Software and the internet are rapidly moving startup investing into the information age. “Equity crowdfunding” is the offer or sale of securities to raise startup capital through relatively small contributions from a large number of individual investors. In April 2012, the Jumpstart Our Business Startups Act (the “JOBS Act”) was passed by Congress and signed by President Barack Obama. Title III of the JOBS Act (the “Crowdfund Act”) creates a crowdfunding exemption under Section 4 of the Securities Act of 1933 to allow for the offering or sale of securities by an issuer to individual unaccredited investors provided the issuer complies with certain limitations.

The Crowdfund Act appears to open the door towards an innovative platform to infuse capital into small business. However, the Crowdfund Act, even without the final Securities and Exchange Commission (“SEC”) regulations, likely proves too restrictive for equity crowdfunding to reach its full potential, diminishing the significant potential infusion of capital for business startups. Instead, Congress and the SEC need to devise innovative regulatory reform to capitalize on software innovation and create a new regulatory environment in which crowdfunding can thrive.

The Crowdfund Act is progress toward leveraging technological innovation. Prior to the Crowdfund Act, equity crowdfunding required full SEC registration unless an exception was available, and the registration costs were prohibitive for small business. Registration is rarely a viable option for startups. Registration is simply too expensive and too time-consuming for raising smaller amounts of capital. Due to the prohibitive costs, startup companies instead look to crowdfunding sites that provide contributors rewards, pre-purchases for contributions or simply treat contributions as donations.

Equity crowdfunding builds upon the crowdsourcing model with the synergistic merging of crowdsourcing and microfinance.

Currently, existing crowdfunding sites promise investor rewards, such as free products or gifts, in lieu of a security interest in the venture. The power of rewards on crowdfunding sites exemplifies the potential power of equity crowdfunding. Equity crowdfunding is a powerful tool to raise capital for startup ventures and jumpstart economic growth by flooding the capital)

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4 Id.
5 Bradford, *supra* note 2, at 42.
6 Id.
7 Id.
8 Id. at 42-3.
9 Id. at 28.
11 Bradford, *supra* note 2, at 11 (“As of December 2011, 600,000 different Kiva lenders had loaned more than $270 million dollars to more than 700,000 entrepreneurs.”)
markets with startup investment capital. Small business growth leads to job growth when small businesses expand. Kickstarter, a leading reward crowdfunding website, facilitated the funding of a smart watch company, which failed to obtain venture capital from firms in the Silicon Valley. The company, Pebble Technology, set a goal of raising $100,000 through the reward crowdfunding model and, in a little over one month, raised over $10 million. In this case, a significant number of investors willingly invested small dollar amounts in the watch company with no equity stake.

Equity crowdfunding’s potential democratization of startup investing is revolutionary. Crowdfunder’s CEO, Chance Barnett, believes equity crowdfunding will have a profound impact on empowering startups to more effectively and more efficiently connect with new potential investors, networks of investors, and broad communities to garner support for startup businesses. Amy Cortese, author of “Locavesting,” frames the transforming potential of equity crowdfunding by pointing out that if Americans invested through equity crowdfunding just 1% of the $30 trillion of long-term investments held by Americans, it would potentially infuse ten times more capital into the economy than venture capitalists invested in 2011. If just 1% of those long-term investments were infused into capital markets for early stage business development, the resulting infusion of roughly $300 billion of capital substantially contributes toward a more robust economy. The progressive policy shift in the Crowdfund Act allows non-accredited investors to participate and invest in non-registered startup equities; bringing significant new capital to the market to fund startups and social enterprises.

I. The Act and the SEC

The SEC acknowledges the adverse effects regulations impose on startup businesses looking for capital. In proposing crowdfunding regulations; the SEC looks to balance rules that are unduly burdensome, which could discourage participation in crowdfunding, and rules that are too permissive, which may increase the risks of fraud for individual investors. The SEC’s recognition of the regulatory risk is illustrative of how the legislative framework of the Crowdfund Act. The act is based upon a traditional securities regulation paradigm, creates an

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12 Bradford, supra note 2, at 103-104.
13 Mashburn, supra note 10, at 129.
14 Id.
16 Koetsier, supra note 1.
17 AMY COTERSE, LOCAVESTING: THE REVOLUTION IN LOCAL INVESTING AND HOW TO PROFIT FROM IT (Wiley, 1st ed. 2011).
19 Id.
20 Koetsier, supra note 1.
22 Id.
initial regulatory framework that inherently diminishes the full impact of equity crowdfunding by its basic legislative structure.\textsuperscript{23}

The traditional regulatory framework assumes individual investors, investing in startup emerging growth companies,\textsuperscript{24} must be protected, and therefore imposes restrictions on individual investors.\textsuperscript{25} The Crowdfund Act has Congress and the SEC regulating in the name of protecting investors and preventing a perceived "inevitable fraud" anticipated from such innovative investment activity. Under the Crowdfund Act, an issuer is limited to selling securities to individual investors in an aggregate amount not to exceed $1,000,000 in any 12-month period and limited to selling securities to any one individual investor, based upon the annual income or the net worth of the investor.\textsuperscript{26} The limit for investors with an annual income or net worth below $100,000 is $2,000 or five percent of annual income or net worth in any 12-month period.\textsuperscript{27} For investors with income above $100,000, the investment amounts are limited to ten percent of annual income or net worth.\textsuperscript{28}

The Crowdfund Act also places regulatory compliance costs and administration upon the issuers.\textsuperscript{29} Issuers under the Crowdfund Act are the startup businesses seeking to raise capital by offering or selling a security exempted by section 4(6), including directors, partners, principal executive officers, principal financial officers, principal accounting officers, and any other persons acting in similar positions on behalf of the issuer.\textsuperscript{30} The Act requires issuers to provide unaudited financial statements reviewed by an independent public accountant when the target offering amount is between $100,000 and $500,000 and to provide audited financial statements above $500,000.\textsuperscript{31} EarlyShares, an online funding platform, conducted market research showing that it would cost an issuer between 134-145 percent of the offering amount to raise $25,000, between 53-65 percent to raise $250,000, between 48-63 percent to raise $501,000 and between 24-32 percent to raise $1 million.\textsuperscript{32} Applying a cost-benefit analysis, such financial disclosures may not be worth the fees startup companies pay professionals to produce them. Whether providing an independent review by a public accountant or audited financial statements, the financial information on a startup company is highly speculative and unreliable and may provide

\begin{flushleft}
\textsuperscript{23} Id.
\textsuperscript{24} Jumpstart Our Business Startups Act §101(a)(19) (defining the term “emerging growth company”, as an issuer that has total annual gross revenues of less than $1,000,000,000); see also Jumpstart Our Business Startups Act §101(b)(2).
\textsuperscript{25} Jumpstart Our Business Startups Act § 302(a).
\textsuperscript{26} Id. (The aggregate limit of $1,000,000 applies to equity crowdfunding); See also supra note 10, at 142 (stating that the aggregate limit of $1,000,000 does not apply to non-equity crowdfunding sites, such as reward crowdfunding illustrated by Pebble Technologies crowdfunding success via Kickstarter).
\textsuperscript{27} See Jumpstart Our Business Startups Act § 302.
\textsuperscript{28} Id.
\textsuperscript{29} Jumpstart Our Business Startups Act § 302 (b) (§ 4A Requirements with respect to certain small transactions)(b).
\textsuperscript{30} Jumpstart Our Business Startups Act § 302(c)(3) (looking at § 302(b)(§ 4A Requirements with respect to certain small transactions)(a)(1)(C) this definition of issuer does not coincide with the definition given)
\textsuperscript{31} Jumpstart Our Business Startups Act, § 302 (b) (§ 4A Requirements with respect to certain small transactions)(b)(1)(D).
\end{flushleft}
investors a false sense of security. Such reporting requirements may actually do more harm than good to investors and issuers by misleading the investors. Due to uncertain projections, the reporting requirements may also set issuers up for liability for inherently speculative financial statements. The Crowdfund Act also imposes extensive regulatory requirements on the intermediaries, which may be brokers or funding portals. Intermediaries are the brokers or “funding portals”, as defined in The Crowdfund Act.

Congress and the SEC appear mindful of the impact of regulations on equity crowdfunding. As a result, the Crowdfund Act and the proposed SEC regulations implementing the Crowdfund Act appear on one hand to be less onerous than traditional full-blown SEC securities regulations. Nonetheless, the relatively small amount of investment dollars involved in equity crowdfunding still makes the current Crowdfund Act and the currently proposed SEC regulations rapidly cost-prohibitive, regardless of how sensitive Congress and the SEC have been to the regulatory costs. As initially proposed, issuers still must spend scarce resources to hire accountants and attorneys early in the startup process to ensure initial compliance and to comply with ongoing regulatory reporting requirements to utilize equity crowdfunding. Issuers risking disclosure liability spend valuable time concerned with regulatory compliance, while the issuers’ time would be more productively spent growing the business.

The promise of democratizing small business finance with an infusion of much needed capital is threatened in its infancy by even the slightest regulations. The hypersensitivity to regulatory costs suggests the need for an innovative regulatory approach to more fully realize the amount of capital investments to be derived from equity crowdfunding. Innovation has transformed industries such as bookselling, cell phones and video entertainment.

Congress and the SEC should seek opportunities to transform the regulation of the securities industry by harnessing technological innovation developed and successfully implemented by leading software companies. Today, Amazon is the world's largest bookseller, but it is a software

33 Gerrit K.C. Ahlers, et. al., Signaling in Equity Crowdfunding, Fung Institute for Engineering Leadership, UC BERKELEY n. 10, available at http://funginstitute.berkeley.edu/sites/default/files/Signaling_in_Equity_Crowdfunding.pdf (stating that directors of startup companies generally believe there is no reasonable basis to forecast future earnings because the operations of the company are inherently uncertain. A standard disclaimer offered states that “[t]he Directors . . . believe that they do not have a reasonable basis to forecast future earnings because the operations of the Company are inherently uncertain. Any forecast or projection would necessarily contain such a broad range of potential outcomes and possibilities that it would be unreliable and, for that reason, the Directors have decided not to include any financial projections or forecasts.”)

34 Id.


36 Jumpstart Our Business Startups Act §304(b) (defining the term “funding portal” under § 3(a)(80) of the Securities Exchange Act of 1934. A funding portal is any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others...that does not offer investment advice or recommendations; solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; hold, manage, possess, or otherwise handle investor funds or securities; or engage in such other activities as the Commission, by rule, determines appropriate).

37 Wilczek, supra note 32.

38 Id.

company. Critical to Amazon’s success is the core capability of Amazon’s software engine for selling virtually everything online. Amazon’s success required a software system that could ensure the integrity of the transactions between the seller and the buyer and a high degree of trust among Amazon users. The same model of ranking issuers and investors may provide the necessary transparency and disclosure to protect issuers and investors from fraudulent activity. Fraud operates in darkness and secrecy and shies away from light and transparency. It is in the interest of the funding portals to implement a platform that maximizes transparency and disclosure to build and maintain issuer and investor trust. This is the foundational incentive toward self-regulation. Intermediaries that violate the trust of issuers, investors, or both will not stay in business. Further, the SEC should focus its resources on vigorously prosecuting intermediaries, issuers and investors engaged in fraudulent activities. The Crowdfund Act’s short title effectively infers the acts purpose to facilitate “capital raising online while deterring fraud and unethical non-disclosures.” The Amazon model provides the framework for an innovative regulatory scheme to achieve the objective of the Crowdfund Act, unleash the full potential of equity crowdfunding and accomplish these goals with minimal regulatory inhibitors.

II. Innovative Securities Regulation

The information age provides for a blossoming new investment landscape, and the resulting innovation should lead the SEC to reconsider and challenge traditional regulatory assumptions. Where critical information on investments was limited in the past, growing numbers of individual investors invested in risky investments with limited transparency and few, if any, disclosure requirements. After the stock market crash of 1929, the Securities and Exchange Commission was created to protect investors by regulating the market and establishing disclosure requirements. In contrast to the 1930s, the information age today offers a changing investment landscape, empowering individual investors through transparency, disclosure and full access to information outside outdated regulatory boundaries. As Marc Andreessen observed, “six decades into the computer revolution, four decades since the invention of the microprocessor, and two decades into the rise of the modern Internet, all of the technology required to transform industries through software finally works and can be widely delivered at global scale.” The impact of equity crowdfunding is the democratization of startup investing and its promise to empower individual investors. However, Congress and the SEC have not fully

40 Id.
41 Id.
42 Jumpstart Our Business Startups Act § 301 (This title may be cited as the “Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012” or the “CROWDFUND Act”).
43 See ALLGOV, Securities and Exchange Commission, (last visited May 9, 2014) http://www.allgov.com/departments/independent-agencies/securities-and-exchange-commission-sec?agencyid=7357 (The Securities and Exchange Commission (SEC) functions as a watchdog protecting securities investors, maintaining order and efficiency in securities markets and working to advance capital formation. Prior to the crash of 1929, there were few regulations regarding the sale of securities. Despite a surge in securities trading after World War I, the federal government made little effort to regulate the securities markets. Investors begin investing more and more into risky investments with limited transparency and disclosure, drawn by the lure of getting rich quick. The stock market crash of 1929 destroyed consumer confidence in the financial markets and Congress developed regulations to restore confidence, including disclosure requirements and better transparency).
44 Id.
45 Andreessen, supra note 39.
leveraged the transformative power of software in the information age through an innovative regulatory scheme. These technological developments require the development of an innovative regulatory scheme for the investment industry.

As overburdened regulatory agencies adjust to the changing information age, there are tremendous challenges, specifically for the SEC, in regulating the investment industry through the development and transformation of the Internet and emerging software innovation. Investors benefit from the emerging software innovation through full access to information leading to full disclosure and transparency, led by an online community acting as independent watchdogs and monitoring the company’s actions. These benefits are the goal of regulations and help to reduce regulatory concerns through transparency. Further, the issuers must be more responsible and accountable when operating with such transparency. If issuers desire to continue to sustain funding sources to grow the business, the issuers will be highly cognizant of their reputation among the investing public. Corporate citizenship and sustainability through self-regulation becomes more of a reality when issuers are operating with the requisite transparency. Transparency and full disclosure potentially become the leading hedge against investment fraud as traditional government regulatory schemes lose efficacy in addressing the complex regulatory issues stemming from these powerful advancements in the information age.

As it becomes increasingly difficult to regulate the internet, software offers solutions to regulatory agencies. Large bureaucratic regulatory agencies tend to trail behind innovative technological advancement. In part, modern regulatory agencies tend to regulate powerful innovation in a way that sustains traditional regulatory roles. The use of information technologies to effectively empower the relatively powerless can best be gauged by the reaction of the establishment. Established leaders constitute a potent special interest group dependent upon the state for continued influence. More information may empower citizens to reduce existing privileges, while established leaders aim to slow or restrict emerging technologies.

In the guise of protecting the traditional assumption that individual investors are vulnerable and lack sound judgment, the Crowdfund Act purports to protect individual investors as the justifying means for the regulatory burden. Such concerns are “alarmist and ill-informed,” says Michael H. Shuman, a long-time advocate for local small business investment and director of research and marketing at Cutting Edge Capital in Oakland, California. The securities regulations that currently govern capital-raising for independent businesses are cumbersome and outdated, he says: “We allow anyone to go to a casino with no income requirements and they can lose everything, but when you’re talking about a neighborhood small business, we demand $100,000 of legal work before the first dollar can come in. That’s way out of balance.” Startup investments are inherently high risk and individual investors will certainly risk the loss of investment. Nonetheless, providing educational tools to investors and providing transparency through adequate disclosures provide investors the opportunity to invest with

47 Id.
48 Id.
49 Id.
51 Id.
improved chance of financial gain.\textsuperscript{52} In contrast, no limits are placed on these similarly situated individuals in purchasing lotto tickets or gambling in Las Vegas, both of which are statistically as risky as short bets on Wall Street.\textsuperscript{53} There are no legal restrictions to prevent individuals from gambling their life savings away. Absent fraud, a small business generally acts with the intent to profit and reward shareholders. A small business that acts fraudulently in the information age will not remain in business. In contrast, the gambling house certainly acts contrary to a gambler’s financial interests, with the motivation of seizing a gambler’s money yet paying out just enough to convince them they might win. This sustains the gambling business.

The potential amount of startup capital to be infused into the capital markets proves compelling and difficult to ignore. Congress could hardly ignore the dollars at stake. Yet Congress felt compelled, in the name of investor protection, to pass the Crowdfund Act with a traditional regulatory framework centered on investor protections while passing overly intrusive regulations that are not likely to provide individual investors with effective protections. The SEC, in their attempt to balance their traditional hyper-reactive role in protecting investors and the need to limit regulatory costs, has proposed rules that still stifle and inhibit the full potential of capital formation through equity crowdfunding.

The scope of this note precludes a detailed review of the proposed regulatory scheme. However, a few highlights will illustrate the concerns. First, the currently proposed regulations (the “Crowdfunding Regulations”) released on October 23, 2013 totaled 582 pages.\textsuperscript{54} The Crowdfund Act is approximately 10 pages.\textsuperscript{55} An average of approximately 58 pages of regulations for each page of the Act is illustrative of the burden placed upon the equity crowdfunding model by the proposed regulations. As an example of the burden, companies seeking to raise between $500 and $1 million are required to have two years of audited financial statements.\textsuperscript{56} In an SEC Small Business Forum for Capital Formation in November 2013, Phillip Laycock, an audit partner from Grassi & Co., acknowledged that audited financial statements could cost anywhere from $18,000 to $25,000.\textsuperscript{57} Kim Wales, an Executive Board Member of CFIRA and the Founder of Wales Capital, a strategic advisory firm focusing on the JOBS Act and CrowdBureau, suggests that most startups have very limited financial resources.\textsuperscript{58} The expense associated with crowdfunding under the proposed regulations is too much for most to absorb and the requirement for two years of audited financial statements is too burdensome.\textsuperscript{59}

\section*{III. Segregation of Investors}

\begin{thebibliography}{2}
\item \textsuperscript{52}See Investor Education \textsc{EarlyShares}, \url{http://www.earlyshares.com/learn-more/university/investor-education}, (last visited May 10, 2014) (stating that in the changing investment environment education is key and Earlyshares provides extensive investor education resources).
\item \textsuperscript{53}Charles Luzar, \textit{Why Regulators are Dead Wrong About Crowdfunding and Risk}, \textsc{VentureBeat} (Oct. 6, 2012, 12:32 PM), \url{http://venturebeat.com/2012/10/06/crowdfunding-risk/}
\item \textsuperscript{54}Crowdfunding, 78 Fed. Reg. 66428-01 (proposed Nov. 5, 2013).
\item \textsuperscript{55}Jumpstart Our Business Startups Act § 77.
\item \textsuperscript{56}Crowdfunding, 78 Fed. Reg. 66428-01 (proposed Nov. 5, 2013).
\item \textsuperscript{57}Kim Wales, \textit{Is Financial Disclosure for Crowdfunding Companies Too Expensive?}, \textsc{Crowdfund Insider} (Dec. 18, 2013), \url{http://www.crowdfundinsider.com/2013/12/28428-is-financial-disclosure-for-crowdfunding-companies-too-expensive/}
\item \textsuperscript{58}Id.
\item \textsuperscript{59}Id.
\end{thebibliography}
In the aftermath of declining financial markets, investors and entrepreneurs are responding to a market need and are discovering innovative ways to provide critical investment capital to startup ventures. Thought to be the democratization of investing, equity crowdfunding may well fall short due to the regulatory foundation articulated by the Crowdfund Act. Further, the Crowdfund Act continues to operate under the segregation of investment opportunities between accredited and unaccredited investors.  

The distinguishing issue with the segregation of investors results in accredited investors getting the first crack at startup investments. The startup companies that succeed with accredited investors are those providing more polished, well-developed business plans that have successfully cleared some initial startup hurdles. Falling to the unaccredited investor are the startup companies unable to attract capital from the handful of accredited investors. As a result, the less polished and less developed startup businesses will look to raise capital through unaccredited investors in the equity crowdfunding model. Unaccredited investors risk ending up with higher risk investments with higher failure rates than do accredited investors.

Further exasperating investor segregation, Title II of the JOBS Act lifted the 80-year solicitation ban on issuers advertising and soliciting accredited investors for business funding.  

With Title II liberating the solicitation rules and allowing startup companies to openly solicit investments from accredited investors, Congress put accredited investors on the same playing field as the unaccredited investors in the equity crowdfunding model. The best investments will still naturally fall to the accredited investors with sophisticated business and stock analysis backgrounds. Riskier equities will fall into the equity crowdfunding group, making for much more risky investments. Higher quality startup investments will be pitched to the smaller and wealthier group of accredited investors.

The presumption that, as measured by their annual income or net worth, small investors are less sophisticated than big investors, is without adequate merit. If an individual investor inherits $1.1 million from a relative, that individual investor is immediately transformed into an accredited investor under current securities law. Such an investor may be more at risk than the individual investor with an annual income of $90,000, a net worth of $675,000, and extensive investment experience. Further, the segregation of investors creates a barrier to entry into the next socioeconomic level. This segregation of investors results in a discriminatory effect on lower socioeconomic classes in the United States. According to Scott Kupor, a managing partner at Andressen Horowitz’s Silicon Valley venture capital firm, “through a series of byzantine regulations, the government has made it virtually impossible for working Americans to enjoy the fruits of America’s greatest strength: innovation.”

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60 See Definitions and terms used in Regulation D, 17 C.F.R. § 230.501 (2013) (defining accredited investors as investors with an annual income in excess of $200,000 or a net worth in excess of $1,000,000, and unaccredited investors as those below those levels).
61 Jumpstart Our Business Startups Act § 201.
62 Id.

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CEDI Society,\(^66\) sums up the state of investing for the individual investors when he points out that “the average person is not allowed to make the types of investments necessary to gain the kinds of returns that generate great wealth.”\(^67\) The regulations effectively benefit the financially elite while limiting the return of middle class individual investors. Kupor goes on to point out that the 96% of Americans that are not accredited investors must wait, on average, nearly nine and a half years for the average startup to go public, thus causing them to miss out on all of the price appreciation in those initial years.\(^68\) To this end, Kupor argues that the Crowdfund Act would introduce 96% of American to the absolute riskiest stage of investing: the early stage startup financing. Kupor’s argument suggests that if individual investors are provided the opportunity to invest in high risk startup financing, then the SEC should look at eliminating the discriminatory accreditor investor restrictions entirely.\(^69\)

Issues of liability also create high risk for issuers and funding portals. Under the Crowdfund Act, funding portals are liable for any material misstatements in the disclosures.\(^70\) Startups are far more likely to fail and result in loss to investors.\(^71\) The nature of a startup business is risk and uncertainty. Individual investors in large numbers raise significant risks that a mistake or the limited ability to predict outcomes in an early startup will give rise to shareholder suit that will debilitate the company. The risk of shareholder litigation can prove prohibitively risky even for entrepreneurs. Properly addressed, the exposure to liability can motivate issuers and funding portals, when combined with transparency and full disclosure, to deter fraudulent stock offerings. Regulations that lower liability when issuers and funding portals comply with procedural steps to ensure disclosure and transparency can be integrated into software designed around the Amazon online retail sales model. One potential method to achieve such a goal is establishing safe harbor provisions for intermediaries that implement software coded to be consistent with SEC disclosure and transparency requirements. Further, the SEC can implement a corresponding incentive for issuers utilizing similar software in exchange for similar safe harbor provisions from the liability of shareholder lawsuits. Such software should also encompass the protocols discussed earlier in the example derived from the Amazon model. Such a multifaceted software model can advance the necessary accountability and trust among investors and issuers with limited regulation and can effectively achieve the purpose of the Crowdfund Act: raising capital online while deterring fraud and unethical non-disclosures.

Further, it is informative to consider remedies available to investors. With the relatively small dollar amounts involved in crowdfunding projects, the question of whether investors have access to adequate remedies is important. Similar to the regulatory costs imposed on startup companies, the cost of litigation will quickly eclipse the amount of potential damage awards, and few attorneys will pursue actions of this nature. As a result, the expense and difficulty in

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\(^68\) See Kupor, supra note 65.

\(^69\) Id. (noting that unaccredited investors under the Crowdfund act are able to invest in the riskiest investments but are still not allowed to invest in IPO’s, when the risk dramatically diminishes and the IPO profits go only to the wealthy).

\(^70\) Sherwood Neiss & Jason Best, How to Save Crowdfunding Before It’s Dead on Arrival, VENTUREBEAT.COM (Feb. 8, 2014), http://venturebeat.com/2014/02/08/how-to-save-crowdfunding-before-its-dead-on-arrival/.

\(^71\) See Mashburn, supra note 10, at 173.
bringing a class action makes it unlikely that the plaintiff’s lawyers will pursue investor remedies.  With funding limits of $1 million, the lack of incentive to pursue a class action suit on a contingent fee basis puts investors in a position to have no actual remedy. At the same time, some startup issuers may be deterred by the perceived potential risk of unknown liability, since even a relatively low damage award is a significant and likely fatal blow to a small business.

As the printing press did in its day, information technologies advancing the ongoing computational revolution can transform politics today. The modern aim of the regulatory scheme should be limited to eradicating fraud. The core problem in free market economies is fraud. Securities fraud was at the center of the economic crises of the 1920s and 1930s. Financial fraud in markets causes fear in investors and tends to lead to investors withdrawing from equity markets. The SEC has institutional incentives to be over-worried about fraud. Consequently, fraud in crowdfunding will cause fear in individual investors, individual investors will withdraw, and the crowdfunding model will fail. Dylan Tweney, writing for VentureBeat.com, rightfully worries about a lack of transparency. He elaborates, “If these new avenues for fundraising aren’t accompanied by an equally vigorous demand for disclosure and accountability, all this surging optimism is going to end in a twisted wreck of securities fraud . . .”

For this reason, funding portals have a very high incentive to eradicate fraud in their activities by bringing together issuers and investors. As stated by Luis A. Aguilar, a Commissioner on the SEC, “[t] is vitally important that investors have confidence in the crowdfunding process – or they will stay away.” Funding portals that fail to eradicate fraud will fail quickly. Neither small startups nor investors will deal with lax funding portals. Economic theory supports the idea that the nature of funding portals have the “strongest incentive” to eradicate fraud. The most successful funding portals will understand fraudulent service participants are not good for sustaining their business. With the widespread competition emerging in the funding portal space, each funding portal will be acutely aware of the other funding portal sites. Competition for profits will drive the right controls. A venture capitalist might adopt a crowdfunding option, and use their prior experience to help differentiate their funding portal from others. Furthermore, venture capitalists may be encouraged to provide better terms to entrepreneurs in a more competitive environment propagated by equity crowdfunding.

72 See Mashburn, supra note 10, at 166.
73 Id. at 157.
76 Id.
79 Id.
80 Id.
82 See Mashburn, supra note 10, at 166.
Government is slow to integrate technological advancement and implement progressive reforms. The Internet and technological advances offer powerful solutions to more effective regulations, but there are groups that will work to avoid transparency and retain the benefits the current regulatory scheme affords. The primary obstacle to reform is private sector interest groups that have the leverage to pressure politicians and use public power for their own benefit. Such groups are desperate to avoid transparency, because they aim to retain those benefits while the Internet does more than merely improve access to information. Coupled with other new technological advances, the Internet also improves the quality of information. To realize the full benefit of technological advances, “government has to act to let the new technologies wash through our politics.”

The information age ushers in the opportunity to shift regulatory schemes and capitalize on the powerful benefits derived from transparency and full disclosures. The federal government has an established track record regarding financial responsibility and sound fiscal policy. It is folly to continue to adhere to a regulatory scheme devised by a federal government that caters to special interests and imposes regulatory schemes favorable to the existing power elite. Congress and the SEC should no longer hold the moral imperative to dictate by law what small investors can do with their investment dollars. Congress and the executive agencies of the federal government are neither better equipped nor more intellectually capable to dictate broad investing parameters applicable to all small individual investors.

The fear of Grandma blowing her retirement savings in startup companies is overblown and designed to play on the emotional fears of those that are already too risk-averse to invest in equities of any kind. Individual investors, armed with disclosures and empowered by transparency, still need to be cautious. Generally, however, individual investors are generally capable men and women, and should not be treated as second-class investors prevented from investing in future innovative ideas. Funding portals leveraging the Amazon model would provide portals with innovative tools to empower investors to make informed investment decisions and to provide an equitable investment market. With advanced technological innovations in software systems, equity crowdfunding can be better advanced with minimal government regulation and existing online business models similar to those thriving now can be tailored to equity crowdfunding. “The successes of electronic marketplaces from eBay to Kickstarter show that the SEC did not need to ‘reinvent the wheel,’” according to John Berlau, Senior Fellow at the Competitive Enterprise Institute.

The ultimate breadth of equity crowdfunding may depend upon Congress and the SEC’s willingness to transform its regulatory paradigm and implement a new regulatory scheme harnessing the powerful benefits of current and developing innovation. The goal should be to leverage the power of the information age to stimulate investment in the United States. The

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82 McGinnis, supra note 74.
83 Id.
84 Id.
85 Id.
88 Id. at 3.
current regulatory framework threatens to undermine the benefit of this innovative investment model with regulations.

Government oversight, designed to protect individual investors, does not eliminate the risk, but merely makes the risk known. There will always be inherent risk in investing in emerging growth companies. It bears repeating that the Crowdfund Act succinctly identifies the essential purpose of Congress in regulating equity crowdfunding. The goal of the SEC is to authorize the raising of capital online while implementing safeguards to deter fraud and unscrupulous lack of disclosures. Since the pinnacle of effective securities regulation is to make investment risk known, and can never be to entirely eliminate risk, Congress and the SEC should look to harness the power of a software system like Amazon to provide the necessary level of transparency and disclosure to best serve the interests of the investor, issuer, and the general public.

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