such a loss.[76]

D. Requirements Imposed on the Issuer

To qualify for the section 4(6) exemption, issuers must comply with the requirements in section 4A(b) of the Act.[77] Section 4A(b) imposes rather extensive disclosure requirements and also limits the issuer's solicitation of investors. The statute also limits the companies that may use the crowdfunding exemption[78] and requires the SEC to enact additional disqualifications by rule.[79]

1. Eligible Companies

To use the section 4(6) exemption, an issuer must be organized under the law of a U.S. state or territory or the District of Columbia[80] and may not be a reporting company under the Exchange Act.[81] Investment companies, or companies that would be investment companies but for the exclusions in section 3(b) or 3(c) of the Investment Company Act, are also ineligible to use section 4(6),[82] and the SEC is authorized to add other categories of ineligible issuers.[83] An issuer is also ineligible to use the section 4(6) exemption if it is subject to the disqualification provisions discussed later in this article.[84]

2. Issuer Disclosure Requirements

The Act imposes extensive disclosure requirements on issuers using the section 4(6) exemption. Issuers must file the required information with the SEC, and provide it to investors, potential investors, and the crowdfunding intermediary through which the offering is made.[85] The following categories of information must be disclosed.[86]

a. General Information about the Company

The issuer must disclose:

- Its name, legal status, physical address, and website address;[87]
- The names of its directors and officers and anyone with a similar status or function;[88] and
- A description of its business and its anticipated business plan.[89]

b. Financial Information

The issuer must provide "a description of the financial condition of the issuer."[90] This must include financial statements, but the exact requirement depends on the size of the offering.[91]

- *$100,000 or less*. If the target amount of the offering is $100,000 or less, the issuer must provide income tax returns for the most recent year, as well as financial statements certified by the issuer's principal executive officer to be true and complete in all material respects.[92]

- *$100,000-$500,000*. If the target amount of the offering is between $100,000 and $500,000, the issuer must provide financial statements reviewed by an independent public accountant, "using professional standards and procedures for such review or standards and procedures established by the Commission" for this purpose.[93]

- *More than $500,000*. If the target amount of the offering is more than $500,000, the issuer is required to provide audited financial statements.[94]

Nothing in the new exemption precludes an issuer from raising more than the specified target amount of the offering. Thus, an issuer might specify a target amount of $100,000, but actually raise more than $100,000. Since the required disclosure depends on the target amount, not the amount sold, this should not change the issuer's disclosure obligation.

c. Ownership and Capital Structure

The issuer must provide a description of its "ownership and capital structure."[95] This information must include all of the following:

- The terms of each class of the issuer's securities, including the class being offered, and a summary of the differences between the different classes;[96]
- A discussion of how the terms of the securities may be modified and how the rights of the securities being offered could be materially limited, diluted, or qualified by the rights of other classes;[97]
- A description of how the exercise of rights held by the principal shareholder of the issuer could negatively affect the purchasers of the securities being offered;[98]
- The names of each person holding more than 20 percent of the issuer's shares;[99]
- The name and ownership level of each existing shareholder who owns more than 20 percent of any class of shares;[100]
- How the securities being offered are being valued, "and examples of how such securities may be valued by the issuer in the future, including during subsequent corporate actions;"[101] and
- The risks to purchasers relating to minority ownership and future corporate actions, including additional issues of shares, a sale of the company or its assets, and transactions with related parties.[102]

d. Disclosure Concerning the Offering

The issuer is required to disclose certain information about the offering itself:

- The purpose of the offering and the intended use of the proceeds;[103]
- The target offering amount and the deadline to reach that target;[104] and
- The price of the securities being offered or the method for determining the price.[105] Prior to sale, the final price must be disclosed to the investor in writing, and the investor must be given a reasonable opportunity to rescind the commitment to purchase.[106]

e. Annual Reporting Requirement

In addition to the disclosures required at the time of the offering, issuers must file annual reports with the SEC and provide those reports to investors.[107] Those reports must include such information on the result of operations and financial statements as the SEC shall require.[108] The SEC is authorized to make exceptions to the annual reporting requirement and to specify a date after which the reporting obligation terminates.[109]

3. Restrictions on Solicitation

Section 4A(b) also imposes restrictions on solicitation by the issuer or others acting on its behalf. The issuer may not advertise the terms of the offering, other than directing investors to the intermediary through which the offering is conducted.[110] And the issuer is prohibited from compensating anyone for promoting the offering "through communication channels provided by the intermediary," unless it complies with SEC rules requiring disclosure of such compensation.[111]

4. SEC Authorized to Add Additional Requirements

The Act authorizes the SEC to add to the required disclosure any other information it feels is necessary "for the protection of investors and in the public interest."[112] The statute also allows the SEC to impose other requirements on the issuer "for the protection of investors and in the public interest."[113]

E. Regulation of Crowdfunding Intermediaries

Section 4(6) offerings must be conducted through a registered broker or funding portal that complies with section 4A(a) of the Securities Act.[114] Certain brokers and funding portals are disqualified from participating in section 4(6) offerings.[115] Section 4A(a) imposes a number of requirements on eligible intermediaries.[116] Among other things, they must make sure that the issuer's disclosure is provided to investors, enforce the investor education requirements, and limit the issuer's access to investor funds. All of these requirements, and others, are discussed below.

1. Registered Broker or "Funding Portal"

Crowdfunding intermediaries using the section 4(6) exemption must register with the SEC, either as brokers or as funding portals.[117] They must also register with any applicable self-regulatory organization.[118] The requirements that brokers register and belong to a self-regulatory organization are obviously not new.[119] But the "funding portal" category is new, created by the Act.

The Exchange Act defines a "funding portal" as "any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to section 4(6)."[120] Funding portals may not

- "offer investment advice or recommendations;"[121]
- "solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal;"[122]
- "compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;"[123]
- "hold manage, possess, or otherwise handle investor funds or securities."[124]

The SEC is authorized to impose additional restrictions on the activities of funding portals.[125]

Funding portals are not subject to the same requirements as brokers. The Act requires the SEC to exempt registered funding portals from registration as brokers or dealers under section 15(a)(1) of the Exchange Act, provided that the funding portal "remains subject to the examination, enforcement, and other rulemaking authority of the Commission."[126] However, the exemption for funding portals may be conditional, and the SEC may impose "such other requirements . . . as the Commission determines appropriate."[127]

Funding portals are not exempted from the requirement of membership in a national securities association.[128] In fact, the Act specifically conditions exemption from treatment as brokers on the portal's membership in a national securities association registered under section 15A of the Exchange Act.[129] However, the national securities association to which the funding portal belongs may apply to the funding portal only rules "written specifically for registered funding portals."[130]

2. Disclosure and Enforcement of Investor Requirements

Crowdfunding intermediaries must provide to potential investors any disclosures required by the SEC, including investor education materials and disclosures related to risks.[131] Crowdfunding intermediaries are required to enforce the investor education requirements discussed earlier,[132] ensuring that investors review the required investor-education information, answer the required questions, and make the required affirmations about risk.[133] The intermediary must also take such steps to enforce the aggregate investor limits as the SEC shall mandate.[134] Curiously, there is no analogous provision requiring the intermediary to enforce the $1 million offering limit applicable to the issuer.

At least 21 days prior to the first day on which an issuer sells securities to any investor, the crowdfunding intermediary must provide the issuer's disclosure to potential investors.[135] As a result of this requirement, a 21-day waiting period is automatically built into every crowdfunded offering.

3. Risk Reduction Steps

Crowdfunding intermediaries must "take such measures to reduce the risk of fraud" in section 4(6) transactions as the SEC shall establish by rule.[136] These steps must include background and securities enforcement regulatory history checks on the issuer's officers, directors, and persons holding more than 20 percent of the issuer's outstanding equity.[137]

4. Use of Proceeds

The intermediary must ensure that the issuer receives the offering proceeds only when the amount of capital raised equals or exceeds the issuer's stated target offering amount. Until then, investors must be allowed to cancel their commitments to invest, in accordance with rules to be adopted by the SEC.[138]

As explained earlier, issuers must disclose both a target offering amount and a deadline for reaching that target.[139] Although section 4A(a) requires the intermediaries to enforce the target amount, it says nothing about the deadline. If the issuer does not reach the target amount by the specified deadline, the statute does not prohibit the intermediary from allowing the issuer to continue the offering and draw on the funds if it subsequently hits the target. However, failure to comply with the stated deadline could constitute fraud, since the deadline could be construed as a representation that the issuer will not continue the offering beyond the deadline if the goal is not reached.

The statute does not prohibit the issuer from changing either the deadline or the target amount mid-offering.[140] Nor does the statute prevent the issuer from setting an artificially low target amount to ensure that the target is met, then accepting tenders of more than the target amount.

5. Privacy

Crowdfunding intermediaries must take steps to protect the privacy of information collected from investors. The exact requirements are left to the SEC.[141]

6. Compensation of Promoters

Crowdfunding intermediaries may not compensate "promoters, finders, or lead generators" for providing the personal identifying information of any potential investor.[142]

7. Conflict of Interest

The intermediary must prohibit its directors, officers, and partners (or any similar persons) from having any financial interest in any issuer using the intermediary.[143] This provision does not prohibit the intermediary itself from having such an interest, so intermediaries could own equity in issuers using their sites.

8. Other Requirements

The statute gives the SEC the authority to impose other requirements on crowdfunding intermediaries "for the protection of investors and in the public interest."[144]

F. Disqualification Provisions

The Act requires the SEC to adopt rules disqualifying certain issuers, brokers, and funding portals from participating in section 4(6) offerings.[145] Those rules must include disqualifications "substantially similar" to those in Rule 262 of the Regulation A exemption.[146] Rule 262 contains a number of "bad actor" disqualifications relating to the issuer, its predecessors, and affiliates;[147] directors, officers, general partners, and 10% beneficial owners of the issuer;[148] promoters;[149] underwriters of the securities being offered;[150] and partners, directors, or officers of the underwriters.[151] These disqualification provisions bar people who have been involved in various kinds of wrongdoing, mostly securities-related.

The Act adds other disqualifications in addition to those specified in Rule 262. One of those disqualifications applies to persons subject to certain final orders of state securities commissioners; state banking, savings and loan, or credit union regulators; state insurance commissioners; federal banking regulators; or the National Credit Union Administration.[152] A person is also disqualified if he "has been convicted of any felony or misdemeanor in connection with the purchase or sale of any security or involving the making of any false filing with the Commission."[153]

Rule 262 allows the SEC to waive the Regulation A disqualification for good cause.[154] Presumably, since the JOBS Act calls for "substantially similar" disqualification provisions, the SEC could include a similar waiver in the section 4(6) disqualification rule. However, the JOBS Act does not provide for a waiver of the specific disqualification provisions it includes, so it is not clear the SEC would have authority to waive those disqualifications.[155]

G. Resale Restrictions

Purchasers in a section 4(6) offering may not resell the securities for a year from the date of purchase.[156] There are five exceptions to this prohibition on resales:

- sales back to the issuer;[157]
- sales to accredited investors;[158]
- sales in a registered offering;[159]
- sales to a member of the purchaser's family "or the equivalent;"[160] or
- sales in connection with the death or divorce of the purchaser "or other similar circumstances."[161]

The SEC is also authorized to impose other limitations on resales.[162]

H. Preemption of State Law

1. State Offering Registration Requirements

Securities sold pursuant to the section 4(6) crowdfunding exemption are "covered securities" under section 18(b)(4) of the Securities Act.[163] As a result, states may not require the registration or qualification of section 4(6) offerings, or regulate section 4(6) offering documents.[164]

For some categories of covered securities, section 18(c) of the Securities Act allows states to require the filing of documents filed with the SEC, as well as annual or periodic reports on the value of securities sold within the state.[165] The states may also in some cases require issuers to pay filing or registration fees.[166] The drafters of the new crowdfunding exemption clearly did not intend to allow the states to require such filings or fees for section 4(6) offerings, with two exceptions: (1) the state in which the principal place of business of the issuer is located; and (2) any state in which the purchasers of 50 percent or more of the dollar amount of the offering reside.[167]

Unfortunately, there's a drafting error in the JOBS Act.[168] The JOBS Act adds a new subsection section 18(c)(2)(F) to the Securities Act that applies to securities that are covered securities pursuant to subsection (b)(4)(B).[169] The drafters clearly intended for subsection (F) to cover section 4(6) securities—the heading of subsection (F) is "FEES NOT PERMITTED ON CROWDFUNDED SECURITIES."[170] But crowdfunded securities are covered securities under subsection 18(b)(4)(C), not (B). Section 18(b)(4)(B) covers securities in transactions that are exempt pursuant to section 4(4) of the Securities Act,[171] which has nothing to do with crowdfunding. The statutory cross-reference is just wrong.[172]

The JOBS Act preemption of state law "relate[s] solely to State registration, documentation, and offering requirements, . . . and . . . [has] . . . no impact on other State authority to take enforcement action with regard to an issuer, funding portal, or any other person or entity using the . . . [section 4(6) exemption]."[173] States retain authority in section 4(6) transactions with respect to fraud or deceit or unlawful conduct by a broker, dealer, funding portal, or issuer.[174] And the Act requires the SEC to make the disclosure provided by section 4(6) issuers and crowdfunding available to the states,[175] which should facilitate state antifraud enforcement.

2. State Regulation of Crowdfunding Intermediaries

State regulation of crowdfunding intermediaries is also affected by the new crowdfunding provisions. The Act does not disturb state authority over brokers, even if those brokers are operating as crowdfunding intermediaries.[176] But new section 15(i)(2) of the Exchange Act provides, with one exception, that states may not "enforce any law, rule, regulation, or other administrative action against a registered funding portal with respect to its business as such."[177] There is a limited exception for the state which is the funding portal's principal place of business,[178] but the principal place of business may not impose any requirement that is "in addition to or different from the requirements for registered funding portals established by the Commission."[179]

I. The New Liability Section

Sales of securities pursuant to the section 4(6) exemption are subject to the same Securities Act and Exchange Act liability rules as other offers and sales, but the CROWDFUND Act adds a new liability provision applicable only to section 4(6) offerings. New section 4A(c) of the Securities Act imposes liability for false or misleading statements and omissions in "any written or oral communication, in the offering or sale of any security in a transaction exempted by the provisions of section 4(6)."[180] Fraud is defined similarly to other federal securities law fraud provisions, such as Rule 10b-5[181] and section 17 of the Securities Act[182]: a communication that "makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading."[183]

Any person "who purchases a security in a transaction exempted by the provisions of section 4(6)" may bring an action under section 4A(c).[184] Presumably, this limits the action to those who actually purchased from the issuer in the offering and would bar subsequent purchasers, since they would not have purchased the security in the section 4(6) transaction.[185] Plaintiffs who prove a violation may tender the security and recover the consideration paid with interest, "less the amount of any income received thereon."[186] If the plaintiff no longer owns the security, the plaintiff may recover damages;[187] the statute does not say how to calculate those damages.

The plaintiff is not required to prove that the fraud caused the plaintiff's loss. Section 4A(c) incorporates the negative causation defense of section 12(b) of the Securities Act, which places the loss causation burden on the defendant.[188] A defendant may avoid liability for all or part of the amount that would otherwise be recoverable by showing that the depreciation in value resulted from something other than the fraud.[189]

Plaintiffs also do not have to prove that the defendant acted with scienter, but defendants may avoid liability by proving that they "did not know, and in the exercise of reasonable care could not have known, of such untruth or omission."[190] This language is identical to the language in section 12(a)(2) of the Securities Act,[191] and presumably will be interpreted in the same way. Section 4A(c), like sections 11 and 12(a)(2) of the Securities Act,[192] expressly bars plaintiffs who themselves had knowledge of the untruth or omission from recovering.

Section 4A(c) imposes liability on "issuers,"[193] but the term issuer is broadly defined to include not only the actual issuer, but also

> any person who is a director or partner of the issuer, and the principal executive officer or officers, principal financial officer, and controller or principal accounting officer of the issuer (and any person occupying a similar status or performing a similar function) that offers or sells a security in a transaction exempted by the provisions of section 4(6), and any person who offers or sells the security in such offering.[194]

This definition raises several issues. First, it is unclear if the parenthetical "(and any person occupying a similar status or performing a similar function)"[195] applies only to the controller or principal accounting officer or applies to all the categories listed prior to the parenthetical.[196]

Second, it is unclear if the listed directors, partners, and officers must themselves offer or sell the securities to be "issuers." The phrase "that offers or sells a security in a transaction exempted by the provisions of section 4(6)"[197] appears to modify the word "issuer," so the listed individuals do not themselves have to offer or sell securities to be liable, only be connected to an issuer that offers or sells pursuant to section 4(6). But the "offers or sells" clause could be read to modify all of the listed defendants, requiring them to offer or sell the securities to be liable. However, the listing of directors and officers would then be redundant, since "issuer" already includes "any person who offers or sells the security" in a section 4(6) offering.[198] The terms "offer" and "sell" are not defined in section 4A, so the usual Securities Act definitions[199] would presumably apply, incorporating the Supreme Court's analysis of "seller" for purposes of section 12 in *Pinter v. Dahl*.[200]

Finally, it is unclear if the non-issuer issuers are liable only for their own fraud, or also for the issuer's fraudulent statements. Clearly, the listed defendants would be liable for false and misleading statements they personally make in connection with the issuer's offering. If, for example, the issuer's CEO directly made a material misstatement to an investor, the CEO could be liable for that statement. If that is all section 4A(c) does, its effect will be limited. In many cases, the issuer's directors, officers, and others covered by the definition of "issuer" will not make any statements directly to crowdfunding investors, especially given the Supreme Court's recent restrictive interpretation of what it means to "make" a statement.[201]

But section 4A(c) could be read to make the non-issuer issuers liable for statements *made by the issuer,* even if they did not personally make any statements. The argument is that "issuer" consists of all the listed people collectively and whenever the collective "issuer" makes a false statement everyone in that collective "issuer" is liable. This interpretation would explain how directors, partners, and officers could be liable as issuers, even if they did not offer or sell any securities.

The section 4A(c) cause of action is subject to the same statute of limitations in section 13 of the Securities Act that would apply to an action under section 12(a)(2).[202] Under section 13, an action must be brought "within one year after the discovery of the untrue statement or the omission, or after such discovery should have been made by the exercise of reasonable diligence," but in no event later than three years after the sale in question.[203]

J. Interaction with Other Offerings

A section 4(6) crowdfunded offering cannot always be considered in isolation. The issuer might have already sold securities, or may subsequently sell securities, pursuant to some other exemption. If so, the issuer needs to consider how those other offerings affect the crowdfunding exemption, and vice versa. Sales by other companies controlled by, or under common control with, the issuer could also present a problem.

1. Determining the Aggregate Offering Price

One potential problem has to do with limits on the amount of securities sold. Section 4(6) limits issuers to $1 million in any 12-month period.[204] As previously discussed, although the statute is a little unclear, that $1 million limit probably does not include securities sold pursuant to other exemptions unless the two offerings are integrated.[205]

Amounts sold pursuant to the section 4(6) exemption would also not affect the aggregate offering price limits in other exemptions as those exemptions are currently worded. The primary Securities Act exemptions with aggregate offering price limits are Regulation A and Rules 504 and 505 of Regulation D. Regulation A's $5 million limit is reduced only by the amount of other Regulation A sales.[206] The Rule 504 and 505 limits, $1 million and $5 million respectively, are reduced by sales of securities "in reliance on any exemption under section 3(b) [of the Securities Act], or in violation of section 5(a) of the Securities Act."[207] The new crowdfunding exemption, created by Congress, is not a section 3(b) exemption.[208] And, if an offering complies with section 4(6), the sales would be exempted from section 5[209] and would not violate section 5(a). Therefore, sales pursuant to the new section 4(6) exemption would not affect the dollar amounts available under these other small offering exemptions.

2. Integration Issues

Integration is another possible problem for section 4(6) offerings. To avoid registration under the Securities Act, an issuer's entire offering must meet the requirements of a single exemption; the issuer may not use two or more exemptions to cover parts of what is essentially a single transaction.[210] Section 4(6), like other Securities Act exemptions, exempts "transactions," so the entire transaction must fall within the exemption.[211] If the issuer sells securities outside of section 4(6), the question is whether those other sales would be considered part of the same transaction and destroy the section 4(6) exemption.

The SEC uses a five-factor test to determine when to integrate ostensibly separate offerings and treat them as part of the same offering. The five-factor test asks whether (1) the different offerings are part of a single plan of financing; (2) the offerings involve the same class of security; (3) the offerings are made at or about the same time; (4) the same type of consideration is paid for the securities sold; and (5) the offerings are for the same general purpose.[212]

Application of the integration doctrine is difficult, to put it mildly. SEC staff interpretations of the test in no-action letters have been confusing and inconsistent.[213] Even experts have difficulty applying the doctrine: "Everyone seems to agree that these criteria are nearly impossible to apply, principally because neither the Commission nor the courts have ever adequately articulated how . . . [the five factors] . . . are to be weighed or how many factors must be present in order for integration to occur."[214] For this reason, an issuer who sells other securities outside the section 4(6) exemption cannot be sure the exemption is available.

Issuers using other Securities Act exemptions can avoid the five-factor integration test by using integration safe harbors within those exemptions.[215] Section 4(6) has no such integration safe harbor, or at least nothing styled as such. Section 4A(g),with the heading "Rule of Construction," provides: "Nothing in this section or section 4(6) shall be construed as preventing an issuer from raising capital through methods not described under section 4(6)."[216] The purpose of section 4A(g) is unclear, but, if it was intended to protect section 4(6) offering from integration with other offerings, its language is incredibly vague in carrying out that intention. Absent a very generous interpretation of section 4A(g), issuers who have offered or sold securities outside section 4(6) must look to the five-factor test to determine the effect of those other offers and sales on their section 4(6) offerings.

3. The "Control" Language and Issuer Integration

Sales of securities by other companies controlled by, or under common control with, the issuer could also be problematic. The SEC sometimes integrates offerings by legally separate, but related, companies.[217] If, for example, Issuer A and Issuer B are related companies and they each offer securities at roughly the same time, the SEC might treat those two sales as a single offering. Section 4(6) includes some puzzling language that might accomplish a similar result.

Section 4(6) exempts offers or sales "by an issuer (including all entities controlled by or under common control with the issuer) . . . ."[218] The purpose and meaning of the parenthetical are unclear, but it could be interpreted to require that the offerings of two issuers be integrated if they are in a control relationship, even though each issuer is offering its own, separate security. At a minimum, it should include within the offering sales by the other entity of the section 4(6) issuer's securities.

Sales by those other companies could affect the section 4(6) exemption in two ways. First, those sales could apply to the issuer's $1 million limit. Second, to the extent that the controlled company's sales are treated as the issuer's for purposes of section 4(6), an investor's purchases from the controlled company would be counted against the individual investment limits.

The "control" parenthetical could affect the exemption even in situations where the company controlled by or under common control with the issuer is not selling securities. For example, do the issuer disclosure requirements in section 4A(b) incorporate this control relationship idea, so that an issuer must disclose information about companies controlled by, or under common control with, the issuer? Does the control language sweep these affiliates into the provision of section 4A(c) imposing liability on "issuers,"[219] making them also potentially liable? The answer to these questions is unclear.

K. Exclusion from Exchange Act § 12(g)

The CROWDFUND Act contains one final, important provision. An issuer's obligation to register and file reports under the Exchange Act sometimes depends on the number of record holders of the issuer's securities.[220] The CROWDFUND Act requires the SEC to "conditionally or unconditionally" exclude section 4(6) purchasers from the count of record holders. [221] Once the SEC adopts the required rule, issuers need not worry about crowdfunded sales triggering Exchange Act registration.[222]

L. SEC Rulemaking

Many of the requirements of the new crowdfunding exemption turn on compliance with rules to be adopted by the SEC. Until the SEC adopts those rules, there is no effective exemption.[223] The Act requires the SEC to issue all required rules no later than 270 days after enactment of the statute.[224] President Obama signed the bill on April 5, 2012, so the deadline for rulemaking is December 31, 2012. The SEC has already begun to solicit public comments on these and other rules required by the JOBS Act,[225] but it is unclear if it will meet the deadline.[226] It still has not completed the rulemaking required by the Dodd-Frank Act, even though the deadlines for those rules have long since passed.[227]

In addition to the required rulemaking, the Act in many places authorizes the SEC to modify the exemption's requirements. The Act also includes a general authorization of "such rules as the Commission determines may be necessary or appropriate for the protection of investors."[228] Appendix B lists all the areas in which SEC rulemaking is specifically required or permitted.

The SEC's rules could toughen the requirements of the statutory exemption. SEC Chairman Mary Schapiro and Commissioner Luis Aguilar both spoke against the JOBS Act prior to its passage.[229] And the Act requires the SEC, in the course of its crowdfunding rulemaking, to consult with state securities regulators and any relevant national securities association.[230] The North American Securities Administrators Association, the organization of state securities regulators, was critical of the JOBS Act,[231] so the state regulators will probably be active participants in the regulatory process.

IV. A Selective Critique of the New Exemption

I have already pointed out a number of specific problems with the new crowdfunding exemption. In this section, I will offer several more general criticisms.

A. The New Exemption is Not Well Drafted

The crowdfunding exemption includes a number of ambiguities, internal inconsistences, and outright drafting errors. These problems introduce unnecessary complexity into the exemption and will increase the cost to small business issuers using the exemption.

The most obvious drafting error is in the preemption provisions, where the drafters included a careless cross-reference to the wrong subsection of the Securities Act.[232] The other glaring drafting mistake appears in the individual investment limits, where the statute applies *both* the lower limit and the higher limit in some cases.[233]

Many of the drafting problems are less blatant, involving ambiguities rather than obvious mistakes. The individual investment limits provide an example of this type of problem. For wealthier investors, the limit is "10 percent of the [investor's] annual income or net worth," but the Act does not say whether the limit is the greater or the lesser of those two figures.[234] The drafters clearly knew how to deal with this issue; the limit for less wealthy investors is "the greater of" three amounts. They just failed to take equal care in drafting the limit for wealthier investors.

At several places, the Act includes troublesome language whose meaning is unclear. For example, what exactly is the purpose of the parenthetical, "(including all entities controlled by or under common control with the issuers)" at the beginning of section 4(6)?[235] What is the effect of including other people in the definition of "issuer" for purposes of liability under section 4A(c)?[236]

The statute is also internally inconsistent in places. That is not necessarily a problem, if the inconsistency was intentional, but most of the inconsistencies appear to be unintentional. Consider, for example, the issuer disclosure requirements of section 4A(b). At one point, the statute requires the issuer to disclose the names of every person owning more than 20 percent of its shares.[237] But, elsewhere, the issuer is required to disclose the names of each person owning more than 20 percent *of any class* of its shares.[238] The two are not, of course, identical.

This example illustrates another persistent problem in the statute—the assumption that issuers will be corporations. Many small issuers using the section 4(6) exemption will be limited liability companies, partnerships, or even sole proprietorships. Those entities must translate the language of the exemption into non-corporate equivalents.

These drafting issues are not surprising. The substitute crowdfunding amendment was introduced on March 21, 2012, the day before the Senate agreed to the amendment and approved the JOBS Act. Senate Bill 2190, the original Merkley-Brown compromise bill on which the amendment was based, was not introduced until March 13, 2012. Neither bill was subjected to committee hearings or markup. The Act clearly could have benefitted from more thorough consideration and markup. The SEC and users of the exemption now have to deal with the consequences.

B. The Exemption is Too Complicated and Expensive

To be useful to small business issuers, a crowdfunding exemption needs to be relatively simple and inexpensive. Regulatory cost is, after all, why registration is not a viable option for these offerings.[239] The largest section 4(6) offering will only be for $1 million and many offerings could be for much less than that. For offerings that small, it will not take much regulatory cost to eliminate crowdfunding as an option.

In addition, any regulatory requirements that are imposed on issuers need to be relatively simple and easy to comply with.[240] The entrepreneurs behind these small startup companies often lack legal and financial sophistication. And complicated filing and disclosure requirements invariably demand lawyers and accountants, increasing the expense of using the exemption.

The issuer disclosure requirements in the new crowdfunding exemption are neither simple nor inexpensive. Issuers must furnish full financial statements for even the smallest offerings. Those financial statements must be reviewed by independent public accountants if the offering is for $100,000 or more, and audited if the offering is for more than $500,000.[241] And, unlike other small business exemptions, the crowdfunding exemption imposes continued, annual reporting requirements even after the offering is completed.[242]

Not only is the amount of disclosure excessive, some of the disclosure items require a rather sophisticated understanding of corporate law and finance. Consider, for example, sections 4A(b)(1)(H)(iv) and (v) of the statute. Subsection (H)(iv) requires the issuer to explain "how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions."[243] Subsection (H)(v) requires the issuer to explain "the risks to purchasers of the securities relating to minority ownership in the issuer, [and] the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related parties."[244] To comply with these two requirements, a budding entrepreneur must have the foresight to predict the future transactions in which the business might engage and the knowledge of corporate finance needed to describe how securities might be valued in those transactions and the risks those future transactions could present to security holders. The entrepreneur must also have the legal knowledge necessary to explain the pitfalls of minority ownership.

The detailed disclosure requirements in the Act, coupled with the new liability section, are a liability trap for unwary, unsophisticated entrepreneurs. Some issuers are bound to bungle the extensive, complicated disclosures required by the exemption. Since the new liability section has no scienter requirement, those issuers will be liable even if their failure to disclose properly was merely negligent, not intentional.

C. The Individual Investment Limits are Too High

The limits on how much each investor may invest in crowdfunded securities offerings are an important investor protection feature. Small business offerings are risky and investor losses are likely.[245] Unsophisticated investors may not adequately understand or evaluate that risk.[246] Appropriate investment limits eliminate the possibility of a catastrophic loss and limit losses to what each investor can bear.[247]

The limits in section 4(6) are too high to fulfill that policy goal. Anyone, regardless of their net worth or annual income, may invest $2,000 per year.[248] That is more than some people can afford to lose, especially on an annual basis. And, if the investor's annual income or net worth is higher, the investor may invest five or ten percent of that annual income or net worth, and continue to invest that amount year after year.[249] It is doubtful that most people, especially those in the lower income categories, have sufficient free cash flow or savings to afford to lose five or ten percent of their net income. Although there is no magic number, and reasonable people can disagree as to the appropriate investor limit, the limits in the Act seem excessive.

D. The Exemption Needs a "Substantial Compliance" Rule

To qualify for the crowdfunding exemption, both issuers and crowdfunding intermediaries must comply with a number of detailed requirements. Compliance with *all* of those requirements is a condition of the exemption.[250] If the crowdfunding intermediary fails to comply with any of the requirements of section 4A(a) or if the issuer fails to comply with any of the requirements of section 4A(b), the exemption is unavailable. It does not matter how important or trivial the violation is, nor does it matter whether the issuer or the intermediary reasonably believed they were in compliance—the exemption is conditioned on compliance with *all* of the requirements and any violation results in the loss of the exemption.

If, for example, the issuer sells more than $1 million worth of securities in a 12-month period, the exemption would be lost for all of the sales, not just those that put the issuer over the limit. If the intermediary fails to properly qualify some of the investors by requiring them to answer the investor education questions, the exemption would be lost as to all investors.

If the statute is read literally, the loss of the exemption might even be retroactive. One of the conditions of the exemption is that the issuer file post-offering annual reports.[251] If the issuer failed to file a required annual report sometime after the offering, the issuer would not meet all of the requirements of section 4A(b), and section 4(6) would not exempt the offering.

The consequence of even a minor violation is drastic. Absent an exemption, section 5(a)(1) of the Securities Act makes it unlawful to sell a security unless a registration statement is in effect.[252] If the offering does not meet the requirements of section 4(6), no exemption would be available, and all of the sales in the offering would violate section 5(a)(1). The issuer would be liable to all of the purchasers for rescission under section 12(a)(1) of the Securities Act.[253]

Both the Regulation A exemption and the Regulation D exemption now include "substantial compliance" rules that protect an issuer even if the issuer failed to comply with the exemption in certain insignificant ways.[254] Regulation D also includes several provisions that protect the issuer if it reasonably believed the requirements of the rule were met, even if they actually were not.[255]

Section 4(6) needs a similar substantial compliance rule. In the absence of such a rule, the exemption's mix of complicated requirements and relatively inexperienced issuers could prove fatal. Inadvertent violations are likely, and the consequence of any violation, no matter how minor, will be loss of the exemption and liability to all of the investors for the full amount invested.

E. Problems with the Regulation of Funding Portals and Other Crowdfunding Intermediaries

The new exemption's regulation of crowdfunding intermediaries poses a couple of problems. First, the exemption omits one of the primary antifraud components of crowdfunding—an open, public web site. Second, the Act seriously handicaps non-broker funding portals as crowdfunding intermediaries. The Act does not adequately protect them from the risk that they will be treated as brokers or investment advisers and the Act imposes other unnecessary restraints on funding portals that will give brokers a competitive advantage.

1. Crowdfunding Sites Should Be Public and Offer an Open Communication Forum for Each Offering

The new exemption omits a crucial element of crowdfunding—an open, public communications channel allowing potential investors to communicate with the issuer and each other.[256] Openness of this sort would allow crowdfunding sites to take advantage of "the wisdom of crowds,"[257] the idea that "even if most of the people within a group are not especially well-informed or rational . . . [the group] can still reach a collectively wise decision."[258] Open communication channels can help protect investors from both fraud and poor investment decisions by allowing members of the public to share knowledge about particular entrepreneurs, businesses, or investment risks.[259] Open communication channels also allow investors to monitor the enterprise better after the investment is made.

Congressman McHenry's and Senator Brown's bills each required open communication channels,[260] but that requirement was excluded from the crowdfunding exemption that was eventually enacted. The new crowdfunding exemption does not even require that crowdfunding sites be open to the public. Crowdfunding sites may be open to the public and provide communications channels to investors, but the Act does not require it.

2. Funding Portals as Brokers or Investment Advisers

Non-brokers may operate section 4(6) crowdfunding sites and the statute makes it clear that operating such a site does not make one a broker.[261] However, to avoid being a broker, the crowdfunding site must be a registered funding portal,[262] and "funding portal" is defined as a person that acts as an intermediary in transactions "solely pursuant to section 4(6)."[263] If a crowdfunding intermediary handles a transaction that is not "pursuant to section 4(6)," it will not qualify as a funding portal and will lose the broker registration exemption. Given the complexity of the new exemption, failed section 4(6) offerings are likely, and each failed offering puts the funding portal's regulatory status at risk.

Crowdfunding intermediaries could also be "investment advisers" required to register under the Investment Advisers Act.[264] The CROWDFUND Act does not protect funding portals from being treated as investment advisers. In fact, the restrictions the Act imposes on funding portals exacerbate the problem.

Funding portals may not "offer investment advice or recommendations."[265] The meaning of investment advice under the Advisers Act is murky at best,[266] and the CROWDFUND Act does nothing to clarify that uncertainty. If, for example, a funding portal places a few offerings in a "featured offerings" section, would that constitute a recommendation or investment advice and violate this prohibition? Funding portals that stray into the uncertain area of investment advice now face not one, but two, negative consequences: (1) they will be violating the Exchange Act restrictions on funding portals; and (2) they could be acting as unregistered investment advisers in violation of the Advisers Act.

Even funding portals that do not "offer investment advice or recommendations" could still be investment advisers. The Investment

Advisers Act has a two-part definition of investment advisers. First, anyone who, "for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities" is an investment adviser.[267] Presumably, a funding portal that complied with the new Exchange Act prohibition on "investment advice or recommendations" would not fall within this prong of the definition.

But the definition of investment adviser has a second part. Anyone who, "for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities" is also an investment adviser.[268] One who merely provides information about companies and investment opportunities can be an investment adviser under this part of the definition even if no formal recommendation is made.[269] The SEC staff has indicated in several no-action letters that providing investors with information of this type falls outside the definition of investment adviser only if certain conditions are met.[270]

It is not clear that one who falls within the second part of the investment adviser definition would be offering investment advice or recommendations within the meaning of the restriction on funding portals. Thus, a crowdfunding site might meet the requirements to be a funding portal and still risk being treated as an investment adviser.

The SEC could harmonize the two definitions by adding an additional restriction prohibiting funding portals from "issuing reports or analyses concerning securities." The definition of funding portal grants the SEC the power to prevent funding portals from "[engaging] in such other activities as the Commission, by rule, determines appropriate."[271] This approach would make the two definitions mutually exclusive, but it would not solve the underlying problem. Funding portals would still need to determine what constitutes "investment advice" or "analyses or reports concerning securities." An "investment advice" safe harbor specifying exactly what is and is not allowed would be helpful.

3. Other Restrictions on Funding Portals

Two other restrictions on funding portals pose interpretive issues under the Act and place funding portals at a disadvantage compared to brokers. First, a funding portal is not allowed to "solicit purchases, sales, or offers to buy the securities offered or displayed on its web site or portal"[272] or to "compensate employees, agents, or other persons for such solicitation."[273] Read literally, this could prevent funding portals from operating crowdfunding sites at all, since issuers' listings on crowdfunding sites are soliciting purchases and offers to buy the issuers' securities. Since the statute clearly allows funding portals to operate crowdfunding sites,[274] the listings themselves cannot violate this prohibition. But what else would the prohibition on solicitation cover? Could a funding portal advertise its site? If so, would it be barred from mentioning particular offerings in those advertisements? Could it contact prospective investors by e-mail and provide a link to the site? Could it do anything more than just provide that link? Even if such communications did not solicit people to buy *particular* securities, they would be soliciting people to purchase "the securities offered or displayed on its web site." However the restriction on solicitation is interpreted, crowdfunding sites operated by funding portals will be at a disadvantage compared to sites operated by brokers, who are not subject to this restriction.

A second restriction on funding portals is also problematic. Funding portals may not "hold, manage, possess, or otherwise handle investor funds or securities."[275] Because of this restriction, securities and funds must be exchanged either directly between issuers and investors or through an independent third party. And since crowdfunding intermediaries must "ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target amount,"[276] the only effective solution is to use a third party escrow agent to handle collection and disbursement.[277] This gives an advantage to brokers, who are not subject to such a restriction.

V. Conclusion

Crowdfunding is a promising possibility for small business startups—a chance for underfunded small businesses to use modern technology to connect to new sources of capital. But that promise remains unfulfilled. Congress could have used crowdfunding as an opportunity to reexamine some of the basic premises of securities regulation of small businesses and to seriously rethink how the Internet can be used to protect investors in less traditional, less expensive ways. Instead, it threw together a poorly drafted regulatory bundle of old ideas that is complicated, expensive, and unlikely to have much of an effect on the small business capital gap.

Ironically, the most important provision in the JOBS Act for Internet offerings by small businesses is not in the CROWDFUND Act and is not specifically aimed at either small businesses or Internet offerings. The JOBS Act requires the SEC to eliminate the prohibition against general solicitation and general advertising from the Rule 506 exemption in Regulation D, provided that all purchasers are accredited investors.[278] The prohibition on general solicitation has effectively precluded public Internet offerings because the SEC staff interprets it to prohibit offers to anyone with whom the issuer or persons selling on the issuer's behalf do not have a preexisting relationship.[279]

The elimination of the general solicitation restriction will make it possible to offer securities in a Rule 506 offering on an Internet site that is open to the general public. Those securities could only be *sold* to accredited investors,[280] but without almost all of the regulatory restrictions in the crowdfunding exemption. The issuer would not have to sell through a broker or funding portal, or, for that matter, through any intermediary. The dollar amount of the offering would be unlimited, as would the amount that each investor could purchase. The issuer would avoid any significant mandatory disclosure requirements,[281] and there would be no annual reporting requirement. Resales would be restricted,[282] but the holding period for Rule 506 would be no longer than that under the crowdfunding exemption.[283] And, as with crowdfunding, state disclosure and registration requirements would be preempted.[284]

Hence, Congress may have taken a great leap forward for Internet offerings by small businesses, just not in the portion of the JOBS Act specifically aimed at those offerings.

APPENDIX A
Sections 4(6) and 4A of the Securities Act (as amended)

Section 4. Exempted transactions

The provisions of section 5 of this Act shall not apply to –

* * *

(6) transactions involving the offer or sale of securities by an issuer (including all entities controlled by or under common control with the issuer), provided that—

> (A) the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, is not more than $1,000,000;
>
> (B) the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, does not exceed—
>
>> (i) the greater of $2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and
>>
>> (ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000;
>
> (C) the transaction is conducted through a broker or funding portal that complies with the requirements of section 4A(a); and
>
> (D) the issuer complies with the requirements of section 4A(b).

Section 4A. Requirements with respect to certain small transactions.

(a) REQUIREMENTS ON INTERMEDIARIES.—A person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others pursuant to section 4(6) shall—

(1) register with the Commission as—

(A) a broker; or

(B) a funding portal (as defined in section 3(a)(80) of the Securities Exchange Act of 1934);

(2) register with any applicable self-regulatory organization (as defined in section 3(a)(26) of the Securities Exchange Act of 1934);

(3) provide such disclosures, including disclosures related to risks and other investor education materials, as the Commission shall, by rule, determine appropriate;

(4) ensure that each investor—

(A) reviews investor-education information, in accordance with standards established by the Commission, by rule;

(B) positively affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor could bear such a loss; and

(C) answers questions demonstrating—

(i) an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers;

(ii) an understanding of the risk of illiquidity; and

(iii) an understanding of such other matters as the Commission determines appropriate, by rule;

(5) take such measures to reduce the risk of fraud with respect to such transactions, as established by the Commission, by rule, including obtaining a background and securities enforcement regulatory history check on each officer, director, and person holding more than 20 percent of the outstanding equity of every issuer whose securities are offered by such person;

(6) not later than 21 days prior to the first day on which securities are sold to any investor (or such other period as the Commission may establish), make available to the Commission and to potential investors any information provided by the issuer pursuant to subsection (b);

(7) ensure that all offering proceeds are only provided to the issuer when the aggregate capital raised from all investors is equal to or greater than a target offering amount, and allow all investors to cancel

their commitments to invest, as the Commission shall, by rule, determine appropriate;

(8) make such efforts as the Commission determines appropriate, by rule, to ensure that no investor in a 12-month period has purchased securities offered pursuant to section 4(6) that, in the aggregate, from all issuers, exceed the investment limits set forth in section 4(6)(B);

(9) take such steps to protect the privacy of information collected from investors as the Commission shall, by rule, determine appropriate;

(10) not compensate promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor;

(11) prohibit its directors, officers, or partners (or any person occupying a similar status or performing a similar function) from having any financial interest in an issuer using its services; and

(12) meet such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest.

(b) REQUIREMENTS FOR ISSUERS.—For purposes of section 4(6), an issuer who offers or sells securities shall—

(1) file with the Commission and provide to investors and the relevant broker or funding portal, and make available to potential investors—

(A) the name, legal status, physical address, and website address of the issuer;

(B) the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer;

(C) a description of the business of the issuer and the anticipated business plan of the issuer;

(D) a description of the financial condition of the issuer, including, for offerings that, together with all other offerings of the issuer under section 4(6) within the preceding 12-month period, have, in the aggregate, target offering amounts of—

(i) $100,000 or less—

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

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

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

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

(E) a description of the stated purpose and intended use of the proceeds of the offering sought by the issuer with respect to the target offering amount;

(F) the target offering amount, the deadline to reach the target offering amount, and regular updates regarding the progress of the issuer in meeting the target offering amount;

(G) the price to the public of the securities or the method for determining the price, provided that, prior to sale, each investor shall be provided in writing the final price and all required disclosures, with a reasonable opportunity to rescind the commitment to purchase the securities;

(H) a description of the ownership and capital structure of the issuer, including—

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

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

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

(iv) how the securities being offered are being valued, and examples of methods for how such securities may be valued by the issuer in the future, including during subsequent corporate actions; and (v) the risks to purchasers of the securities relating to minority ownership in the issuer, the risks associated with corporate actions, including additional issuances of shares, a sale of the issuer or of assets of the issuer, or transactions with related parties; and

(I) such other information as the Commission may, by rule, prescribe, for the protection of investors and in the public interest;

(2) not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker;

(3) not compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal, without taking such steps as the Commission shall, by rule, require to ensure that such person clearly discloses the receipt, past or prospective, of such compensation, upon each instance of such promotional communication;

(4) not less than annually, file with the Commission and provide to investors reports of the results of operations and financial statements of the issuer, as the Commission shall, by rule, determine appropriate, subject to such exceptions and termination dates as the Commission may establish, by rule; and

(5) comply with such other requirements as the Commission may, by rule, prescribe, for the protection of investors and in the public interest.

(c) LIABILITY FOR MATERIAL MISSTATEMENTS AND OMISSIONS.—

(1) ACTIONS AUTHORIZED.—

(A) IN GENERAL.—Subject to paragraph (2), a person who purchases a security in a transaction exempted by the provisions of section 4(6) may bring an action against an issuer described in paragraph (2), either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if such person no longer owns the security.

(B) LIABILITY.—An action brought under this paragraph shall be subject to the provisions of section 12(b) and section 13, as if the liability were created under section 12(a)(2).

(2) APPLICABILITY.—An issuer shall be liable in an action under paragraph (1), if the issuer—

(A) by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by any means of any written or oral communication, in the offering or sale of a security in a transaction exempted by the provisions of section 4(6), makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading, provided that the purchaser did not know of such untruth or omission; and

(B) does not sustain the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.

(3) DEFINITION.—As used in this subsection, the term “issuer” includes any person who is a director or partner of the issuer, and the principal executive officer or officers, principal financial officer, and controller or principal accounting officer of the issuer (and any person occupying a similar status or performing a similar function) that offers or sells a security in a transaction exempted by the provisions of section 4(6), and any person who offers or sells the security in such offering.

(d) INFORMATION AVAILABLE TO STATES.—The Commission shall make, or shall cause to be made by the relevant broker or funding portal, the information described in subsection (b) and such other information as the Commission, by rule, determines appropriate, available to the securities commission (or any agency or office performing like functions) of each State and territory of the United States and the District of Columbia.

(e) RESTRICTIONS ON SALES.—Securities issued pursuant to a transaction described in section 4(6)—

(1) may not be transferred by the purchaser of such securities during the 1-year period beginning on the date of purchase, unless such securities are transferred—

(A) to the issuer of the securities;

(B) to an accredited investor;

(C) as part of an offering registered with the Commission; or

(D) to 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, in the discretion of the Commission; and

(2) shall be subject to such other limitations as the Commission shall, by rule, establish.

(f) APPLICABILITY.—Section 4(6) shall not apply to transactions involving the offer or sale of securities by any issuer that—

(1) is not organized under and subject to the laws of a State or territory of the United States or the District of Columbia;

(2) is subject to the requirement to file reports pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934;

(3) is an investment company, as defined in section 3 of the Investment Company Act of 1940, or is excluded from

the definition of investment company by section 3(b) or section 3(c) of that Act; or

(4) the Commission, by rule or regulation, determines appropriate.

(g) RULE OF CONSTRUCTION.—Nothing in this section or section 4(6) shall be construed as preventing an issuer from raising capital through methods not described under section 4(6).

(h) CERTAIN CALCULATIONS.—

(1) DOLLAR AMOUNTS.—Dollar amounts in section 4(6) and subsection (b) of this section shall be adjusted by the Commission not less frequently than once every 5 years, by notice published in the Federal Register to reflect any change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics.

(2) INCOME AND NET WORTH.—The income and net worth of a natural person under section 4(6)(B) shall be calculated in accordance with any rules of the Commission under this title regarding the calculation of the income and net worth, respectively, of an accredited investor.

APPENDIX B
Required and Optional SEC Rulemaking

Type of Regulation	Statutory Authority
Such rules as necessary or appropriate for the protection of investors to carry out sections 4(6) and 4A	JOBS Act § 302(c)
Disqualification provisions for issuers and crowdfunding intermediaries	JOBS Act § 302(d)
Disclosure required by crowdfunding intermediaries	Securities Act § 4A(a)(3)
Standards for investor-education information to be reviewed by investors	Securities Act § 4A(a)(4)(A)
Other matters that investors must demonstrate an understanding of	Securities Act § 4A(a)(4)(C)(iii)
Measures to be taken by intermediaries to reduce the risk of fraud	Securities Act § 4A(a)(5)
Alternative period prior to offering by which intermediaries must make available to the SEC and potential investors information provided by the issuer	Securities Act § 4A(a)(6)
Cancellation of commitment to invest prior to issuer reaching target	Securities Act § 4A(a)(7)
Efforts required by intermediaries to ensure that no investor has exceeded the 12-month aggregate crowdfunding cap	Securities Act § 4A(a)(8)
Steps by intermediaries to protect the privacy of information collected by investors	Securities Act § 4A(a)(9)
Other requirements imposed on intermediaries for the protection of investors and in the public interest	Securities Act § 4A(a)(12)
Professional standards and procedures for review by independent accountants of issuer financial statements for offerings in the $100,000-500,000 range	Securities Act § 4A(b)(1)(D)(ii)
Alternate amount of offering for which audited financial statements are required	Securities Act § 4A(b)(1)(D)(iii)
Other information to be filed and disclosed by the issuer	Securities Act § 4A(b)(1)(I)

Steps required to ensure that persons compensated by the issuer for promoting its offerings through communication channels provided by crowdfunding intermediaries disclose that compensation upon each communication	Securities Act § 4A(b)(3)
Contents of annual reports on results of operations and financial statements to be filed by crowdfunding issuers, and exceptions and termination dates for the annual reporting requirement	Securities Act § 4A(b)(4)
Other requirements imposed on issuers for the protection of investors and in the public interest	Securities Act § 4A(b)(5)
Other information that crowdfunding intermediaries must make available to state securities regulator	Securities Act § 4A(d)
Circumstances similar to death or divorce in which crowdfunded securities may be resold within the one-year period after purchase	Securities Act § 4A(e)(1)(D)
Other limitations on resales	Securities Act § 4A(e)(2)
Other issuers not eligible to use the crowdfunding exemption	Securities Act § 4A(f)(4)
Adjustment of dollar amounts for changes to CPI	Securities Act § 4A(h)(1)
Conditional or unconditional exemption of section 4(6) securities from section 12(g) of Exchange Act	Exchange Act § 12(g)(6)
Conditional or unconditional exemption of registered funding portals from the requirement to register as brokers or dealers	Exchange Act § 3(h)(1)
Other requirements for registered funding portals to be eligible for exemption from the requirement to register as brokers or dealers	Exchange Act § 3(h)(1)(C)
Extent to which the term "broker or dealer" shall not include registered funding portals for purposes of section 15(c)(8) and 15A of the Exchange Act	Exchange Act § 3(h)(2)
Other activities that funding portals may	Exchange Act §

not engage in	3(a)(80)(E)

NOTES

[1] Jumpstart Our Business Startups Act, Pub. L. 112-106, 126 Stat. 306 (2012) [hereinafter, "JOBS Act"].
[2] JOBS Act, Pub. L. 112-106, §§ 301-305, 126 Stat. 306 (2012). "CROWDFUND" is an acronym for "Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure." *Id.*, § 301.
[3] *See* Paul Belleflamme, Thomas Lambert & Armin Schwienbacher, *Crowdfunding: Tapping the Right Crowd* 2 (Center for Operations Discussion and Research, Discussion Paper No. 2011/32, 2011), *available at* http://ssrn.com/abstract=1836873.
[4] *See* C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 10 (2012).
[5] *See About Us - History*, KIVA, http://www.kiva.org/about/history (last visited Mar. 5, 2012)
[6] KEVIN LAWTON & DAN MAROM, THE CROWDFUNDING REVOLUTION: SOCIAL NETWORKING MEETS VENTURE FINANCING 66 (2010).
[7] According to one study, crowdfunding raised $1.5 billion worldwide in 2011. *See* Natalie Huet, *European Start-Ups Court Crowds for Cash*, REUTERS, May 9, 2012, *available at* http://www.reuters.com/article/2012/05/09/finance-crowdfunding-idUSL5E8G50RB20120509.
[8] *See* Angela Moscaritolo, *Pebble Smartwatch Sells Out, Collects $10 Million on Kickstarter*, PCMag.com (May 10, 2012), http://www.pcmag.com/article2/0,2817,2404295,00.asp.
[9] *See* Abraham J. B. Cable*, Fending for Themselves: Why Securities Regulations Should Encourage Angel Groups*, 13 U. PA. J. BUS. L. 107, 108 (2010); Jill E. Fisch, *Can Internet Offerings Bridge the Small Business Capital Barrier?*, 2 J. SMALL & EMERGING BUS. L. 57, 59–64 (1998); Darian M. Ibrahim, *The (Not So) Puzzling Behavior of Angel Investors*, 61 VAND. L. REV. 1405, 1417 (2008).
[10] *See* Bradford, *supra* note 4, at 100-104.
[11] *See id.*, at 101.
[12] *See id.*, at 104.
[13] *See id.*, at 109-112 (discussing a number of studies of financial sophistication).
[14] *See id.*, at 106-107, and sources cited therein.
[15] *See id.*, at 108, and sources cited therein.
[16] *See id.*, at 108-109, and sources cited therein.
[17] Absent an exemption, it is unlawful to sell securities unless a registration statement is in effect as to those securities. Securities Act of 1933 § 5(a)(1), 15 U.S.C. § 77e(a)(1) (2010).
[18] *See* Bradford, *supra* note 4, at 42-49.
[19] *See id.*, at 51-80.
[20] *See id.*, at 15-16.
[21] *See id.*, at 16-19.

[22] *Id.*
[23] *Id.*, at 31-33.
[24] *See* Bradford, *supra* note 4, at 33-42.
[25] Securities Act of 1933 § 4(6), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)).
[26] *See* Securities Act of 1933 § 4A(a),(b), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a),(b)).
[27] *See* Section III.G, *infra*.
[28] *See* Section III.E.1, *infra*.
[29] *See* Section III.H, *infra*.
[30] *See* Section III.I, *infra*.
[31] *See* Bradford, *supra* note 4, at 98-117.
[32] *See id.*, at 117-149.
[33] *See* Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879 (2011); Nikki D. Pope, *Crowdfunding Microstartups: It's Time for the Securities and Exchange Commission to Approve a Small Offering Exemption*, 13 U. PA. J. BUS. L. 973, 978–81 (2011); Edan Burkett, *A Crowdfunding Exemption? Online Investment Crowdfunding and U.S. Securities Regulation*, 13 TRANSACTIONS 63 (2011); Thomas Lee Hazen, *Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why any Specially Tailored Exemption Should be Conditioned on Meaningful Disclosure*, N. C. L. REV. (forthcoming 2012), available at http://ssrn.com/abstract=1954040.
[34] *See* Troy A. Paredes, *On the Decision to Regulate Hedge Funds: The SEC's Regulatory Philosophy, Style, and Mission*, 2006 U. ILL. L. REV. 975, 1005-1006 (2006) (discussing the need to balance investor protection and capital formation in securities regulation).
[35] For a discussion of what I think those structural requirements should be and their justifications, *see* Bradford, *supra* note 4, at 117-150.
[36] I consulted with House and Senate staff members who drafted the legislation discussed in this section. However, I was not directly involved in drafting or lobbying for any of the bills.
[37] Sustainable Economies Law Ctr., *Request for Rulemaking to Exempt Securities Offerings Up to $100,000 With $100 Maximum Per Investor From Registration*, SEC File No. 4-605, at 2 (July 1, 2010), available at http://www.sec.gov/rules/petitions/2010/petn4-605.pdf.
[38] *See* Letter from Woodie Neiss, Member, SBE Council Advisory Committee, to Gerald J. Laporte, Chief, Office of Small Business Policy, Division of Corporate Finance, SEC (Dec. 21, 2010), *available at* http://www.sec.gov/info/smallbus/2010gbforum/2010gbforum-sbe.pdf; STARTUP EXEMPTION, http://www.startupexemption.com (last visited Mar. 5, 2012).
[39] *See* Bradford, *supra* note 4, at 85-86.
[40] Letter from Mary L. Schapiro, Chairman, SEC, to Darrell E. Issa, Chairman, House Comm. on Oversight & Gov't Reform 22-23 (Apr. 6, 2011), *available at* www.sec.gov/news/press/schapiro-issa-letter-040611.pdf.

[41] *Id.*, at 1.
[42] *See* Press Release, White House Office of the Press Secretary issues Fact Sheet and Overview for American Jobs Act 2 (Sept. 8, 2011), *available at* http://www.whitehouse.gov/the-press-office/2011/09/08/fact-sheet-and-overview.
[43] *See* Entrepreneur Access to Capital Act, H.R. 2930, 112th Cong. (as passed by House, Nov. 3, 2011). For a full discussion of this bill, *see* Bradford, *supra* note 4, at 88-91.
[44] *See* Executive Office of the President, Statement of Administration Policy (Nov. 2, 2011), *available at* www.whitehouse.gov/sites/default/files/omb/legislative/sap/112/saphr2930r_20111102.pdf ("The Administration supports House passage of H.R. 2930.").
[45] 157 CONG. REC. H7311 (Nov. 3, 2011).
[46] Democratizing Access to Capital Act of 2011, S. 1791, 112th Cong. (2011). For a full discussion of S. 1791, *see* Bradford, *supra* note 4, at 91-93.
[47] Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2011, S. 1970, 112th Cong. (2011). For a full discussion of S. 1970, *see* Bradford, *supra* note 4, at 94-97.
[48] Jumpstart Our Business Startups Act, H.R. 3606, 112th Cong. (as passed by House, Nov. 3, 2011). *See* 158 CONG. REC. H1288 (Mar. 8, 2012).
[49] Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012, S. 2190, 112th Cong. (2012).
[50] Senate Amendment 1884, 112th Cong. (2012).
[51] 158 CONG. REC. S1976-1977 (Mar. 22, 2012).
[52] 158 CONG. REC. H1598 (Mar. 27, 2012).
[53] Jumpstart Our Business Startups Act, Pub. L. 112-106, 126 Stat. 306 (2012).
[54] For the convenience of the reader, the new sections 4(6) and 4A of the Securities Act, as added by the JOBS Act, appear in Appendix A.
[55] Securities Act of 1933 § 4(6), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)).
[56] Securities Act of 1933 § 4(6)(A), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(A)).The SEC is required to adjust this dollar amount at least every five years to reflect changes in the Consumer Price Index for All Urban Consumers. Securities Act of 1933 § 4A(h)(1), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(h)(1)).
[57] New section 4(6)(A) provides that "the aggregate amount sold to *all* investors by the issuer, *including* any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction" may not exceed the cap. Securities Act of 1933 § 4(6)(A), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(A)). (emphasis added).
[58] Sales by companies controlled by, or under common control with, the issuer could also count against the issuer's $1 million limit. *See* Section III.J.3, *infra*.
[59] *See* Section III.J.2, *infra*.
[60] *See id*.

[61] Securities Act of 1933 § 4A(h), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(h)). Currently, the only such rules are Rules 215 and 501 under the Securities Act. Under those rules, a spouse's income and net worth are included when calculating a person's annual income and net worth. *See* Securities Act Rules 215(e),(f); 501(a)(5),(6), 17 C.F.R. §§ 230. 215(e),(f); 501(a)(5),(6) (2012). The value of an investor's primary residence is excluded in calculating net worth. *See* Securities Act Rules 215(e), 501(a)(5), 17 C.F.R. §§ 230.215(e), 230.501(a)(5) (2012).
[62] The SEC is required to adjust the $100,000 barrier at least every five years to reflect any changes in the Consumer Price Index for All Urban Consumers. *See* Securities Act of 1933 § 4A(h)(1), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(h)(1)).
[63] Securities Act of 1933 § 4(6)(B)(i), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)(i)).
[64] Securities Act of 1933 § 4(6)(B)(ii), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)(ii)).
[65] Subsection 4(6)(B)(i) clearly says that the limit is "the greater of" the alternatives. Securities Act of 1933 § 4(6)(B)(i), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)(i)). But subsection 4(6)(B)(ii) contains no such language. *See* Securities Act of 1933 § 4(6)(B)(ii), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)(ii)).
[66] Securities Act of 1933 § 4(6)(B)(ii), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)(ii)) (emphasis added).
[67] Securities Act of 1933 § 4(6)(B)(i), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)(i)).
[68] Securities Act of 1933 § 4(6)(B)(ii), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)(ii)).
[69] Securities Act of 1933 § 4(6)(B), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)) (emphasis added).
[70] *See* Section III.C.2, *infra*.
[71] Sales of securities by companies controlled by, or under common control with, the issuer could also be counted against the single-issuer limit. *See* Section III.J.3, *infra*.
[72] Securities Act of 1933 § 4A(a)(8), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(8)) (emphasis added).
[73] *See* Section III.C.1, *supra*.
[74] A crowdfunding intermediary is required to ensure that each investor "reviews investor-education information, in accordance with standards established by the Commission." Securities Act of 1933 § 4A(a)(4)(A), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(4)(A)).
[75] Securities Act of 1933 § 4A(a)(4)(C), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(4)(C)).
[76] Securities Act of 1933 § 4A(a)(4)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(4)(B)).
[77] The section 4(6) exemption is available only "provided that . . . the issuer complies with the requirements of section 4A(b)." Securities Act of 1933 § 4(6)(D), JOBS Act,

Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(D)).
[78] *See* Securities Act of 1933 § 4A(f), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(f)).
[79] *See* JOBS Act, Pub. L. 112-106, § 302(d), 126 Stat. 306 (2012).
[80] Securities Act of 1933 § 4A(f)(1), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(f)(1)).
[81] Securities Act of 1933 § 4A(f)(2), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(f)(2)).
[82] Securities Act of 1933 § 4A(f)(3), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(f)(3)).
[83] Securities Act of 1933 § 4A(f)(4), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(f)(4)).
[84] *See* Section III.F, *infra*.
[85] Securities Act of 1933 § 4A(b)(1), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)).
[86] Rather than follow the order of the statute, I have in certain places reorganized the information into more useful categories.
[87] Securities Act of 1933 § 4A(b)(1)(A), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(A)).
[88] Securities Act of 1933 § 4A(b)(1)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(B)).
[89] Securities Act of 1933 § 4A(b)(1)(C), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(C)).
[90] Securities Act of 1933 § 4A(b)(1)(D), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(D)).
[91] The SEC is required to adjust these dollar amount categories at least every five years to reflect any changes in the Consumer Price Index for All Urban Consumers. Securities Act of 1933 § 4A(h)(1), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(h)(1)).
[92] Securities Act of 1933 § 4A(b)(1)(D)(i), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(D)(i)).
[93] Securities Act of 1933 § 4A(b)(1)(D)(ii), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(D)(ii)). An issuer in this category is not required to provide its tax returns.
[94] Securities Act of 1933 § 4A(b)(1)(D)(iii), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(D)(iii)). No tax returns are required.
[95] Securities Act of 1933 § 4A(b)(1)(H), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)).
[96] Securities Act of 1933 § 4A(b)(1)(H)(i), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)(i)).
[97] *Id*.

[98] Securities Act of 1933 § 4A(b)(1)(H)(ii), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)(ii)). "Principal shareholder" is not defined.
[99] Securities Act of 1933 § 4A(b)(1)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(B)).
[100] Securities Act of 1933 § 4A(b)(1)(H)(iii), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)(iii)). This requirement and the previous requirement come from separate parts of the statute. Although similar, they are not necessarily the same. If the issuer has two classes of shares outstanding, one who owns 20% of one class doesn't necessarily own 20% of all of the issuer's outstanding shares.
[101] Securities Act of 1933 § 4A(b)(1)(H)(iv), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)(iv)).
[102] Securities Act of 1933 § 4A(b)(1)(H)(v), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)(v)).
[103] Securities Act of 1933 § 4A(b)(1)(E), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(E)).
[104] Securities Act of 1933 § 4A(b)(1)(F), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)91)(F)). The issuer must also provide "regular updates" on its progress towards meeting that target. *Id. See* Section III.E.4, *infra*, for a discussion of the effect of the target amount and deadline.
[105] Securities Act of 1933 § 4A(b)(1)(G), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(G)).
[106] It is unclear from the statute if this final price disclosure and opportunity to rescind applies in all cases or only when the price is not set in advance (i.e., when only the method for determining the price is specified).
[107] Securities Act of 1933 § 4A(b)(4), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(4)).
[108] *Id.*
[109] *Id.*
[110] Securities Act of 1933 § 4A(b)(2), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(2)).
[111] Securities Act of 1933 § 4A(b)(3) , JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(3)). This restriction undoubtedly reflects a concern that issuers might pay people to tout the offerings on crowdfunding websites.
[112] Securities Act of 1933 § 4A(b)(1)(I), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(I)).
[113] Securities Act of 1933 § 4A(b)(5), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(5)).
[114] Securities Act of 1933 § 4(6)(C), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(C)).
[115] *See* Section III.F, *infra*.
[116] *See* Securities Act of 1933 § 4A(a), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)).

[117] Securities Act of 1933 § 4A(a)(1), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(1)).
[118] Securities Act of 1933 § 4A(a)(2), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(2)).
[119] *See* Securities Exchange Act of 1934 § 15(a),(b), 15 U.S.C. § 78o(a),(b) (2010).
[120] Securities Exchange Act of 1934 § 3(a)(80), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)).
[121] Securities Exchange Act of 1934 § 3(a)(80)(A), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(A)).
[122] Securities Exchange Act of 1934 § 3(a)(80)(B), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(B)).
[123] Securities Exchange Act of 1934 § 3(a)(80)(C), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(C)).
[124] Securities Exchange Act of 1934 § 3(a)(80)(D), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(D)).
[125] Securities Exchange Act of 1934 § 3(a)(80)(E), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(E)).
[126] Securities Exchange Act of 1934 § 3(h)(1), JOBS Act, Pub. L. 112-106, § 304(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(h)(1)). The rules providing for such an exemption must be issued no later than 270 days after enactment of the Act. JOBS Act, *supra*, § 304(a)(2).
[127] Securities Exchange Act of 1934 § 3(h)(1)(C), JOBS Act, Pub. L. 112-106, § 304(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(h)(1)(C)).
[128] Section 15(b)(8) of the Exchange Act requires brokers to belong to a national securities association registered pursuant to section 15A of the Exchange Act. *See* Securities Exchange Act of 1934 § 15(b)(8), 15 U.S.C. § 78o(b) (2010). New section 3(h) of the Exchange Act provides that, for purposes of sections 15(b)(8) and 15A, the term "broker or dealer" includes funding portals. Securities Exchange Act of 1934 § 3(h)(2), JOBS Act, Pub. L. 112-106, § 304(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(h)(2)).
[129] *See* Securities Exchange Act of 1934 § 3(h)(1)(B), JOBS Act, Pub. L. 112-106, § 304(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(h)(1)(B)).
[130] Securities Exchange Act of 1934 § 3(h)(2), JOBS Act, Pub. L. 112-106, § 304(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(h)(2)).
[131] Securities Act of 1933 § 4A(a)(3), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(3)).
[132] *See* Section III.C.3, *supra*.
[133] *See* Securities Act of 1933 § 4A(a)(4), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(4)).
[134] Securities Act of 1933 § 4A(a)(8), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(8)). For a discussion of these limits, *see* Section III.C.2, *supra*.
[135] Securities Act of 1933 § 4A(a)(6), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(6)). The Act allows the SEC to change the 21-day period. *Id*.

[136] Securities Act of 1933 § 4A(a)(5), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(5)).
[137] As previously discussed, the statute sometimes refers to the holders of 20 percent of any class of security and sometimes refers to the holders of 20 percent of the overall equity. See Section III.D.2.c, *supra*. The reference here is to all of the outstanding equity, not to any particular class.
[138] Securities Act of 1933 § 4A(a)(7), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(7)).
[139] *See* Section III.D.2.d, *supra*.
[140] The issuer could avoid fraud claims by notifying investors of the amendment and giving them an opportunity to withdraw.
[141] Securities Act of 1933 § 4A(a)(9), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(9)).
[142] Securities Act of 1933 § 4A(a)(10), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(10)).
[143] Securities Act of 1933 § 4A(a)(11), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(11)).
[144] Securities Act of 1933 § 4A(a)(12), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)12)).
[145] JOBS Act, Pub. L. 112-106, § 302(d), 126 Stat. 306 (2012).
[146] *See* Securities Act Rule 262, 17 C.F.R. § 230.262 (2012).
[147] *See* Securities Act Rule 262(a), 17 C.F.R. § 230.262(a) (2012).
[148] *See* Securities Act Rule 262(b), 17 C.F.R. § 230.262(b) (2012).
[149] *See id*.
[150] *See* Securities Act Rule 262(b),(c), 17 C.F.R. § 230.262(b),(c) (2012).
[151] *See* Securities Act Rule 262(b), 17 C.F.R. § 230.262(b) (2012).
[152] JOBS Act, Pub. L. 112-106, § 302(d)(2)(B)(i), 126 Stat. 306 (2012). A person is disqualified if such an order bars the person from associating with a regulated entity; engaging in the business of securities, insurance, or banking; or engaging in savings association or credit union activities. The person is also disqualified if the order is a final order "based on a violation of any law or regulation that prohibits fraudulent, manipulative, or deceptive conduct within the 10-year period ending on the date of filing of the offer or sale." *Id.*, § 302(d)(2)(B)(i)(II). It is unclear from the language of the statute whether the violation or only the order has to be within ten years of the section 4(6) offering, although the better reading is probably that the conduct constituting the violation has to be within ten years.
[153] JOBS Act, Pub. L. 112-106, § 302(d)(2)(B)(ii), 126 Stat. 306 (2012).
[154] Securities Act Rule 262, 17 C.F.R. § 230.262 (2012).
[155] Section 302(c) of the Act grants the SEC the authority to "issue such rules as the Commission determines may be necessary or appropriate for the protection of investors to carry out sections 4(6) and section 4A," JOBS Act, Pub. L. 112-106, § 302(c), 126 Stat. 306 (2012), but it's not clear that an exception to what Congress has expressly required would fall within this language. However, section 28 of the Securities Act authorizes the SEC to "conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or

transactions, from any provision or provisions of this subchapter or of any rule or regulation issued under this subchapter, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors." Securities Act of 1933 § 28, 15 U.S.C. § 77z-3 (2010). Perhaps section 28 would give the SEC the authority to waive the JOBS Act disqualifications.

[156] Securities Act of 1933 § 4A(e)(1), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(e)(1)).

[157] Securities Act of 1933 § 4A(e)(1)(A), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(e)(1)(A)).

[158] Securities Act of 1933 § 4A(e)(1)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(e)(1)(B)).

[159] Securities Act of 1933 § 4A(e)(1)(C), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(e)(1)(C)).

[160] Securities Act of 1933 § 4A(e)(1)(D), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(e)(1)(D)). The statute provides no clue as to what the "equivalent" of a family member is.

[161] *Id*. The statute does not say what other circumstances might be similar—presumably other involuntary transfers. The SEC's authority under this portion of the statute is also ambiguous. The exception is for sales "to 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*, in the discretion of the Commission*." *Id*. (emphasis added). It is unclear if the SEC's discretion is only to define "other similar circumstances," or if the SEC has discretion to decide whether to allow resales in any of the categories covered in subsection (D).

[162] Securities Act of 1933 § 4A(e)(2), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(e)(2)).

[163] *See* JOBS Act, Pub. L. 112-106, § 305(a), 126 Stat. 306 (2012) (adding a new category in § 18(b)(4)(C) for securities exempt from registration pursuant to section (4)(6)).

[164] Securities Act of 1933 § 18(a)(1),(2),(3).

[165] Securities Act of 1933 § 18(c)(2)(A), 15 U.S.C. § 77r(c)(2)(A), *as amended by* JOBS Act, Pub. L. 112-106, § 305(c), 126 Stat. 306 (2012).

[166] Securities Act of 1933 § 18(c)(2), 15 U.S.C. § 77r(c)(2), *as amended by* JOBS Act, Pub. L. 112-106, § 305(c), 126 Stat. 306 (2012).

[167] *See* Securities Act of 1933 § 18(c)(2)(F), 15 U.S.C. § 77r(c)(2)(F), *as amended by* JOBS Act, Pub. L. 112-106, § 305(c), 126 Stat. 306 (2012).

[168] *See* Keith Paul Bishop, How Many Errors Can You Make in 9,000 Word, More or Less?, California Corporate and Securities Law (Apr. 17., 2012), http://calcorporatelaw.com/2012/04/how-many-errors-can-you-make-in-9000-words-more-or-less/.

[169] New subsection (F) restricts state filings and fees "with respect to any security that is a covered security pursuant to subsection (b)(4)(B) or will be such a covered security upon completion of the transaction." Securities Act of 1933 § 18(c)(2)(F), 15 U.S.C. § 77r(c)(2)(F), *as amended by* JOBS Act, Pub. L. 112-106, § 305(c), 126 Stat. 306 (2012).

[170] See Securities Act of 1933 § 18(c)(2)(F), 15 U.S.C. § 77r(c)(2)(F), *as amended by* JOBS Act, Pub. L. 112-106, § 305(c), 126 Stat. 306 (2012).
[171] Securities Act of 1933 § 4(4), 15 U.S.C. § 77d(4) (2010).
[172] A court might correct this mistaken cross-reference. *See* U.S. v. Coatoam, 245 F.3d 553, 557-558 (6th Cir. 2001) (correcting a statutory cross-reference where legislative intent was clear, and reading the cross-reference literally would produce an absurd result and render part of the statute mere surplusage). *But see* U.S. v. Moore, 136 F.3d 1343, 1344 (9th Cir. 1998) (refusing to correct a statutory cross-reference retroactively, even though Congress subsequently amended the statute to correct its mistake).
[173] JOBS Act, Pub. L. 112-106, § 305(b)(1), 126 Stat. 306 (2012).
[174] Securities Act of 1933 § 18(c)(1)(B), 15 U.S.C. § 77r(c)(1)(B), *as amended by* JOBS Act, Pub. L. 112-106, §§ 305(b)(2), 305(d)(2), 126 Stat. 306 (2012).
[175] Securities Act of 1933 § 4A(d), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(d)).
[176] The Securities Exchange Act already preempts certain state regulation of securities brokers. *See* Securities Exchange Act of 1934 § 15(i), 15 U.S.C. § 78o(i), *as amended by* JOBS Act, Pub. L. 112-106, § 305(d)(1), 126 Stat. 306 (2012).
[177] Securities Exchange Act of 1934 § 15(i)(2)(A), 15 U.S.C. § 78o(i)(2)(A), *as amended by* JOBS Act, Pub. L. 112-106, § 305(d)(1), 126 Stat. 306 (2012).
[178] Securities Exchange Act of 1934 § 15(i)(2)(B), 15 U.S.C. § 78o(i)(2)(B), *as amended by* JOBS Act, Pub. L. 112-106, § 305(d)(1), 126 Stat. 306 (2012).
[179] *Id.*
[180] Securities Act of 1933 § 4A(c)(2)(A), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(2)(A)). The statute includes an interstate commerce requirement: the liable person must make "use of any means or instruments of transportation or communication in interstate commerce or of the mails." *Id*.
[181] Exchange Act Rule 10b-5, 17 C.F.R. § 240.10b-5 (2012).
[182] Securities Act of 1933 § 17(a), 15 U.S.C. § 77q(a) (2010).
[183] Securities Act of 1933 § 4A(c)(2)(A), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(2)(A)). The "required to be stated" language does not appear in Rule 10b-5, section 17, or section 12(a)(2) of the Securities Act. It would impose liability for failure to disclose any material fact required to be disclosed pursuant to the exemption, whether or not that omission rendered any other statements made to investors materially misleading.
[184] Securities Act of 1933 § 4A(c)(1)(A), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(1)(A)).
[185] Compare section 11 of the Securities Act, which grants a cause of action to "any person acquiring such security," such security being the security sold in a registered offering. *See* Securities Act of 1933 § 11(a), 15 U.S.C. § 77k(a) (2010). Under section 11, anyone who can trace the securities they own back to the registered offering whose registration statement was fraudulent may assert a cause of action, even if they did not purchase directly from the issuer or underwriter in that offering. *See, e.g.*, Hertzberg v. Dignity Partners, Inc., 191 F.3d 1076 (9th Cir. 1999).

[186] Securities Act of 1933 § 4A(c)(1)(A), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(1)(A)).
[187] *Id.*
[188] Securities Act of 1933 § 4A(c)(1)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(1)(B)).
[189] *See* Securities Act of 1933 § 12(b), 15 U.S.C. § 77l(b) (2010).
[190] Securities Act of 1933 § 4A(c)(2)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(2)(B)).
[191] *See* Securities Act of 1933 § 12(a)(2), 15 U.S.C. § 77l(a)(2) (2010).
[192] *See* Securities Act of 1933 §§ 11(a), 12(a)(2), 15 U.S.C. §§ 77k(a), 77l(a)(2) (2010).
[193] Securities Act of 1933 § 4A(c)(2), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(2)) ("An issuer shall be liable…").
[194] Securities Act of 1933 § 4A(c)(3), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(3)). The "partner of the issuer" language is ambiguous. It is probably intended to make partners liable when the issuer is a partnership, but it could also be read to cover people with whom the issuer is in partnership.
[195] *Id*.
[196] Elsewhere in the Act, a similar parenthetical modifies officers and directors. Section 4A(b)(1)(B) requires the issuer to disclose "the names of the directors and officers (and any persons occupying a similar status or performing a similar function), . . ." Securities Act of 1933 § 4A(b)(1)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(B)).
[197] Subsection 4A(c)(3) says:

> As used in this subsection, the term "issuer" includes any person who is a director or partner of the issuer, and the principal executive officer or officers, principal financial officer, and controller or principal accounting officer of the issuer (and any person occupying a similar status or performing a similar function) that offers or sells a security in a transaction exempted by the provisions of section 4(6), and any person who offers or sells the security in such offering."

Securities Act of 1933 § 4A(c)(3), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(3)).
[198] *Id.*
[199] *See* Securities Act of 1933 § 2(a)(3), 15 U.S.C. § 77b(a)(3) (2010).
[200] 486 U.S. 622 (1988) (holding that "seller" for purposes of section 12(a)(2) of the Securities Act includes not only the person who passes title to the buyer, but also anyone who solicits the purchaser to serve his own financial interests or the interests of the title-passing seller).
[201] *See* Janus Capital Group, Inc. v. First Derivative Traders, -- U.S. --, 131 S.Ct 2296, 2303 (2011) (For purposes of Rule 10b-5, a person makes a false statement only if the person has legal authority over its content and how to communicate it). *Janus Capital* was interpreting only Rule 10b-5, so its holding would not apply directly to the new section 4A(c). However, section 4A(c) uses essentially the same language and was adopted after *Janus*, so there is a strong argument for the same interpretation.

[202] Securities Act of 1933 § 4A(c)(1)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(c)(1)(B)).
[203] Securities Act of 1933 § 13, 15 U.S.C. § 77m (2010).
[204] Securities Act of 1933 § 4(6)(A), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(A)).
[205] *See* Section III.B, *supra*. I discuss the integration issues in Section III.J.2, *infra*.
[206] Under Regulation A, the aggregate offering price "shall not exceed $5,000,000, . . ., less the aggregate offering price for all securities sold within the twelve months before the start of and during the offering of securities *in reliance upon Regulation A*." Securities Act Rule 251(b), 17 C.F.R. § 230.251(b) (2012) (emphasis added).
[207] *See* Securities Act Rule 504(b)(2), 17 C.F.R. § 230.504(b)(2) (2012); Securities Act Rule 505(b)(2)(i), 17 C.F.R. § 230.505(b)(2)(i) (2012).
[208] Section 3(b) authorizes the SEC to create regulatory exemptions for offerings of $5 million or less. *See* Securities Act of 1933 § 3(b), 15 U.S.C. § 77c(b) (2010), as amended by JOBS Act Pub. L. 112-106, § 401(a), 126 Stat. 306 (2012).
[209] *See* Securities Act of 1933 § 4, 15 U.S.C. § 77d (2010) ("The provisions of section 5 of this Act shall not apply to . . .").
[210] C. Steven Bradford, *Expanding the Non-Transactional Revolution: A New Approach to Securities Registration Exemptions*, 49 EMORY L. J. 437, 460 (2000).
[211] Securities Act of 1933 § 4(6), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)).
[212] *See* Non-Public Offering Exemption, Securities Act Release No. 4552, 1 Fed. Sec. L. Rep. (CCH) ¶¶ 2770-83 (Nov. 6, 1962).
[213] *See* Bradford, *supra* note 210, at 463 and authorities cited therein.
[214] Rutheford B Campbell, Jr., *The Plight of Small Issuers (and Others) Under Regulation D: Those Nagging Problems That Need Attention*, 74 KY. L.J. 127, 164 (1985-86). *See also* Subcommittee on Partnerships, Trusts and Unincorporated Associations, *Integration of Partnership Offerings: A Proposal for Identifying a Discrete Offerings*, 37 BUS. LAW. 1591,1605 (1982) (No-action letters dealing with integration are "difficult to reconcile even when dealing with similar fact situations involving the same subject matter").
[215] *See* Securities Act Rule 147(b)(2),17 C.F.R. § 230.147(b)(2) (2012); Rule 251(c), 17 C.F.R. § 230.251(c) (2012); Rule 502(a), 17 C.F.R. § 230.502(a) (2012).
[216] Securities Act of 1933 § 4A(g), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(g)). This provision was also in H.R. 2930, the first crowdfunding bill introduced. *See* H.R. 2930, 112th Cong. § 2(b) (as passed by House, Nov. 3, 2011) (proposed section 4A(f)(2) of the Securities Act).
[217] *See, e.g.*, SEC v. Murphy, 626 F.2d 633 (9th Cir. 1980).
[218] Securities Act of 1933 § 4(6), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)).
[219] *See* Section III.I, *supra*.
[220] Prior to passage of the JOBS Act, Section 12(g)(1) of the Exchange Act, as modified by Rule 12g-1, required an issuer to register any class of equity security held of record by 500 or more shareholders if the issuer has total assets exceeding $10 million. *See* Securities Exchange Act of 1934 § 12(g)(1)(B), 15 U.S.C. § 78l(g)(1)(B)

(2010), *amended by* JOBS Act, Pub. L. 112-106, §§ 303(a),501,601(a) 126 Stat. 306 (2012) (total assets exceeding $1 million and a class of equity security held of record by five hundred or more persons); Exchange Act Rule 12g-1, 17 C.F.R. § 240.12g-1 (2012) (increasing the total assets threshold to $10 million). The JOBS Act changed the record holder threshold to 2,000 persons or 500 persons who are not accredited investors. *See* JOBS Act, Pub. L. 112-106, § 501, 126 Stat. 306 (2012).

[221] Securities Exchange Act of 1934 § 12(g)(6), JOBS Act, Pub. L. 112-106, § 303(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78l(g)(6)). The SEC must issue the required rule within 270 days of the Act's enactment. *Id.*, § 303(b).

[222] Even this simple provision raises questions. If a crowdfunding purchaser resells the security, does the exclusion carry over or does the holder then count for purposes of the Exchange Act registration requirement?

[223] *See* SEC, *Information Regarding the Use of the Crowdfunding Exemption in the JOBS Act* (April 23, 2012), available at http://www.sec.gov/spotlight/jobsact/crowdfundingexemption.htm (reminding issuers that offerings in reliance on the crowdfunding exemption are unlawful until the SEC adopts implementing regulations).

[224] JOBS Act, Pub. L. 112-106, § 302(c), 126 Stat. 306 (2012).

[225] *See* SEC, *Public Comments on SEC Regulatory Initiatives under the JOBS Act*, http://www.sec.gov/spotlight/jobsactcomments.shtml (April 18, 2012).

[226] *See* Yin Wilczek, *Much Work Lies Ahead of the SEC In Implementing JOBS Act, Attorneys Say*, Bloomberg BNA Securities Law Daily (Apr. 20, 2012), available at http://news.bna.com/sdln/SDLNWB/split_display.adp?fedfid=25859584&vname=sldbulallissues&jd=a0d1p0y9k6&split=0 ("[A]ttorneys who have been closely following the legislation say the SEC is not likely to make the mandated deadlines"). Before the legislation was passed, SEC Chair Mary Schapiro indicated that 18 months was a more realistic deadline. *See* Yin Wilczek, *Schapiro Faults JOBs Bill for Gaps In Investor Protection, Short Deadlines*, Bloomberg BNA Securities Law Daily (March 15, 2012), available at http://news.bna.com/sdln/SDLNWB/split_display.adp?fedfid=24828096&vname=sldbulallissues&jd=a0d0z7t7f8&split=0.

[227] *See* Dan Froomkin, *SEC Stall Leaves Key Dodd-Frank Rules More than a Year Overdue*, Huffington Post: Business, http://www.huffingtonpost.com/2012/04/17/sec-dodd-frank-rules-year-overdue_n_1432839.html (April 17, 2012).

[228] JOBS Act, Pub. L. 112-106, § 302(c), 126 Stat. 306 (2012).

[229] See David S. Hilzenrath, *Jobs Act Could Remove Investor Protections, SEC Chair Mary Schapiro Warns*, The Washington Post, March 14, 2012, available at http://www.washingtonpost.com/business/economy/jobs-act-could-open-a-door-to-investment-fraud-sec-chief-says/2012/03/14/gIQA1vx1BS_story.html; Luis A. Aguilar, *Investor Protection is Needed for True Capital Formation*, The Harvard Law School Forum on Corporate Governance and Financial Regulation (Mar. 25, 2012), http://blogs.law.harvard.edu/corpgov/2012/03/25/investor-protection-is-needed-for-true-capital-formation/.

[230] JOBS Act, Pub. L. 112-106, § 302(c), 126 Stat. 306 (2012).

[231] *See, e.g.*, *NASAA: The JOBS Act an Investor Protection Disaster Waiting to Happen*, http://www.nasaa.org/11548/nasaa-the-jobs-act-an-investor-protection-disaster-waiting-to-happen/ (March 22, 2012).
[232] *See* Section III.H.2, *supra*.
[233] *See* Section III.C.1, *supra*.
[234] *See id*.
[235] *See* Section III.J.3, *supra*.
[236] *See* Section III.I, *supra*.
[237] *See* Securities Act of 1933 § 4A(b)(1)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(B)).
[238] *See* Securities Act of 1933 § 4A(b)(1)(H)(iii), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)(iii)).
[239] *See* Bradford, *supra* note 4, at 42-43.
[240] *See* Bradford, *supra* note 4, at 117.
[241] *See* Section III.D.2.b, *supra*.
[242] *See* Section III.D.2.e, *supra*.
[243] Securities Act of 1933 § 4A(b)(1)(H)(iv), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)(iv)).
[244] Securities Act of 1933 § 4A(b)(1)(H)(v), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(b)(1)(H)(v)).
[245] *See* Bradford, *supra* note 4, at 104-109.
[246] *See id.*, at 109-112.
[247] Bradford, *supra* note 4, at 123. *See also* Request for Rulemaking to Exempt Securities Offerings Up to $100,000 With $100 Maximum Per Investor From Registration, SEC File No. 4-605, available at http://www.sec.gov/rules/petitions/2010/petn4-605.pdf (arguing that a proposed $100 individual investment limit would prevent investors from incurring a crippling financial risk).
[248] If an investor's net worth and annual income are each less than $100,000, the limit is the greater of $2,000, five percent of annual income, or five percent of net worth. *See* Securities Act of 1933 § 4(6)(B)(i), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(B)(i)).
[249] *See* Section III.C, *supra*.
[250] Section 4(6) exempts "transactions involving the offer or sale of securities by an issuer . . . *provided that*" the listed requirements are met. Securities Act of 1933 § 4(6), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)) (emphasis added). The required conditions include the intermediary's compliance with section 4A(a) and the issuer's compliance with section 4A(b). *See* Securities Act of 1933 § 4(6)(C),(D), JOBS Act, Pub. L. 112-106, § 302(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d(6)(C),(D)).
[251] *See* Section III.D.2.e, *supra*.
[252] Securities Act of 1933 § 5(a)(1), 15 U.S.C. § 77e(a)(1) (2010). Section 4(6) is an exemption from section 5 of the Act. *See* Securities Act of 1933 § 4, 15 U.S.C. § 77d (2010) ("The provisions of section 5 of this Act shall not apply to -- . . .")

[253] Securities Act of 1933 § 12(a)(1), 15 U.S.C. § 77l(a)(1) (2010). *See* Carl W. Schneider & Charles C. Zall, *Section 12(1) and the Imperfect Exempt Transaction: The Proposed I & I Defense*, 28 BUS. LAW. 1011 (1973) (proposing a defense where an issuer's failure to comply with a registration exemption was innocent and immaterial).
[254] *See* Securities Act Rule 260, 17 C.F.R. § 230.260 (2012) (Regulation A); Securities Act Rule 508, 17 C.F.R. § 230.508 (2012) (Regulation D). *See also* Carl W. Schneider, *A Substantial Compliance ("I&I") Defense and Other Changes are Added to SEC Regulation D*, 44 BUS. LAW. 1207 (1989) (discussing the addition of Rule 508 to Regulation D).
[255] *See* Securities Act Rules 501(a), 17 C.F.R. § 230.501(a) (2012) (reasonable belief that investors are accredited investors); 501(h) (reasonable belief that purchaser representatives meet the requirements to serve as purchaser representatives); 505(b)(2)(ii), 17 C.F.R. § 230.505(b)(2)(ii) (2012) (reasonable belief that there are no more than 35 purchasers); 506(b)(2)(i), 17 C.F.R. § 230.506(b)(2)(i) (2012) (reasonable belief that there are no more than 35 purchasers); 506(b)(2)(ii), 17 C.F.R. § 230.506(b)(2)(ii) (2012) (reasonable belief that non-accredited purchasers meet a sophistication requirement).
[256] *See* Bradford, *supra* note 4, at 134-136 (arguing for public crowdfunding sites with open communication platforms).
[257] *See generally* JAMES SUROWIECKI, THE WISDOM OF CROWDS: WHY THE MANY ARE SMARTER THAN THE FEW AND HOW COLLECTIVE WISDOM SHAPES BUSINESS, ECONOMIES, SOCIETIES, AND NATIONS (2004).
[258] *Id.*, at xiii-xiv. *See also* Armin Schwienbacher & Benjamin Larralde, *Crowdfunding of Small Entrepreneurial Ventures,* at 12*, in* HANDBOOK OF ENTREPRENEURIAL FINANCE (Douglas Cumming ed., forthcoming 2012), *available at*: http://ssrn.com/abstract=1699183at 12 (although crowdfunders might not have any special knowledge about the industry in which they are investing, they can be more efficient as a crowd than a few equity investors alone).
[259] *See* Bradford, *supra* note 4, at 134-136.
[260] *See* H.R. 2930, 112th Cong. § 2(b) (as passed by House, Nov. 3, 2011); S. 1791, 112th Cong. § 6 (2011).
[261] *See* Section III.E.1, *supra*.
[262] Securities Exchange Act of 1934 § 3(h)(1), JOBS Act, Pub. L. 112-106, § 304(a), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(h)(1)).
[263] Securities Exchange Act of 1934 § 3(a)(80), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)).
[264] For a full discussion of this issue, *see* Bradford, *supra* note 4, at 67-80. This problem affects primarily crowdfunding intermediaries who are not brokers. The Investment Advisers Act excepts from the definition of investment adviser "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." Investment Advisers Act of 1940 § 202(a)(11)(C), 15 U.S.C. § 80b-2(a)(11)(C) (2010). If the operation of a crowdfunding site is part of the

conduct of a broker's ordinary business, the broker would not be an investment adviser, as long as the broker received no special compensation for any advice.
[265] Securities Exchange Act of 1934 § 3(a)(80)(A), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(A)).
[266] See Bradford, supra note 4, at 69-73, and authorities cited therein.
[267] Investment Advisers Act of 1940 § 202(a)(11), 15 U.S.C. § 80b-2(a)(11) (2010).
[268] *Id*.
[269] *See* Abrahamson v. Fleschner, 568 f.2D 862, 870 (2D Cir. 1977) (General partner providing financial reports on the partnership's investments to limited partners); SEC v. Saltzman, 127 F.Supp.2d 660, 669 (E.D. Pa. 2000) (same). The general partners in both cases were also making investment decisions for the partnerships, but the courts apparently held that the reports alone were sufficient to make the partners investment advisers.
[270] The information provided must readily available to the public in its raw state; the categories of information presented may not be highly selective; and the information may not be organized or presented in a manner that suggests the purchase, holding, or sale of any security. *See*, *e.g.*, Angel Capital Elec. Network, SEC No-Action Letter, 1996 WL 636094 (Oct. 25, 1996); Mo. Innovation Ctr., Inc., SEC No-Action Letter, 1995 WL 643949 (Oct. 17, 1995); Media Gen. Fin. Servs., Inc., SEC No-Action Letter, 1992 WL 198262 (July 20, 1992); Investex Inv. Exch. Inc., SEC No-Action Letter, 1990 WL 286331 (Apr. 9, 1990); Charles St. Sec., Inc., SEC No-Action Letter, 1987 WL 107616 (Jan. 28, 1987). *See generally* HOWARD M. FRIEDMAN, SECURITIES REGULATION IN CYBERSPACE 17-3 (3d ed. 2005); THOMAS P. LEMKE & GERALD T. LINS, REGULATION OF INVESTMENT ADVISORS 7 (2011).
[271] Securities Exchange Act of 1934 § 3(a)(80)(E), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(E)).
[272] Securities Exchange Act of 1934 § 3(a)(80)(B), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(B)).
[273] Securities Exchange Act of 1934 § 3(a)(80)(C), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(C)).
[274] *See* Securities Act of 1933 § 4A(a)(1)(B), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(1)(B)) (allowing funding portals to act as intermediaries in section 4(6) offerings).
[275] Securities Exchange Act of 1934 § 3(a)(80)(D), JOBS Act, Pub. L. 112-106, § 304(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 78c(a)(80)(D)).
[276] Securities Act of 1933 § 4A(a)(7), JOBS Act, Pub. L. 112-106, § 302(b), 126 Stat. 306 (2012) (to be codified at 15 U.S.C. § 77d-1(a)(7)).
[277] Some of the earlier crowdfunding bills required this. *See* H.R. 2930, 112th Cong. § 1(b) (as passed by House, Nov. 3, 2011) (in proposed section 4A(a)(10) of the Securities Act, requiring intermediaries to outsource cash-management functions to third-party custodians); S. 1791, 112th Cong. § 7(a) (2011)(in proposed section 3(a)(4)(G) of the Exchange Act, a similar requirement).
[278] JOBS Act, Pub. L. 112-106, § 201(a)(1), 126 Stat. 306 (2012). The SEC must act on this requirement within 90 days of the Act's enactment. *Id*. Prior to this change,

Rule 502(c) prohibited offering or selling securities in most Regulation D offerings "by any form of general solicitation or general advertising." Securities Act Rule 502(c), 17 C.F.R. § 230.502(c) (2012). Certain Rule 504 offerings are excluded from this prohibition. *See id*.

[279] *See, e.g.*, In the Matter of Kenman Corp., Exchange Act Release No.21962, 1985 WL 548507 (Apr. 19, 1985). The staff has softened this prohibition by allowing brokers to solicit and pre-qualify potential investors and then invite them to participate in *subsequent* Regulation D offerings. *See, e.g.*, Bateman Eichler, Hill Richards, Inc., SEC No-Action Letter, 1985 WL 55679 (Dec. 3, 1985); E. F. Hutton, SEC No-Action Letter, 1985 WL 55680 (Dec. 3, 1985).

[280] JOBS Act, Pub. L. 112-106, § 201(a)(1), 126 Stat. 306 (2012).

[281] The information requirements of Regulation D apply to a Rule 506 offering only when the issuer sells to non-accredited investors. Securities Act Rule 502(b)(1), 17 C.F.R. § 230.502(b)(1) (2012).

[282] *See* Securities Act Rule 502(d), 17 C.F.R. § 230.502(d) (2012).

[283] Under Rule 144, the resale safe harbor applicable to Regulation D restricted securities, the holding period is six months for the securities of reporting companies and one year for non-reporting companies. *See* Securities Act Rule 144(d)(1), 17 C.F.R. § 230.144(d)(1) (2012). Small businesses using Rule 506 would presumably be non-reporting companies, but, if so, the one-year holding period would be identical to that in the crowdfunding exemption.

[284] Securities sold pursuant to Rule 506, a safe harbor for section 4(2) of the Securities Act, are "covered securities." Securities Act of 1933 § 18(b)(4)(E), 15 U.S.C. § 77r(b)(4)(E), *as amended by* JOBS Act, Pub. L. 112-106, § 305(a), 126 Stat. 306 (2012). (This category was formerly in subsection (D), but the JOBS Act amendments changed it to subsection (E).) State registration requirements are generally preempted for offerings of covered securities. *See* Securities Act of 1933 § 18(a), 15 U.S.C. § 77r(a) (2010).