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## 1000 Days Late & \$1 Million Short: The Rise and Rise of Intrastate Equity Crowdfunding

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## Note

# 1000 Days Late<sup>1</sup> & \$1 Million Short<sup>2</sup>: The Rise and Rise of Intrastate Equity Crowdfunding

Timothy M. Joyce\*

## INTRODUCTION

Congress enacted the Jumpstart Our Business Startups Act (the JOBS Act)<sup>3</sup> in 2012 in order to “open domestic capital markets to small businesses.”<sup>4</sup> In the wake of the 2007 global market recession, bank lending to small businesses slowed dramatically.<sup>5</sup> The problems traditionally associated with obtaining funding for small businesses—informational inefficiency and unavailability of funds in smaller amounts, for example—were compounded by a risk-averse financial sector.<sup>6</sup>

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1. A reference to the delay of more than three years between when the JOBS Act mandated SEC rulemaking for federal crowdfunding (Summer 2012) and when the SEC published its Final Rules (Autumn 2015). The delay is discussed more fully in Parts I.B & I.D, *infra*.

2. A reference to the difference between the federal yearly crowdfund raising limit (\$1 million) and that of several state models (e.g., Minnesota, \$2 million). The differences between the federal and Minnesota crowdfunding rules are discussed more fully in Part II, *infra*.

3. Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.) [hereinafter The JOBS Act].

4. WILLIAM MICHAEL CUNNINGHAM, THE JOBS ACT: CROWDFUNDING FOR SMALL BUSINESSES AND STARTUPS 27 (2012).

5. See *id.*, at 21 (“When banks are told to reduce risk, small businesses, especially startups, are the first to see credit levels reduced.”) (commenting generally on the effect of new federal banking regulations on the small business sector).

6. See C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 101–04 (2012) (explaining informational

To unlock the untapped power of small businesses to spur job growth,<sup>7</sup> Congress borrowed an innovation from the social media age: crowdfunding.<sup>8</sup> Title III of the JOBS Act “seek[s] to model [equity securities offerings after] popular websites like Kickstarter and IndieGoGo” by providing an online marketplace for entrepreneurs to solicit investment from the general public via equity crowdfunding.<sup>9</sup> By opening up securities investment to the “crowd” without the need for expensive registration and ongoing compliance filings by issuers, the Act was an attempt to close the capital funding gap faced by small businesses.<sup>10</sup>

However, the Act’s crowdfunding regulations have not been welcomed as the cure-all some predicted, especially as the rise of intrastate options have provided investors with state-level crowdfunding alternatives.<sup>11</sup> While the delay for federal Final Rules for Regulation Crowdfunding,<sup>12</sup> and the conflicts between revisions to Security and Exchange Commission (SEC) Rule

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inefficiency, and outlining the historical funding gap for companies with limited operations history or only a small fundraising need).

7. See CUNNINGHAM, *supra* note 4, at 24 (“What is unquestioned is that small companies are responsible for most of the new jobs created in the U.S. economy.”).

8. See *id.*, at 6 (“At its best, the law recognizes that changes in technology have necessitated a revision to securities laws.”).

9. Peter J. Loughran et al., *The SEC Hands Out a Halloween Treat to Crowdfunding Supporters*, ABA BUS. L. TODAY (Dec. 2015), [http://www.americanbar.org/publications/blt/2015/12/06\\_loughran.html](http://www.americanbar.org/publications/blt/2015/12/06_loughran.html).

10. See Bradford, *supra* note 6, 99–100 (“Very small businesses, particularly startups, have an unmet need for capital that securities crowdfunding would help to meet.”).

11. Christopher Douglas Mitchell, *Charting a New Revolution in Equity Crowdfunding: The Rise of State Crowdfunding Regimes in Response to the Inadequacy of Title III of the JOBS Act*, 3 J. MARSHALL GLOBAL MKT. L.J., 135, 135 (2015) (“While the federal crowdfunding provisions in the [JOBS Act] have received much publicity, states are taking a leading role in enacting equity crowdfunding laws. State-enacted intrastate crowdfunding laws authorize securities offerings by residents of a single state . . . . Securities offerors who meet a state’s intrastate crowdfunding exemption can engage in a securities offering without registering the offering with the federal or applicable state government.”).

12. See Kevin LaCroix, *Guest Post: Some States Have Sidestepped the JOBS Act’s Burdensome Crowdfunding Rules*, THE D&O DIARY (May 15, 2014), <http://www.dandodiary.com/2014/05/articles/securities-litigation/some-states-have-sidestepped-the-jobs-acts-burdensome-crowdfunding-rules/> (describing how the SEC’s delayed enactment of the JOBS Act affected crowdfunding).

147 and intrastate models<sup>13</sup> mean that there is not yet a perfect option, there are reasons why investors might still opt for crowdfunding in general over other fundraising options. To the extent that a client is interested in the marketing appeal of crowdfunding and able to meet its funding goals within the yearly limits of either the state or federal option, this Note will provide useful guidance as to which crowdfunding program might be most appealing. The Note will first defend a commonsense approach for how to deal with the Rule 147 amendment proposal.<sup>14</sup> In the end, this Note concludes that use of crowdfunding models can ultimately make some sense, especially as investors cautiously tiptoe out of the recession.

Part I of this Note will trace the history of equity crowdfunding, beginning with an examination of the general features and practices of crowdfunding and how they implicate federal and state securities laws. Part I then introduces Title III of the JOBS Act and the SEC's subsequent attempt at the mandated rulemaking. Part I further describes the reaction by many state legislatures to major delays in the SEC's rulemaking process, and to doubts about the desirability of the SEC's 2013 proposed rules. Part I concludes by framing the situation today, where small businesses have choices between a new, restrictive federal option and state options impacted by

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13. See, e.g., Letter from Anthony Zeoli, Partner, Freeborn & Peters LLP, to Brent Fields, Sec'y, U.S. Sec. & Exch. Comm'n, (Nov. 5, 2015) (Re: File Number S7-22-15) [hereinafter Zeoli Letter] (describing the conflicts between proposed SEC Rule 147 revisions and intrastate models as well as possible solutions).

14. Editor's Note: This Note was substantively drafted and selected for publication in early 2016, during the notice and comment period for the SEC's proposed Rule 147 amendments. In fact, the SEC adopted final rules in October 2016 (published in the Federal Register in November 2016) that substantially conform to several parts of the approaches analyzed and advocated in Part II.B, *infra*. See Exemptions To Facilitate Intrastate and Regional Securities Offerings, Securities Act Release No. 33-10238, Exchange Act Release No. 34-79161, 81 Fed. Reg. 83,494 (Nov. 21, 2016) (to be codified in scattered sections of 17 C.F.R.) [hereinafter Final Rule 147/147A Rules] (adopting changes to modernize Rule 147's application in the internet age while remaining a safe harbor under Securities Act Section 3(a)(11), and creating a new standalone exemption in Rule 147A); Press Release, Sec. & Exch. Comm'n, SEC Adopts Final Rules to Facilitate Intrastate and Regional Securities Offerings (Oct. 26, 2016), <https://www.sec.gov/news/pressrelease/2016-226.html> (SEC Release 2016-226). Even though the final rules adopt a combination of the approaches analyzed below, the subsequent comparative analysis of state vs. federal models remains relevant.

potential<sup>15</sup> Rule 147 revisions for their securities crowdfunding offerings. Part II delves deeper into the mechanics of the competing crowdfunding models, comparing the federal final rules against one state's (Minnesota's) attempt at a state-level crowdfunding exemption. Part III ultimately concludes with a suggestion that companies with smaller capital requirements and local customer base might prefer the comparatively less onerous state models, while companies requiring larger capital outlays or lacking local name recognition may prefer the federal crowdfunding model.

## I. BACKGROUND

### A. TRADITIONAL SECURITIES LAW ROADBLOCKS TO THE RISE OF EQUITY CROWDFUNDING

Crowdfunding is “the use of the Internet to raise money through small contributions from a large number of investors.”<sup>16</sup> The collective “wisdom of the crowd” . . . allow[s] investors to identify and reward good ideas.”<sup>17</sup> By its very name, crowdfunding implies that there must be a large group of potential investors from which to draw funding.<sup>18</sup> Prior to the JOBS Act, federal securities law prohibited general solicitation and advertising (including by internet) of most securities offerings, thus preventing entrepreneurs from full access to the crowd.<sup>19</sup> However,

[w]hen it passed the JOBS Act of 2012, Congress ordered the SEC to eliminate this prohibition on general solicitation and advertising in two instances. Title II of the JOBS Act ordered the SEC to allow

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15. See Editor's Note *supra* note 14, regarding the final status of the Rule 147 amendments.

16. See, e.g., Bradford, *supra* note 6, at 1.

17. See Jamie Hopkins & Katie Hopkins, *Not All that Glitters is Gold – Limitations of Equity Crowdfunding Regulations*, 16 DUQ. BUS. L.J. 1, 9–10 (2013) (quoting *Statement Regarding the Proposing Release on Crowdfunding*, U.S. Sec. & Exch. Comm'n, (Oct. 23, 2013) (statement of Comm'r Kara M. Stein)).

18. See Regulation Crowdfunding, Securities Act Release No. 33-9974, Exchange Act Release No. 34-76324, 80 Fed. Reg. 71,388, 71,389 n.5 (Nov. 16, 2015) (codified at 17 C.F.R. pt. 227) [hereinafter Regulation Crowdfunding Final Rules Release].

19. See Frank Vargas et al., *Understanding Crowdfunding: The SEC's New Crowdfunding Rules and the Universe of Public Fund-Raising*, ABA BUS. L. TODAY (Dec. 2015), [http://www.americanbar.org/publications/blt/2015/12/03\\_vargas.html](http://www.americanbar.org/publications/blt/2015/12/03_vargas.html).

solicitation and advertising under [SEC] Rule 506(c) for an offerings made solely to accredited investors. Title III of the JOBS Act ordered amended Section 4(a) of the Securities Act of 1933 to allow for solicitation and advertising in to [*sic*] unaccredited investors in a limited offering.<sup>20</sup>

This limited offering available to everyone, not merely accredited investors, most closely parallels the models of portals like Kickstarter and Indiegogo.<sup>21</sup>

There are at least two different categories of crowdfunding models in existence: donation-based, and equity-based.<sup>22</sup> Under models in the donation-based category, the individual contributor donates money to a worthy cause with no expectation of receiving anything in return.<sup>23</sup> For projects where the fundraising goal does not involve making a product or supporting a business, donation-based models may be the most logical form of crowdfunding.<sup>24</sup>

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20. *Id.*

21. *See id.* While relaxing the advertising restrictions under Rule 506(c) allows for an unlimited offering to *accredited investors*, that group is likely too small to qualify as the crowd. *See id.* These are individuals with high enough earnings or net worth that the traditional investor protection rationale for securities regulation is weakened. *Id.* “Accredited investor” is a defined term under SEC Regulation D. 17 C.F.R. § 230.501(a) (2016) (alternative income or net worth requirements). It is estimated that, even considering the SEC’s recent deliberations to increase Regulation D’s accredited investor income and net worth thresholds, the number of accredited investors in the entire country does not exceed 8.5 million (i.e., somewhere between 2–3% of the population). *Accord* Devin Thorpe, *SEC Mulls Changes to Accredited Investor Standards, 18 Crowdfunders React*, FORBES (July 15, 2014, 12:32 PM), <http://www.forbes.com/sites/devinthorpe/2014/07/15/sec-mulls-changes-to-accredited-investor-standards-18-crowdfunders-react/> (indicating, via a SeedInvest estimate of approximately 8.75 million accredited investors under then-current definitions, that “the number of accredited investors [could be reduced] from 8.5 million to just 3.75 million.”).

22. Vargas et al., *supra* note 19. The various crowdfunding services/platforms available often mix & match their offerings to include part pure-donation and part rewards-based campaigns. *See, e.g., I’m Raising Funds for . . .*, INDIEGOGO, <https://www.indiegogo.com/campaigns/new#/choose-your-platform> (last visited Oct. 25, 2016) (allowing alternative models for “a project” or “a cause”). For the purposes of this Note, “equity” crowdfunding should be considered synonymous with “securities” crowdfunding.

23. *See* Vargas, et al. *supra* note 19. An example of this kind of model is GoFundMe. GOFUNDME, [www.gofundme.com](http://www.gofundme.com) (last visited Oct. 25, 2016).

24. While not all platforms offering donation-based crowdfunding portals support tax-deductible donations, several do. Vargas, et al., *supra* note 19 (mentioning options available to verified 501(c)(3) non-profits through GoFundMe and Indiegogo). Crowdfunding models based on donations—

Rewards-based crowdfunding campaigns are a variation on the typical type of model within the donation-based model category.<sup>25</sup> The general process for this model is to ask a large number of people for financial support based only on the perceived merit of a project or cause.<sup>26</sup> In rewards-based crowdfunding, the project's creator also offers some small token in exchange for a contributor's support.<sup>27</sup> Such rewards can range from VIP access during the creative process, to branded memorabilia from the campaign, to a first-run version of the final project output itself.<sup>28</sup>

Finally, in an equity-based model, a contributor—probably more accurately described as an investor, in this case—gives money to a project creator in exchange for some future return based on the project's profits.<sup>29</sup> This return can come in several forms, including common or preferred stock and convertible debt obligations.<sup>30</sup> In these cases, such an exchange of an

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instead of the offer and sale of securities—do not trigger securities regulation. Cf. 15 U.S.C. § 77a (2012).

25. See Vargas et al., *supra* note 19 (defining crowdfunding as “raising money from a potentially unlimited number of people over the Internet”).

26. *Id.*

27. See Vargas et al., *supra* note 19. Traditionally, these crowdfunding campaigns target the 3 F's of investors: Friends, Family, and Fools. By way of example, in return for crowdfunding support of the University of Minnesota Law School's Theatre Of the Relatively Talentless (TORT) 2016 musical production, the author promised a mention in this Note to any member of his interpersonal network who donated. So: thanks Mom, Katie, and Marshall & Katie (all friends and family; none fools)! See *Thank You to Our Crowdfunding Supporters!*, TORT, <http://umntort.org/thank-you-to-our-crowdfunding-supporters> (last visited Feb. 11, 2016).

28. Carol Benovic & Sid Orlando, *Need Some Reward Ideas? Here are 96 of Them*, KICKSTARTER: THE KICKSTARTER BLOG (Apr. 16, 2015), <https://www.kickstarter.com/blog/need-some-reward-ideas-here-are-96-of-them>. For an absurd crowdfunded project with even more absurd rewards, see Zack “Danger” Brown, *Potato Salad*, KICKSTARTER, <https://www.kickstarter.com/projects/zackdangerbrown/potato-salad/description> (last visited Oct. 25, 2016) (listing as rewards for donations of \$110 and up: “THE PLATINUM POTATO: Receive the recipe book, the shirt and the hat along with a bite of the potato salad, a photo of me making the potato salad, a ‘thank you’ posted to our website and I will say your name out loud while making the potato salad.”).

29. See Vargas, et al., *supra* note 19.

30. Joseph Hogue, *Types of Crowdfunding Deals and Investment*, CROWD101.COM (Aug. 2, 2016), <http://www.crowd101.com/types-crowdfunding-deals-investment/> (explaining the different investment opportunities crowdfunding could provide).

investment for a share of future profits triggers the application of federal and state securities laws.<sup>31</sup>

In general terms, whenever an issuer offers or sells a share of profits in exchange for capital, that issuer is offering a “security.”<sup>32</sup> The SEC is responsible for protecting investors by policing the federal securities arena.<sup>33</sup> Under the Securities Act of 1933<sup>34</sup> (Securities Act), an offer or sale of a security can trigger substantial registration requirements.<sup>35</sup> But, “where there is [sic] an exemption available,”<sup>36</sup> an issuer of securities may be relieved of some or all registration requirements. Several exemptions existed prior to the JOBS Act, including: Regulation A, Section 4(a)(2) of the Securities Act and the related provisions of Regulation D, and Section 3(a)(11) of the Securities Act.<sup>37</sup> On the other hand, and as discussed in more

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31. Securities Act of 1933, 15 U.S.C. §§ 77a to 77aa (2012); *see also* Joan MacLeod Heminway, *Crowdfunding and the Public/Private Divide in U.S. Securities Regulation*, 83 U. CIN. L. REV. 477, 479 (2014) (“The archetypal business or project that [engages in crowdfunding seeks] business financing in a very unrestricted way: by openly soliciting funds over the Internet from a large, varied group of people. This type of securities transaction looks and feels like a public offering and, until the JOBS Act was signed into law, was regulated as one.”).

32. *See* 15 U.S.C. § 77b(a)(1) (definition of “security”). Of course, like many robust legal regimes, there are numerous exceptions to this broad statement. Indeed, the legal analysis for defining a security can take up several weeks of an introductory law school course dedicated to securities regulation. *See generally* JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIALS* 25–89 (Aspen Publishers 7th ed. 2013) (providing an extensive case study for the multiple types of “security” under the Acts). For the purposes of this Note, it will be assumed without deciding that most, if not all, equity crowdfunding transactions will meet the definition of an offer and/or sale of securities under federal and state laws.

33. *See* 15 U.S.C. § 78d (2012); *see also* *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/about/whatwedo.shtml> (last visited Oct. 26, 2016) (“The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.”).

34. 15 U.S.C. §§ 77a to 77aa.

35. *See* 15 U.S.C. § 77f (“Registration of securities”).

36. Hopkins & Hopkins, *supra* note 17, at 7.

37. *See* 17 C.F.R. § 230.251 (2016) (Regulation A); 15 U.S.C. § 77d(a)(2) (2012) (Securities Act Section 4(a)(2)); 17 C.F.R. §§ 230.501 to .508 (Regulation D); 15 U.S.C. § 77c(a)(11) (Securities Act Section 3(a)(11)). *See generally* Hopkins & Hopkins, *supra* note 17, at 7–9 (outlining the details of each registration exemption). In addition to creating securities crowdfunding, the JOBS Act also tweaked several of the then-existing exemptions, and created



detail below, only some of these exemptions—in particular the exemptions under *existing* Section 3(a)(11) and *new* Section 4(a)(6)<sup>38</sup>—are truly applicable to a discussion of crowdfunding as it relates to securities law.<sup>39</sup> In light of the considerable literature critiquing the use of existing federal securities exemptions in the crowdfunding context,<sup>40</sup> this Note will focus on those exemptions most likely to appeal to companies as potential substitutes to crowdfunding.

## B. PREVIOUS EXEMPTIONS AGAINST WHICH TO JUDGE THE FEDERAL CROWDFUNDING MODEL

The crowdfunding exemption under Title III required the SEC to promulgate final rules.<sup>41</sup> Prospective crowdfunders awaited these rules eagerly.<sup>42</sup> However, the proposed rules released by the SEC in 2013 were met with vigorous criticism

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some new exemptions. To the extent they are not applicable to a comparison to crowdfunding, they are outside the scope of this Note.

38. 15 U.S.C. § 77d(a)(6).

39. Arguably, the crowdfunding label should apply only when there are sufficiently large groups of potential investors (i.e., a “crowd”), and the three other exemptions are only or mainly available to “sophisticated” or “accredited” investors—roughly 2–3% of the U.S. population by some estimates. *See* Thorpe, *supra* note 21 (“Around 7% of the US population could qualify as accredited investors today. Instead of reducing the number of people who can invest in privately held companies, we should be seeking ways to expand the growth of investments in small businesses.”) (internal quotations omitted). The SEC seems to agree that allowing *solicitation* to a large group, only a handful of whom would otherwise qualify to contribute, is antithetic to the spirit of a crowdfunding campaign. *See* Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,389 n.5 (“Although this rule facilitates the type of broad solicitation emblematic of crowdfunding, crowdfunding is premised on permitting sales of securities to any interested person, not just to investors who meet specific qualifications, such as accredited investors.”).

40. *E.g.*, Hopkins & Hopkins, *supra* note 17. For perspectives of industry participants and analysts, see the 480+ letters submitted as public comments after the 2013 proposed Regulation Crowdfunding rules. *Comments on Proposed Rule: Crowdfunding*, U.S. SEC. & EXCH. COMM’N., <https://www.sec.gov/comments/s7-09-13/s70913.shtml> (last visited Oct. 25, 2016) (Release No. 33-9470; File No. S7-09-13).

41. *See* The JOBS Act, Pub. L. No. 112-106, 126 Stat. 306, 320 (2012) (codified as amended in scattered sections of 15 U.S.C.) (establishing a 270-day target after adoption of the Act for SEC rulemaking).

42. *See, e.g.*, Stacy Cowley, *Tired of Waiting for U.S. to Act, States Pass Crowdfunding Laws and Rules*, N.Y. TIMES (June 3, 2015), <http://nyti.ms/1GZlYm1> (commenting in June 2015 that entrepreneurs were still waiting for SEC rulemaking to be completed).

from the small business community.<sup>43</sup> In fact, the SEC “received over 485 comment letters on the Proposing Release, including from professional and trade associations, investor organizations, law firms, investment companies and investment advisers, broker-dealers, potential funding portals, members of Congress, the Commission’s Investor Advisory Committee, state securities regulators, government agencies, potential issuers, accountants, individuals and other interested parties.”<sup>44</sup> Among the more prevalent critiques were claims that the regulatory regime proposed would cost too much to administer and would therefore preclude the very businesses the JOBS Act hoped to benefit from access to securities crowdfunding.<sup>45</sup> Indeed, this echoes many criticisms of traditional securities regulation stressing that, as applied to small business capital formation, the costs of qualification and/or compliance are prohibitive.<sup>46</sup> While the SEC reviewed and considered the large volume of responses, Title III crowdfunding remained unavailable for small businesses.<sup>47</sup>

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43. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,389.

44. *Id.* (footnote omitted).

45. The Commissioners did at least consider giving the smallest of businesses a break from the rules:

We also considered whether there should be an exemption from coverage of the rule, or any part of the rule, for small issuers. However, because the rules have been designed to implement crowdfunding, which focuses on capital formation by issuers that are small entities, while at the same time provide appropriate investor protections, we do not believe that small issuers should be exempt, in whole or in part, from the proposed rules.

*Id.* at 71,535. In the end, the SEC erred on the side of caution for investor-protection. *Id.* (“[W]e do not believe we should establish different requirements for small entities . . . that engage in crowdfunding.”). This may not be such a bad thing for investors. See Sara Hanks & Andrew Stephenson, *The Role of Counsel in Intrastate Securities Crowdfunding*, ABA BUS. L. TODAY, (Dec. 2015) [http://www.americanbar.org/publications/blt/2015/12/04\\_hanks.html](http://www.americanbar.org/publications/blt/2015/12/04_hanks.html). (“Entrepreneurs are optimistic by nature. That optimism can lead to omissions of required information for investors.”).

46. As evidence for the validity of this argument, look no further than the relaxed disclosure and compliance requirements under many of the registration-exempt securities—e.g., under Regulation A, Regulation D, etc.—discussed more fully later in this Part I.B.

47. The JOBS Act, Pub. L. No. 112-106, 126 Stat. 306, 320 (2012) (codified as amended in scattered sections of 15 U.S.C.). Clearly, Oct. 31, 2015 was significantly more than 270 days past the JOBS Act’s enactment on Apr. 10, 2012.

Companies were not wholly without options in the meantime, however. The notice and comment procedures merely delayed the addition of JOBS Act crowdfunding to the list of fundraising options available to companies.<sup>48</sup> For a long time prior to 2012, small businesses had several options for raising capital under federal and state securities law.<sup>49</sup> These exemptions shielded companies from the long reach of the SEC's enforcement arm.<sup>50</sup> However, none of these options had been particularly attractive for the type of startups the JOBS Act hoped to jumpstart.<sup>51</sup>

One example, Regulation A,<sup>52</sup> was amended to its current form pursuant to the JOBS Act.<sup>53</sup> An exempt issuer under the new Regulation A can now offer up to \$50 million of securities for public sale,<sup>54</sup> with no restriction on general advertising or solicitation—a key component to the success of crowdfunding. Regulation A securities may be offered and sold to accredited investors, and also to unaccredited investors subject to

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48. See LaCroix, *supra* note 12 (describing how the SEC's delayed enactment of the JOBS Act affected crowdfunding).

49. Cf., e.g., *Helping Small Businesses and Protecting Investors*, U.S. SEC. & EXCH. COMM'N (Mar. 25, 2015) (statement of Comm'r. Luis A. Aguilar), <https://www.sec.gov/news/statement/helping-small-businesses-and-protecting-investors.html> (describing the severe decline in Regulation A notifications filed by small businesses since 1960).

50. See *id.* (“Congress has provided the Commission with authority to pass rules to make it easier for small businesses to raise capital.”).

51. See, e.g., Regulation Crowdfunding, 80 Fed. Reg. at 71,389 (“Limitations under existing regulations, including purchaser qualification requirements for offering exemptions that permit general solicitation and general advertising, have made private placement exemptions generally unavailable for crowdfunding transactions, which are intended to involve a large number of investors and not be limited to investors that meet specific qualifications.”).

52. 17 C.F.R. § 230.251 (2016).

53. For a brief summary of the major provisions of amended Regulation A (sometimes referred to as Regulation A+), see *Amendments to Regulation A: A Small Entity Compliance Guide\**, U.S. SEC. & EXCH. COMM'N (June 18, 2015), <https://www.sec.gov/info/smallbus/secg/regulation-a-amendments-secg.shtml>.

54. See Amendments for Small and Additional Issues Exemptions Under the Securities Act (Regulation A), Securities Act Release No. 33-9741, Exchange Act Release No. 34-74578, Trust Indenture Act Release No. 39-2501, 80 Fed. Reg. 21,806, 21,807 (Apr. 20, 2015) [hereinafter Regulation A Final Amendments] (“Overview”); see also *Helping Small Businesses and Protecting Investors*, *supra* note 49 (“[T]he Commission is increasing the dollar amount that can be raised from \$5 million to \$50 million.”).

individual investment limits.<sup>55</sup> This broad base of customers from which to solicit offers is also consistent with crowdfunding models.<sup>56</sup> However, companies making these offerings are subject to onerous and ongoing reporting requirements.<sup>57</sup> The costs of initial qualification and ongoing compliance can reach into the hundreds of thousands of dollars annually.<sup>58</sup> These costs alone, despite otherwise favorable factors, ultimately dooms Regulation A as a viable option for many, if not most, startups.<sup>59</sup>

A “private placement” offering under the complementary Section 4(a)(2) of the Securities Act<sup>60</sup> and the Rule 506 “safe harbor” of Regulation D<sup>61</sup> offers a popular alternative to the heavy regulatory burdens associated with Regulation A offerings.<sup>62</sup> Properly done, a private placement offering allows for unlimited fundraising.<sup>63</sup> The hallmark of a private placement is its nonpublic nature; to that end, general advertising and solicitation would disqualify an attempted offering under the safe harbor.<sup>64</sup> The safe harbor allows for nonpublic fundraising proposals directed either (1) only to accredited investors, or (2) to unlimited accredited, and a very small number of unaccredited but “sophisticated,” investors.<sup>65</sup> Preparation of a private placement memorandum (to avoid claims of fraud) is arguably less expensive than the disclosure

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55. Regulation A Final Amendments, 80 Fed. Reg. at 21,807.

56. *See, e.g.*, Bradford, *supra* note 6, at 1 (considering a large investor base to be the major idea behind crowdfunding).

57. *Id.*

58. *See* Regulation A Final Amendments, 80 Fed. Reg. at 21,883 (“One commenter estimated the qualification and reporting costs of a Tier 2 issuer to be approximately \$400,000 in the first year and \$200,000 annually thereafter (per issuer).”).

59. *Id.*

60. 15 U.S.C. § 77d (2012).

61. *See generally* 17 C.F.R. § 230.506 (2016 (providing Rule 506 safe harbors for offerings using the private placement exemption)).

62. *See id.*

63. *See* 15 U.S.C. § 77d.

64. MUNCK WILSON MADALA, PRIVATE OFFERINGS UNDER THE SEC’S NEW RULES: PRACTICAL IMPLICATIONS AND ACTIONS TO CONSIDER NOW 5 (Sept. 23, 2013), <http://www.munckwilson.com/sites/default/files/Client%20Alert%209-13.pdf> (“An issuer cannot rely on any of the . . . safe harbors if it . . . has knowledge that the purchaser is not an accredited investor.”).

65. *See id.*

documents required under Regulation A.<sup>66</sup> But, any sophisticated-but-unaccredited investors must be given “disclosure documents that are generally the same as those used in registered offerings.”<sup>67</sup> Further, restricting the crowd from which to attract investors to only those individuals with high enough income or net worth to meet the accredited investor definition can prevent companies with limited operating history or smaller interpersonal networks from connecting with the necessary number of investors.<sup>68</sup> The allowance of up to thirty-five additional sophisticated-but-unaccredited investors surely does not increase the crowd enough to make up for the costs of preparing their additional disclosure documents.<sup>69</sup> Thus, due to the limited means of publicizing the offering, a limited pool of potential investors, and the high costs associated with potential disclosure requirements, a private placement is not always an ideal option for small businesses trying to raise startup capital.<sup>70</sup>

Rules 504 and 505 of Regulation D<sup>71</sup> solve some of the problems of Regulation A and the private placement exemption.<sup>72</sup> In contrast to Regulation A, the preparation of filing documents under Rules 504 and 505 is less extensive and less expensive.<sup>73</sup> In contrast to private placements, these rules

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66. See Mike Goodrich, *Raising Money: What is a Private Placement Memorandum (PPM) and When Do You Need One?*, WELD FOR BIRMINGHAM (June 19, 2012), <http://weldbham.com/blog/2012/06/19/raising-money-what-is-a-private-placement-memorandum-ppm-and-when-do-you-need-one> (estimating that a skilled attorney can prepare a private placement memorandum for around \$20,000).

67. See *Fast Answers: Rule 506 of Regulation D*, U.S. SEC. & EXCH. COMM’N (Oct. 6, 2014), <https://www.sec.gov/answers/rule506.htm>.

68. See Thorpe, *supra* note 21 (discussing the small percentage of the U.S. population that actually meets the Rule 506 thresholds for sophistication and accreditation, and that “[a]round 7% of the US population could qualify as accredited investors today”).

69. *But see* Darrell Zahorsky, *How to Finance Your Business by Private Placement*, <https://www.thebalance.com/how-to-finance-your-business-by-private-placement-2951211> (last updated May 4, 2016) (arguing that despite private placement not being the most ideal option, it is the best option for small business owners).

70. *But see id.*

71. 17 C.F.R. § 230.504 (2016).

72. See *generally* Zahorsky, *supra* note 69 (“Regulation D is the most popular form of non-public private placement.”).

73. Compare 17 C.F.R. § 230.504(b) (Rule 504), and 17 C.F.R. § 230.505 (Rule 505), and 17 C.F.R. § 230.502(b) (general information requirements for

also allow for general advertising and solicitation in states with certain filing requirements or state-based exemptions to be directed at all investors.<sup>74</sup> It would seem, therefore, that these rules provide an ideal combination for crowdfunding: lower costs, and a larger crowd. However, it is clear the costs related to some state filing requirements, which would allow general advertising as described above, are not insubstantial.<sup>75</sup> Additionally, Rule 504 caps the exemption at \$1 million in any twelve month period.<sup>76</sup> Rule 505 is capped at \$5 million.<sup>77</sup> It is

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private placement memoranda), with 17 C.F.R. § 230.251(d) (Regulation A “offering conditions”), and FORM 1-A, REGULATION A OFFERING STATEMENT UNDER THE SECURITIES ACT OF 1933: GENERAL INSTRUCTIONS, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/about/forms/form1-a.pdf> (last visited Feb. 13, 2016) (listing information for Regulation A filings).

74. See 17 C.F.R. § 230.504(b)(i)–(iii). Indeed, the Maine intrastate crowdfunding model, discussed *infra*, is based directly on the exemption available under Rule 504. See ME. REV. STAT. ANN. tit. 32, § 16,304 (6-A)(D) (2014) (“The offering meets the requirements of the federal exemption . . . in 17 Code of Federal Regulations, Section 230.504 (2013)”).

75. See *A Guide for Small Businesses on Raising Capital and Complying with the Federal Securities Laws*, U.S. SEC. & EXCH. COMM’N., <https://www.sec.gov/info/smallbus/qasbsec.htm> (last modified Feb. 1, 2016) (“[New businesses] must comply with both federal regulations and state securities laws and regulations in the states where securities are offered and sold.”).

76. 17 C.F.R. § 230.504(b)(2). Many commentators have suggested that such a limit is too small to meet the needs of many companies seeking to access capital markets. See Kristin A. Gerber & Samuel Effron, Regulation Crowdfunding: *Long Wait Is Over, But Is Equity Crowdfunding D.O.A.?*, NAT’L L. REV. (Dec. 8, 2015), <http://www.natlawreview.com/article/regulation-crowdfunding-long-wait-over-equity-crowdfunding-doa>, and the accompanying parenthetical quote. Indeed, this is almost identical to a criticism commonly voiced as to Regulation Crowdfunding, that the fundraising limit is too small to justify the costs of compliance. See Letter from Youngro Lee, Esq., Co-Founder & CEO, NextSeed TX LLC, to Brent Fields, Sec’y, U.S. Sec. & Exch. Comm’n (Jan. 7, 2016) (Re: File Number S7-22-15), at n.1 (noting that, by the SEC’s own estimates, even small-scale federal crowdfunding issuers will likely incur costs of over \$20,000 per issuance). The SEC recognizes this possibility, and is currently considering a proposal to increase the fundraising limit under Rule 504 to \$5 million. See Exemptions To Facilitate Intrastate and Regional Securities Offerings, Securities Act Release No. 33-9973, Exchange Act Release No. 34-76319, 80 Fed. Reg. 69,786, 69,801 (proposed Oct. 30, 2015) [hereinafter Rule 147 Proposal] (“Increasing the offering limit from \$1 million to \$5 million may also make the Rule 504 exemption more attractive to start-up companies seeking capital financing . . .”). Editor’s Note: In the same release that finalized the Rule 147 amendments, the SEC did increase the Rule 504 offering limit to \$5 million, and added bad-actor disqualifications to the rule. The SEC also repealed Rule 505, effective 180 days after publication in the Federal Register. See Final Rule 147/147A Rules, 81 Fed. Reg. at 83,494, and accompanying text, *supra* note 14.

therefore likely that some businesses are caught in the gap where these fundraising limits make any cost savings moot because the company simply cannot raise its desired capital using these Rules.<sup>78</sup>

Prior to the JOBS Act's enactment, therefore, there was no one ideal model for companies seeking to raise capital using federal securities law exemptions.<sup>79</sup> The SEC rulemaking delays only exacerbated the problem.<sup>80</sup> One final federal exemption—Section 3(a)(11) of the Securities Act, and its Rule 147 safe harbor—provided a somewhat workable alternative for purely intrastate offerings.<sup>81</sup> But, as will be outlined in the next section, even that exemption is an imperfect solution to the problem of how to develop a large enough crowd to raise enough money without violating securities law.

### C. PREVIOUS EXEMPTIONS AGAINST WHICH TO JUDGE THE INTRASTATE CROWDFUNDING MODELS

Offerings of securities can trigger additional state level securities regulation under “blue sky” laws.<sup>82</sup> The Securities Act “expressly preserve[s] the jurisdiction of state securities commissions” to regulate securities activity outside the jurisdiction of the SEC.<sup>83</sup> Even when it might otherwise fall outside the scope of federal securities laws—by being offered entirely in-state and with no general solicitation or advertising,

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77. 17 C.F.R. § 230.505(b)(2). Compare this to the \$50 million under Regulation A or absence of limit under a private placement. Editor's Note: Rule 505 has been repealed, effective 180 days after publication in the Federal Register. See Final Rule 147/147A Rules, 81 Fed. Reg. at 83,494, and accompanying text, *supra* note 14.

78. 17 C.F.R. § 230.505.

79. See PRIVATE PLACEMENT: SELECTED EXEMPTION AND DISCLOSURE ISSUES AFTER THE JOBS ACT, FAIRFIELD & WOODS P.C., <http://www.fwlaw.com/news/123-private-placements-selected-exemption-disclosure-issues-after-jobs-act-> (last updated Jun. 10, 2016) (describing the many capital-raising options available to small businesses following the JOBS Act).

80. See LaCroix, *supra* note 12.

81. See 17 C.F.R. § 230.147 (2016) (Rule 147).

82. See Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 348 (1991) (tracing the etymology of the “blue sky” name, and explaining why these laws exist).

83. See *id.*, at 348; see also 15 U.S.C. § 77r (2012). *But cf.* National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.) (preempting certain state level regulation for securities offered under federal exemptions).

for example<sup>84</sup>—an offering can still be restricted under a state’s blue sky authority.<sup>85</sup> To the extent that small businesses want to take advantage of securities crowdfunding, their offerings will need to comply with *all* applicable state and federal regulatory regimes.<sup>86</sup>

As frustrations grew around the SEC’s delay in releasing final crowdfunding rules, state legislatures began to take matters into their own hands.<sup>87</sup> To avoid a situation where an issuer might comply with state law but still run afoul of federal mandates, many states adopted crowdfunding models legislated entirely within preexisting federal exemptions.<sup>88</sup> Section 3(a)(11) of the Securities Act exempts from registration any offering that is offered and sold entirely to residents of the state where the company does most of its business.<sup>89</sup> SEC Rule 147 provides a safe harbor for compliance with Section 3(a)(11).<sup>90</sup> Compliance with both of these requirements exempts an issuer from SEC regulation. One example of state legislation using this model is MNvest, the Minnesota crowdfunding statute signed into law in June 2015 and effective as of June 2016 (hereafter, the “Minnesota model”).<sup>91</sup>

An alternative model has arisen in at least two other states: Maine<sup>92</sup> (hereafter the “Maine model”) and

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84. See 15 U.S.C. § 77c(a)(11) (providing an intrastate offering exemption).

85. For example, the State of Minnesota provides additional state-level filing requirements for offerings that are otherwise exempt from registration under Rule 504 of SEC Regulation D (15 U.S.C. § 77c). See MINN. STAT. § 80A.50(b) (2015) (“Small corporation offering registration,” or SCOR).

86. The consequences of non-compliance run the gamut from mere denial of approval of registration statement, all the way through severe criminal liability. See generally COX ET AL., *supra* note 32, at 107–248 (overview of “The Initial Public Offering”).

87. See, e.g., Zeoli Letter, *supra* note 13 (describing the conflicts between proposed SEC Rule 147 revisions and intrastate models as well as possible solutions); see also LaCroix, *supra* note 12.

88. E.g., MINN. STAT. § 80A.461 (Minnesota).

89. See 15 U.S.C. § 77c(a)(11).

90. See 17 C.F.R. § 230.147 (2015). The safe harbor helps issuers know exactly when they are “doing business” entirely within a state. *Id.*

91. See About, MNVEST.ORG, <http://mnvest.org/about> (last visited Sept. 24, 2016). MNvest issuers were unable to complete an offering until June 2016 because they simply did not know how to provide the necessary regulatory disclosures to the Minnesota Department of Commerce. See *id.*

92. We refer to this as the “Maine model” because Mississippi’s crowdfunding statute actually contains some version of both state-based



Mississippi.<sup>93</sup> The Maine model, takes advantage of a different federal exemption: Rule 504 of Regulation D.<sup>94</sup> Under this exemption, offerings of \$1 million or less in a state with state securities registration requirements, or that are made entirely to accredited investors, are also outside the purview of the SEC.<sup>95</sup>

As of January 2016, more than half the states have some crowdfunding legislation on the books.<sup>96</sup> The substantial majority of these state laws use the Section 3(a)(11) model.<sup>97</sup> For this reason, and in the interest of providing the most useful guidance to the greatest number of readers, Part II of this Note will focus on MNvest as proxy for all state statutes mirroring Minnesota model.

The major obstacle confronting companies wishing to take advantage of crowdfunding under the Minnesota model is the antiquated nature of SEC Rule 147.<sup>98</sup> Rule 147 “provides a safe harbor for compliance with the Section 3(a)(11) exemption from registration for intrastate securities offerings.”<sup>99</sup> It limits the safe harbor to offerings where *both* offers *and* sales are limited only to residents of the state where the company does a certain

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crowdfunding models. *See generally id.*; Mississippi Securities Act of 2010, MISS. CODE ANN. § 75-71-101 to -701(2015) (statutory authority for Rule 7.21—tied to federal intrastate under Section 3(a)(11)—and Rule 2.04—tied to federal Rule 504 in Regulation D).

93. For a mostly up-to-date chart of all the current, pending, and defeated state-level crowdfunding statutes, visit the North American Securities Administrators Association’s website. *Intrastate Crowdfunding Legislation*, N. AM. SEC. ADMIN. ASSOC., <http://www.nasaa.org/industry-resources/corporation-finance/intrastate-crowdfunding-resource-center> [click “Intrastate crowdfunding legislation/regulation” to view a stored pdf] (last visited Jan. 31, 2016).

94. 17 C.F.R. § 230.504 (2016).

95. *See id.*; *see also* Whit Richardson, *New Crowdfunding Law Lends Mainers a Hand*, PORTLAND PRESS HERALD (Jan. 8, 2015), <http://www.pressherald.com/2015/01/08/new-crowdfunding-law-lends-mainers-a-hand> (“Th[e] exemption boils down to: ‘If the investment is under \$1 million, the SEC isn’t going to worry about it and leaves the regulation of that offering to states.’”).

96. *See Intrastate Crowdfunding Legislation*, *supra* note 93.

97. *See id.*; *see, e.g.*, MINN. STAT. § 80A.461 (2015) (MNvest statutory codification).

98. 17 C.F.R. § 230.147 (“Part of an issue”, “person resident”, and “doing business within” for purposes of section 3(a)(11)).

99. *See* Rule 147 Proposal, 80 Fed. Reg. at 69,786.

threshold amount of business.<sup>100</sup> The rule purports to give guidance by “provid[ing] objective standards for local businesses seeking to rely on Section 3(a)(11).”<sup>101</sup> As applied to state laws using the Section 3(a)(11) model, however, the application of Rule 147’s standards is not as useful as it might appear at first blush.

The restrictions placed on Section 3(a)(11) intrastate offerings in order to comply with Rule 147 are out of step with commerce in the digital age. The SEC has said that an offering under the Section 3(a)(11) model does not prohibit general solicitation or advertising *if conducted within the state*.<sup>102</sup> However, under the Section 3(a)(11) model, companies are arguably still prohibited from advertising the offering on their websites and social media platforms because “these communication tools reach beyond state borders and would likely involve *offers* to residents outside of the [ ] state.”<sup>103</sup> Additionally, Rule 147 requires that certain thresholds of business income, expenditure, and asset holdings occur in

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100. 17 C.F.R. § 230.147(a) (investor limitations); 17 C.F.R. § 230.147(c)(2)(i)–(iii) (business “issuer” threshold restrictions); *see also* Rule 147 Proposal, 80 Fed. Reg. at 69,788 (reciting thresholds, and noting market participants’ criticisms thereof).

101. *See* Rule 147 Proposal, 80 Fed. Reg. at 69,787.

102. *See* Timothy J. Capen, *Tired of Waiting for the SEC, States Adopt Their Own Crowdfunding Rules*, ICEMILLER LEGAL COUNS. (Sept. 19, 2014), <http://www.icemiller.com/Ice-on-Fire-Insights/Publications/Tired-of-Waiting-for-the-SEC,-States-Adopt-Their> [<https://web.archive.org/web/20151210171525/http://www.icemiller.com/ice-on-fire-insights/publications/tired-of-waiting-for-the-sec,-states-adopt-their-w>] (last accessed Nov. 25, 2016) (“[T]he SEC . . . stated that the intrastate exemption from registration under Section 3(a)(11) . . . does not prohibit general solicitation or advertising.”); *see also* Compliance & Disclosure Interpretation Question 141.05, U.S. SEC. & EXCH. COMM’N (last updated Aug. 6, 2015), <https://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm>.

103. Capen, *supra* note 102 (emphasis added); *see also* Compliance & Disclosure Interpretation (CDI) Question 141.05, *supra* note 102. For the most risk-averse clients, violating the SEC’s CDIs is likely unfathomable. However, at least some members of the ABA Business Law Section think that certain internet-based advertising and solicitation activities should be permissible while still complying with Rule 147. *See* Letter from David M. Lynn, Chair, Fed. Regulation of Sec. Comm., to Brent Fields, Sec’y, Sec. Exch. Comm’n (Apr. 8, 2016) (Re: File Number S7-22-15) (citing earlier CDIs, SEC no-action letters, and legislative history to argue that the recent CDIs are inconsistent with the rationale behind the solicitation and advertising prohibitions).

state.<sup>104</sup> Sales to out of state buyers, raw materials sourced from out of state sellers, and the trend toward geographical diversification in order to compete in a global marketplace could all jeopardize an equity crowdfunder's compliance with the exemption.<sup>105</sup> Thus, some of the very tools that initially made donation- and rewards-based crowdfunding so successful—like the internet and social media platforms—are the same tools which prevent equity crowdfunding from enjoying immediate widespread use.<sup>106</sup>

Issuers have used the intrastate crowdfunding laws of both state models with varying degrees of success and enthusiasm.<sup>107</sup> Some laws stall while state regulatory agencies continue to finalize rulemaking for the intermediary portals required under the state rules.<sup>108</sup> Other states have had laws on the books for some time but simply do not seem to have the interest from investors.<sup>109</sup> In certain circumstances, the

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104. These requirements are called the “80% tests” and are further discussed in Part II.A, *infra*.

105. See Andrew Stephenson, *Intrastate Crowdfunding: Nice, but Not a Game Changer*, CROWDCHECK: CROWDCHECK BLOG (June 11, 2014), <http://www.crowdcheck.com/blog/intrastate-crowdfunding-nice-not-game-changer> (noting the problems with the intrastate crowdfunding exemptions and that “very few companies have successfully raised funds as a result of the exemption”).

106. See Rule 147 Proposal, 80 Fed. Reg. at 69,788 (“[T]he use of the Internet for offerings makes it difficult for issuers to limit offers to in-state residents.”).

107. See Stephenson, *supra* note 105.

108. For instance, at the time of initial drafting of this Note (early 2016), Minnesota’s MNvest crowdfunding law required “the state Commerce Department [to] write the rules for how MNvest will be implemented and the [online intermediary] portals certified.” David Fonder, *State Enacts MNvest, to Connect Small Business with Small Investors*, TWINCITIES.COM PIONEER PRESS (June 20, 2015), <http://www.twincities.com/2015/06/20/state-enacts-mnvest-to-connect-small-business-with-small-investors/> (last visited Feb. 1, 2016). The MNvest regulations have since been published, see MNVEST.ORG, *supra* note 91, and issuers are just beginning to use them. (The author was also fortunate enough to have been able to work on one of the first MNvest offerings in August 2016 as part of his summer associateship at Winthrop & Weinstine, P.A., Minneapolis, MN, under the supervision of Zach Robins, who participated in drafting MNvest.)

109. See, e.g., Cowley, *supra* note 42 (quoting founder of Georgia crowdfunding portal SterlingFunder arguing investor awareness as major hurdle to successful projects). Cf. Gerber & Efron, *supra* note 76 (“[T]he relatively low maximum offerings amounts and investment limitations, will make Reg. CRWD young companies’ least appealing option for an equity financing.”).

regulations surrounding the funding intermediaries (e.g., internet portals) may be too burdensome to incentivize enough players to enter that niche of the market.<sup>110</sup> On the other hand, at least some businesses have been able to successfully avail themselves of the new state level rules.<sup>111</sup> The companies that seem to have the most success “at using the local laws to raise money tend to be those with existing networks of eager supporters.”<sup>112</sup> None of the states, however, are witnessing the explosion in equity crowdfunding activity contemplated by Congress when it enacted the JOBS Act.<sup>113</sup>

#### D. PUBLICATION OF FINAL RULES FOR REGULATION CROWDFUNDING, AND PROPOSED AMENDMENTS TO RULE 147

The SEC recently finished its review of comments to the 2013 proposed rules and published final rules entitled Regulation Crowdfunding on October 31, 2015.<sup>114</sup> The final rules went into effect in May 2016.<sup>115</sup> They address many of the concerns articulated by the business community regarding the 2013 rules, including complaints about the costs of public accountant review and ongoing reporting obligations for companies offering securities under Regulation

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110. See Gerber & Effron, *supra* note 76 (“Intermediaries, investors and even directors and officers of intermediaries and issuers will also have compliance requirements and limitations . . .”).

111. E.g., Rick Romell, *MobCraft Beer Becomes First to Use State’s Crowdfunding Law*, MILWAUKEE J. SENTINEL (Sept. 24, 2014), <http://archive.jsonline.com/business/mobcraft-beer-becomes-first-to-use-states-crowdfunding-law-b99358411z1-276938661.html> (last visited Oct. 20, 2016) (naming a Wisconsin brewery as the first to use state’s crowdfunding law).

112. Cowley, *supra* note 42.

113. *Id.* (“Around 95 companies nationwide have filed applications to raise money using the state laws, according to data compiled by The New York Times from state regulators.”).

114. See Press Release 2015-249, Sec. & Exch. Comm’n, SEC Adopts Rules to Permit Crowdfunding, Proposes Amendments to Existing Rules to Facilitate Intrastate and Regional Securities Offerings (Oct. 30, 2015), <https://www.sec.gov/news/pressrelease/2015-249.html>; see also Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,388 (codified at 17 C.F.R. pt. 227).

115. See Loughran et al., *supra* note 9, at 1 (“Regulation Crowdfunding will become effective May 16, 2016. The forms that will enable funding portals to register with the SEC will become effective January 29, 2016.”).

Crowdfunding.<sup>116</sup> At the same time, the final rules retain many of the burdensome disclosure and qualification requirements originally proposed in 2013, citing the rationale of investor protection.<sup>117</sup> In effect, a company wishing to take advantage of intrastate securities crowdfunding now has two competing options: a federal option under Title III/Section 4(a)(6) and Regulation Crowdfunding, and (if available) a state-based alternative.<sup>118</sup>

To complicate matters still further, proposed revisions to SEC Rule 147 were published in tandem with the final rules under Regulation Crowdfunding.<sup>119</sup> The proposed amendments respond to industry's concerns regarding the allowable use of the internet for solicitation and advertising, and the domiciliary restrictions on businesses seeking the statutory exemption.<sup>120</sup> In addition, and most relevant to issuers considering using state crowdfunding laws, the proposed amendments would end the Rule's "safe harbor" status and instead create an entirely new exemption.<sup>121</sup> This is motivated in part by the desire to update Rule 147 to the reality of modern business practices.<sup>122</sup> As discussed in more detail below, an issuer will no longer be able to strictly satisfy Section 3(a)(11)'s requirements on offers and sales if it takes full advantage of proposed Rule 147's permission to advertise and

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116. See, e.g., Regulation Crowdfunding, 80 Fed. Reg. at 71,419–21 (addressing complaints regarding the modified accounting reporting requirements).

117. The JOBS Act bumps up against traditional securities regulation even where business owners have the best of intentions. See Hanks & Stephenson, *supra* note 45 ("Entrepreneurs are optimistic by nature. That optimism can lead to omissions of required information for investors.").

118. See *id.* (illustrating the variations in state-based securities crowdfunding).

119. See Press Release 2015-249, Sec. & Exch. Comm'n, *supra* note 114. See generally Rule 147 Proposal, 80 Fed. Reg. at 69,786 (stating the actual text of the Rule 147 proposal). Editor's Note: The Final Rules have since been published, but not in time to address here before this issue went to print.

120. See Rule 147 Proposal, 80 Fed. Reg. at 69,787–88 (under the heading "A. Rationale for Proposed Amendments to Rule 147").

121. *Id.* at 69,789 ("Rule 147, as proposed to be amended, would no longer fall within the statutory parameters of Section 3(a)(11)."). The SEC's general authority to create exemptions is derived from 15 U.S.C. § 77z-3 (2012). *Id.* at 69,789, n.31.

122. See *id.* at 69,789, n.32 (stating that the proposed amendments are meant to encourage state based crowdfunding statutes).

solicit.<sup>123</sup> Additionally, a final rule that changes Rule 147 to a standalone exemption will therefore necessarily impact the workings of intrastate crowdfunding.<sup>124</sup>

The JOBS Act's stated mission to jumpstart business startups by enabling federally recognized securities crowdfunding has taken three years longer than expected.<sup>125</sup> The SEC's October 2015 release of final Regulation Crowdfunding rules has created a situation where companies have two possible options for offering and selling securities to the crowd.<sup>126</sup> At the same time, though, the proposed changes to Rule 147 have created further uncertainty about the future of the dominant state law solutions to the funding gaps targeted by the JOBS Act.<sup>127</sup> To the extent a potential issuer qualifies for and still has interest in using either of the federal or state based crowdfunding models, Part II attempts to provide some comparative guidance between the two. As a necessary corollary, Part II first advocates a common sense solution to the messy situation introduced by the Rule 147 amendment proposal.<sup>128</sup>

## II. ANALYSIS

In this Part II, this Note will describe the proposed changes to Rule 147 and outline one sensible path forward. Then, the Note will compare the mechanics of the new federal rules with the Minnesota model under the assumed solution to Rule 147 to analyze which, if either, model is preferable to certain types of small businesses. Through a comparison of how crowdfunding regulations affect the key players in any

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123. Most "[s]tate-based crowdfunding provisions generally require that an issuer, in addition to complying with various state-specific requirements to qualify for the exemption, also comply with Section 3(a)(11) and Rule 147." *Id.* at 69,788 (emphasis added).

124. See, e.g., Zeoli Letter, *supra* note 13.

125. See The JOBS Act, *supra* note 3, at 1 (stating the underlying purpose of The JOBS Act).

126. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,389 (illustrating the two options for offering and selling securities).

127. See *id.* at 71,488 ("Since the passage of the JOBS Act, many U.S. states have made changes to their securities laws to accommodate intrastate securities-based crowdfunding transactions.").

128. The common sense solution is substantially similar to the final rules recently adopted by the SEC. See Editor's Note, *supra* note 14, and the accompanying citation.

crowdfunding transaction—investors, issuers, and intermediaries—this Part illustrates why issuers might prefer one model over another.

#### A. THE PROBLEM WITH AMENDING RULE 147 AS CURRENTLY PROPOSED

The main problems with current Rule 147 as it relates to crowdfunding are (1) the restrictions on offers and sales “raise[] questions about the proper use of the Internet for [Section 3(a)(11)] offerings,” and (2) “[t]he limitation of eligible issuers only to those that are incorporated or organized in-state . . . excludes local issuers with local operations that incorporate or organize in a different state for business reasons.”<sup>129</sup> At the time of drafting,<sup>130</sup> SEC Rule 147 provides a safe harbor for securities offerings conducted entirely within a state (i.e., an “intrastate” offering) under Section 3(a)(11).<sup>131</sup> The Rule restricts both offers and sales of Section 3(a)(11) securities to people within one state, and further imposes restrictions in order for a company to qualify as doing business within a state.<sup>132</sup> The proposed amendment to the rule would eliminate the prohibition on general advertising and solicitation, and alter the limitations on issuers in order to do business in state, but it would also make Rule 147 a standalone exemption instead of a safe harbor.<sup>133</sup>

There are several positive aspects included in the Rule 147 proposal, designed to “modify certain regulatory requirements of the rule that no longer comport with modern business

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129. Rule 147 Proposal, 80 Fed. Reg. at 69,788.

130. The most recent substantive revisions to this Note occurred in September 2016. At that time, the SEC had yet to release any updates on its consideration of the comments provided to its proposed amendments.

131. See 17 C.F.R. § 230.147 (2016); see also 15 U.S.C. § 77c(a)(11) (2012) (stating exemption for “[a]ny security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory”).

132. See 17 C.F.R. § 230.147.

133. Rule 147 Proposal, 80 Fed. Reg. at 69,788 (“The proposed amendments to Rule 147 would amend these requirements and revise the rule to allow an issuer to engage in any form of general solicitation or general advertising.”).

practices or communications technology.”<sup>134</sup> The current Rule’s very strict threshold requirements for a company to be considered “doing business” within a state—commonly referred to as the “80% tests”<sup>135</sup>—are one example. It was previously difficult for an issuer to meet all of the 80% tests and failure to do so would prevent exemption under the original Rule 147.<sup>136</sup> Rule 147 as proposed would alter the current requirement of compliance with all three 80% tests to a more manageable “pick one” test approach.<sup>137</sup> Further, under Rule 147 as proposed, companies are “doing business” in the state where their “principal business activities” are carried out,<sup>138</sup> so long as one of the former 80% tests is met<sup>139</sup> or a majority of the issuer’s employees are based in that state.<sup>140</sup> Thus, under Rule 147 as proposed, a company that is truly local but might otherwise fail one of the 80% tests<sup>141</sup> will not be thereby prevented from accessing needed capital in the intrastate crowdfunding market. This should track more closely with modern business practices without abandoning the SEC’s desire “that the securities sold in an intrastate offering in one state should have to come to rest within such state before sales are permitted to out of state residents.”<sup>142</sup>

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134. *Id.* at 69,787–88. This section also notes that compliance with *all* three 80% requirements under Rule 147 may “unduly restrict[] the local businesses that may rely upon the exemption”; *see id.*

135. *See* 17 C.F.R. § 230.147(c)(2)(i)–(iii). Under current Rule 147, an issuer is deemed to be “doing business within” a state if (i) it derives at least 80% of its income in-state, (ii) it has at least 80% of its assets within the state, and (iii) it uses at least 80% of its income for business operations in-state. *Id.* As currently in force, Rule 147 also requires the issuer to have its principal office located within the state as well. *Id.* at subsec. (c)(2)(iv).

136. *See* 17 C.F.R. § 230.147(c)(2)(i)–(iii) (noting the mandatory nature of the statutory language).

137. *See* Rule 147 Proposal, 80 Fed. Reg. at 69,790–92, n.49 (“II.B.3 (Requirements for Issuers ‘Doing Business’ In-State)”).

138. *See* 17 C.F.R. § 230.147(c)(1) (as proposed).

139. *See* 17 C.F.R. § 230.147(c)(2)(i)–(iii) (as proposed).

140. *See* 17 C.F.R. § 230.147(c)(2)(iv) (as proposed).

141. The reader can imagine a situation where a Moorhead, Minnesota-based company might sell more than 20% of its products just across the Red River in Fargo, North Dakota. The company might also store goods in a Fargo warehouse, or have a lucrative contract with a Fargo-based buyer, such that 20% of those goods or revenue are derived from out of Minnesota. The rationale for punishing a company for success in its geographical region, even if that success means the company cannot strictly comply with all three 80% tests, is difficult to defend.

142. Rule 147 Proposal, 80 Fed. Reg. at 69,791.



As proposed to be amended, Rule 147 would also eliminate the restrictions on general advertising and solicitation of offers.<sup>143</sup> Almost by definition, “[c]rowdfunding involves the use of the Internet.”<sup>144</sup> In theory, this proposed tweak solves the problem with internet advertising and solicitation because issuers no longer have to worry about whether out-of-state investors might accidentally view online advertising materials (arguably an “offer” under many securities law analyses).<sup>145</sup>

Unfortunately, amending the rule to create a standalone exemption<sup>146</sup> would present latent problems for operation of state crowdfunding statutes that currently require compliance with both Section 3(a)(11) and Rule 147.<sup>147</sup> For states like Minnesota, whose crowdfunding statutes require compliance with both Section 3(a)(11) *and* Rule 147, making Rule 147 a standalone exemption would create an illusory option for use of internet advertising.<sup>148</sup> Recall that Section 3(a)(11) provides an exemption for securities “offered and sold *only* to persons resident within a single State or Territory.”<sup>149</sup> Thus, even if an issuer conducts the offering entirely within a Minnesota model state hoping to take advantage of Proposed Rule 147’s relaxed internet advertising standards, state law would still require compliance with Section 3(a)(11), which at least arguably does not allow offers or sales over the internet.<sup>150</sup> If enacted as

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143. *See id.* at 69,789 (“II.B.1 Elimination of Limitation on Manner of Offering”).

144. *See* Hopkins & Hopkins, *supra* note 17, at 9.

145. *See* Rule 147 Proposal, 80 Fed. Reg. at 69,789 (stating that any form of mass media would be permitted when locating potential investors).

146. *Id.* (“As amended, Rule 147 would function as a separate exemption from Securities Act registration rather than as a safe harbor under Section 3(a)(11).”).

147. *See, e.g.*, MINN. STAT. § 80A.461, subdiv. 3(2) (2015) (codifying the MNvest requirement for compliance with Section 3(a)(11) and Rule 147).

148. *See* Rule 147 Proposal, 80 Fed. Reg. at 69,799; *see also* Zeoli Letter, *supra* note 13.

149. 15 U.S.C. § 77c(a)(11) (2012) (emphasis added).

150. Remember, in this scenario Section 3(a)(11) no longer has a defined safe harbor for offers and sales. Without the prior guidance of Rule 147 CDIs on which to rely, the arguments by the ABA’s Federal Regulation of Securities Committee that there are still ways to protect issuers who utilize internet advertising or sales mechanisms, mentioned *supra* note 103, become less persuasive.

proposed, Rule 147 would be giving with one hand while taking with the other.<sup>151</sup>

At the time of writing, there are more than twenty five comment letters filed for comment on the Rule 147 proposals.<sup>152</sup> For clients who require a safest-possible, belt-and-suspenders approach to avoiding securities registration requirements but still must advertise on the internet, the Rule 147 amendment would effectively render Minnesota model statutes unavailable.<sup>153</sup> Any solution to this problem will necessarily involve a balancing of the benefits gained by keeping some of the proposals against the costs of achieving those desired results.

#### B. A SENSIBLE APPROACH TO DEALING WITH RULE 147 AS PROPOSED

[Editor's Note: The SEC's November 2016 release of final rules addressing, *inter alia*, Rule 147 renders much of the following discussion more academic than practical. However, the concerns underlying each hypothetical outcome described below remain valid. To the extent the analysis below may be useful when considering future revisions to the rules, we have preserved it in substantially unchanged form.]

A simple solution, of course, to the problems posed by the Rule 147 proposal would be to amend Section 3(a)(11) to remove the words "offers and," so that the general solicitation amendment in Rule 147 could be given its intended permissive effect for "sales" in a state which makes use of Proposed Rule 147's permission to advertise and solicit.<sup>154</sup> This solution would not require any action at the state level, would allow Rule 147

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151. Zeoli Letter, *supra* note 13 ("In reality, if Rule 147 and Section 3(a)(11) are treated separately, Issuers would not be able to avail themselves of the more permissive Rule 147 provisions the SEC is proposing and still be in compliance with the state-based crowdfunding.").

152. Comments on Proposed Rule: Proposed Rule Amendments to Facilitate Intrastate and Regional Securities Offerings, U.S. SEC. & EXCH. COMM'N, <https://www.sec.gov/comments/s7-22-15/s72215.shtml> (last visited Oct. 26, 2016).

153. The Rule 147 proposal of course does not directly affect Maine model states. However, any changes to Rule 504 that increase the offering limits thereunder will impact the relative desirability of those models in the first place.

154. Zeoli Letter, *supra* note 13 ("The 'offer' portion of Section 3(a)(11) is the issue.").

as proposed to work as its own exemption, solving both the internet advertising problem and the 80% tests problem.<sup>155</sup> However, given the current tense political climate in Washington, D.C., it may be impossible to create the legislative momentum necessary to achieve such a major shift in securities regulation policy.<sup>156</sup>

One other simple solution would be to leave current Rule 147 as is, and simply rebrand the SEC's proposal as "Rule 147A."<sup>157</sup> The SEC has general exemptive authority under 15 U.S.C. § 77z-3 to accomplish this.<sup>158</sup> In this proposed solution, current Rule 147 would retain its status as a Section 3(a)(11) safe harbor, complete with the 80% tests requirements and the perceived ban on internet advertising/sales.<sup>159</sup> Rule 147A, on the other hand, would look exactly like Rule 147 as proposed, only as a standalone exemption.<sup>160</sup> The potential benefits of having a standalone Rule 147A have already been discussed in Part II.A. On the negative side, even though Rule 147A is ideally suited for intrastate crowdfunding of any model, every (or nearly every) state would need to amend its crowdfunding statute in order to take advantage of its benefits.<sup>161</sup>

For its part, the SEC does acknowledge that "states that have crowdfunding provisions based on compliance with . . . both Section 3(a)(11) and Rule 147, would need to amend these provisions in order for issuers to take full advantage of . . . [the Rule 147] amendments."<sup>162</sup> As a middle ground, the SEC could decline to make Rule 147 a standalone

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155. *See id.* (explaining how if this change was implemented, there would be no conflict between the state and federal level legislation on this issue).

156. *See id.* (stating that the SEC was aware of the issue, but concluded that it would be up to the states to change their current statutes on the matter in order for issuers to benefit from the new amendments).

157. *See id.* (noting that such a solution would arduously require a total of twenty-seven states to amend their state statutes on the issue).

158. 15 U.S.C. § 77z-3 (2012).

159. *See* Zeoli Letter, *supra* note 13 ("Not only would keeping the proposed amended Rule 147 as a 'safe harbor' under Section 3(a)(11) alleviate the need for state level amendments and be consistent with the stated purpose of the proposed amendments, it would clearly be consistent with the existing opinions and guidance issued by legislators and the SEC to date.").

160. *Id.*

161. *Id.* (explaining that every state would need to modify their crowdfunding statutes in order to benefit from the proposed amended rule 147).

162. Rule 147 Proposal, 80 Fed. Reg. at 69,799.

exemption, while still adopting the revision to the 80% tests and clarifying exactly how issuers can use the internet for advertising and solicitation without violating Section 3(a)(11) (without eliminating the requirement altogether – a likely violation of the statute).<sup>163</sup> Crowdfunders would gain the benefits of a more modern regulation, but legislatures would not have to move mountains (again) to create ideal conditions for crowdfunding.<sup>164</sup> An assumption that the legislature adopts this proposed “middle ground” solution will form the basis of comparison for the remainder of the paper.<sup>165</sup>

Of course, state legislatures could act first to amend their crowdfunding statutes to account for the potentially conflicting nature of Section 3(a)(11) and Rule 147 as proposed.<sup>166</sup> This solution assumes that Rule 147 as proposed becomes its own standalone exemption under the (theoretical) Rule 147A analysis above; the effect would also be to leave Section 3(a)(11) without a safe harbor. In particular, the statutes that require compliance with both Section 3(a)(11) “and” Rule 147 could be reworded to use the disjunctive “or.” The state legislatures that have codified certain Rule 147 requirements directly into their statutes—as opposed to merely cross-referencing the federal rule—would also probably want to revisit their reasons for doing so.<sup>167</sup> Presumably, issuers wanting to advertise or solicit over the internet would always choose the more permissive standalone exemption over the now-without-a-safe-harbor Section 3(a)(11) model. Alternatively, states under the Minnesota model could amend their statutes to parallel the

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163. See Zeoli Letter, *supra* note 13 (illustrating some ways that the language may be clarified regarding use of the internet for advertising and solicitation purposes).

164. See *id.* (expressing a strong preference for expanding Rule 147 rather than creating a separate exception).

165. Editor’s Note: The final rules do not quite adopt the middle ground solution. They instead import many of the Section 3(a)(11)-compliant revisions (like modernizing the definition of “doing business” within a state), while creating a standalone exemption (complete with permission to internet-advertise, so long as “sales” stay within a state) predictably called Rule 147A. See Final Rule 147/147A Rules, 81 Fed. Reg. at 83,494, and accompanying text, *supra* note 14.

166. See Rule 147 Proposal, 80 Fed. Reg. at 69,799 (stating that suggestions from the states on which approach to take would be helpful); see also Zeoli Letter, *supra* note 13.

167. See, e.g., MINN. STAT. § 80A.461, subdiv. 1(b)(2) (2015) (incorporating Rule 147’s business asset location 80% thresholds to Minnesota’s state model).

Maine model under Regulation D's Rule 504, which does not even involve Rule 147.<sup>168</sup>

Either of these solutions would require multiple state legislatures to enact amendments, as compared with the relative simplicity of a single federal amendment.<sup>169</sup> Unfortunately, the time needed to mobilize this kind of legislative willpower might further delay the need for economic recovery that indeed first prompted the state-level crowdfunding legislation.<sup>170</sup> However, considering the fact that states may still have legislative momentum due to the relatively recent passage of their crowdfunding statutes, state level action may be more likely than a federal solution.<sup>171</sup>

One final solution would be to simply do nothing and accept the SEC's proposal to amend Rule 147.<sup>172</sup> The likely outcome in this case would be that federal Regulation Crowdfunding becomes the vastly more attractive option for issuers. To the extent that issuers operating under Regulation Crowdfunding do not even need to address the issues of offers and sales across state lines, it is hard to imagine in this situation that an issuer would choose a state crowdfunding program over the federal option.<sup>173</sup>

Time will be the judge of the wisdom of the SEC's ultimate decision on the matter. In consideration of the limited scope, for the purposes of discussion in the next section this Note will assume that the SEC's final rules for Rule 147 adopt the "middle ground" solution proposed earlier in this section. That is, the SEC will update the 80% tests and somehow clarify how issuers can use the internet for advertising and sales without

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168. See Rule 147 Proposal, 80 Fed. Reg. at 69,804 (stating that both Rule 147 and Regulation D's Rule 504 still share the same baseline for economic analysis).

169. See *id.* at 69,788 (stating that "the current statutory requirements in Section 3(a)(11) and regulatory requirements in Rule 147 make it difficult for issuers to take advantage of . . . state crowdfunding provisions").

170. See Zeoli Letter, *supra* note 13 (explaining that it took two years to get Illinois' crowdfunding statute passed).

171. See Cowley, *supra* note 42 (illustrating the state lead crowdfunding legislation movement that arose out of federal government's inaction).

172. See, e.g., Rule 147 Proposal, 80 Fed. Reg. at 69,786 (showing the unmodified SEC proposal to amend Rule 147).

173. See *id.* at 69,787 (illustrating how the provisions of the federal crowdfunding option address only intrastate interactions).

creating a standalone exemption.<sup>174</sup> The Note will further limit its discussion to a comparison of the new federal Regulation Crowdfunding with Minnesota's MNvest.

The next section will attempt to isolate and compare the rules of each model as they apply to the main parties in any crowdfunding offering: *issuers* offering and selling securities, *investors* buying securities, and, if applicable, the *intermediaries* and/or funding portals through which the securities travel. To the extent the analysis allows, it will also indicate which equity crowdfunding model might be preferable to a given issuer.

### C. COMPARISON OF MNVEST RULES & REGULATION CROWDFUNDING RULES

Unfortunately, at the time of writing Regulation Crowdfunding has only been in force for a few months<sup>175</sup> and the Minnesota Commerce Department has only recently adopted regulations for MNvest offerings.<sup>176</sup> One general statement that can be made without knowing how all the details will ultimately work in practice over time: issuers will probably not be interested in using securities crowdfunding models unless the requirements are at most comparable to, and ideally much less restrictive than, the requirements under other security sales regimes.<sup>177</sup>

#### 1. Issuer Restrictions

Issuers wishing to take advantage of state crowdfunding under MNvest must satisfy Section 3(a)(11)'s requirement that the issuer be doing business within the state.<sup>178</sup> This will be true whether Rule 147 lands in the "middle ground" proposal,

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174. Editor's Note: As noted several times already, the November 2016 final rules adopt portions similar but not identical to this middle ground approach. See Final Rule 147/147A Rules, 81 Fed. Reg. at 83,494, and accompanying text, *supra* note 14.

175. The regulations went into effect in May 16, 2016. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,388.

176. See MINN. R. 2876.3050 (2016) ("Published Electronically: June 22, 2016").

177. See Rachele Damico, *What New SEC Crowdfunding Rules Mean for Your Small Business*, CRAIN'S DETROIT BUS. (Jan. 10, 2016, 8:00 AM), <http://www.crainsdetroit.com/article/20160110/NEWS/160109872/what-new-sec-crowdfunding-rules-mean-for-your-small-business> (updated Feb. 8, 2016).

178. 15 U.S.C. § 77c(a)(11) (2012).

or simply does not change at all.<sup>179</sup> On the other hand, an issuer under Regulation Crowdfunding is of course not restricted to doing business within a state in the same way as under Minnesota model statutes.<sup>180</sup> If the company truly needs to reach a substantially large crowd to raise its funds, either because it is relatively unknown in one state<sup>181</sup> or relatively unknown in general because it is so new, Regulation Crowdfunding's model may be the better option.

MNvest disqualifies certain bad actors from acting as issuers in MNvest offerings.<sup>182</sup> So also does Regulation Crowdfunding.<sup>183</sup> Each regime will bring with it certain compliance costs for issuers hoping to conduct a crowd-funded securities offering.<sup>184</sup> Because each regime requires these kinds

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179. See *id.* (showing that both the “middle ground” and “no change” proposals must satisfy Section 3(a)(11)’s requirements).

180. See generally Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,388 (showing generally lacking residency requirements). This is, however, to say nothing of state filing requirements. *E.g.*, Regulation of Securities, MINN. STAT. ch. 80A.

181. This may be a very salient point for those looking to make the leap from rewards-based to equity crowdfunding, particularly in light of the fact that the average geographical distance between a Kickstarter project and a Kickstarter funder is roughly 2,317 miles. Justin Kazmark & Andrew Nichols, *The First 100,000 Funded Kickstarter Projects in 100 Numbers*, KICKSTARTER: THE KICKSTARTER BLOG (Feb. 8, 2016), <https://www.kickstarter.com/blog/the-first-100000-funded-kickstarter-projects-in-100-numbers>.

182. See MINN. STAT. § 80A.461, subdiv. 9 (2015). Bad actors are, generally speaking, individuals who have previously run afoul of securities laws and regulations, or are under investigation for violations of laws designed to protect investors.

183. The bad actor disqualification is mandated by the Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat 306 (2012) (codified as amended in scattered sections of 15 U.S.C.) (§ 302(d) requires substantially similar disqualification criteria as in 17 C.F.R. § 230.262).

184. See Kendall Almerico, *How the SEC “Bad Actor” Rules Will Affect Equity Crowdfunding*, CROWDFUNDING INSIDER (Dec. 9, 2013, 11:01 AM), <http://www.crowdfundinsider.com/2013/12/28004-sec-bad-actor-rules-will-affect-equity-crowdfunding> (discussing the 2013 proposed rules on disqualification), which states:

When it comes to bad actors, the proposed JOBS Act rules are just as burdensome as those that apply to Regulation D offerings . . . . For those concerned about potential fraud in the equity crowdfunding world, these bad actor rules provide a comfort zone . . . . But the tradeoff is another expensive undertaking for a startup company using equity crowdfunding to raise the \$100,000 that banks and angel investors are no longer interested in funding.

*Id.*

of disclosures in order for an issuer to conduct a registration, neither MNvest nor Regulation Crowdfunding seems to have any advantage over the other.<sup>185</sup> Each will obviously be at a cost disadvantage to securities offering models that do not require such ongoing disclosures.<sup>186</sup>

Both MNvest and Regulation Crowdfunding assume that some amount of solicitation and advertising must happen over the internet for a crowdfunding campaign to work.<sup>187</sup> Indeed, one of the SEC's cornerstone reasons for proposing to amend Rule 147 is to bring the antiquated restriction on general solicitation and advertising into the twenty-first century.<sup>188</sup> Both regimes still regulate heavily around the amount and types of communications that issuers may use to advertise and solicit offers.<sup>189</sup> The SEC and state agencies justify these requirements for investor protection reasons.<sup>190</sup> The theory, as in other areas of securities law, is that investors should always be given sufficiently complete and reliable information, and that this generally happens when the information is centered in one place.<sup>191</sup> As both models restrict the content and

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The 2013 proposed rules were eventually adopted in 2015 in substantially the same form. *See* Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,479.

185. By this measure, neither crowdfunding regime is much different from certain other federal securities fundraising options that require bad actor disqualification, including Regulation A and Rule 506 of Regulation D. *See* "Bad Actor" Reports, CROWDCHECK, <http://www.crowdcheck.com/content/bad-actor-reports> (last visited Oct. 26, 2016).

186. For example, a private placement under Section 4(a)(2) of the Securities Act. While bad actor requirements are increasingly common, they are still a relatively new phenomenon. *See id.*

187. *See* Fondler, *supra* note 108 (showing the relevance of the internet in crowdfunding).

188. *See* Rule 147 Proposal, 80 Fed. Reg. at 69,798–99 (providing the rationale for proposed amendments to Rule 147).

189. *See, e.g.,* MINN. STAT. § 80A.461, subdiv. 3(12) (2015) (prescribing the limits of issuer communication on its own behalf); Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,542 (final rule § 227.204(b); similar limitations on content of issuer advertising). Generally, both models prescribe both a floor and a ceiling for the types of information which must/may be disclosed in advertising communications.

190. *See* Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,390 (explaining that investors must use an SEC approved site when conducting transactions for investor protection).

191. *See generally* COX ET AL., *supra* note 32, at 107–248 (Chapter 4: Initial Public Offering).



methods of advertisement in similar ways, neither seems to have an advantage over the other.<sup>192</sup>

The annual fundraising limits provide one distinction between the federal and Minnesota models.<sup>193</sup> Issuers using the Section 3(a)(11)-model state *exemptions from registration* are capped at raising \$5 million in any twelve-month period.<sup>194</sup> Under blue sky authority, Minnesota has further restricted crowdfunding raises to a maximum of either \$2 million or \$1 million, depending on the type of review given to the issuer's financial documents.<sup>195</sup> In contrast, Regulation Crowdfunding limits issuers to a total of \$1 million in a twelve-month period.<sup>196</sup> Clearly, on this measure the MNvest model wins so long as an issuer can justify the additional costs of audited or certified financial statements.<sup>197</sup>

In both Regulation Crowdfunding and Rule 147 as proposed the SEC contemplated, and ultimately declined to adopt, rules that would integrate all securities offerings pursuant to a federal crowdfunding exemption.<sup>198</sup> The upshot of

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192. Note that under Regulation Crowdfunding, the SEC allows issuers to contact investors *through* the portals, so long as they identify themselves clearly and the communications are public. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,447 (“We are requiring intermediaries to make the communications on the channels publicly available for viewing. We believe that this requirement is consistent with the concept of crowdfunding, as it provides for transparent crowd discussions about a potential investment opportunity.”).

193. See, e.g., *id.* at 71,389 (stating that the amount raised in a twelve-month period may not exceed \$1 million).

194. See Rule 147 Proposal, 80 Fed. Reg. at 69,831 (proposed rule § 230.147(a)(2)). Rule 147 as proposed does not set an explicit fundraising limit on offerings conducted pursuant to its exemption, so long as the issuer *registers* the securities in the state. *Id.* (proposed rule § 230.147(a)(1)). As previously discussed, however, crowdfunding issuers are almost invariably seeking cost savings, and state registration can entail significant filing fees and ongoing reporting obligations.

195. See MINN. STAT. § 80A.461, subdiv. 3(5) (2015) (stating the applicable industry standards for each limit).

196. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,537 (final rule § 227.100(a)(1)). Regulation Crowdfunding also provides some flexibility in financial documentation requirements depending on the size of the raise, but still limits yearly offerings to \$1 million. *Id.* at 71,359 (final rule § 227.201(t)).

197. See MINN. STAT. § 80A.461, subdiv. 3(5).

198. See *generally* Rule 147 Proposal, 80 Fed. Reg. at 69,795-96 (integration under proposed Rule 147); Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,392 (“Capital raised through other . . . [means

this is that, although an issuer may not be able to close the *entire* fundraising gap using crowdfunding under either model, they will be permitted to use both models concurrently, in addition to any other securities exemptions available.<sup>199</sup>

Probably the most costly requirements under either the federal or the intrastate crowdfunding models are those relating to disclosures and disclosure documents. An investor familiar with trading securities in the secondary markets will recognize many of the same features in the crowdfunding documents as in prospectus requirements.<sup>200</sup> MNvest's disclosure requirements are significantly similar, with only minor variations on the above items,<sup>201</sup> not likely to increase or decrease the cost of creating and updating an offering document. Issuers are therefore not likely to base their federal crowdfunding vs. state crowdfunding decisions on this particular factor.<sup>202</sup> The Appendix following Part III below compares the disclosure requirements under the two crowdfunding regimes side by side. When comparing to full securities registration under the Securities Act, however, issuers are likely to prefer creating an offering document "*significantly more limited* [for a crowdfunding offering] than the disclosure that would be required in connection with a registered offering of securities."<sup>203</sup>

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should] not be counted in determining the aggregate amount sold in reliance on Section 4(a)(6)."). Integration is a serious worry for issuers because of its potential for loss of exemption.

199. For example, a private placement under Section 4(a)(2) of the Securities Act.

200. See generally *Crowdfunding Part 2 - Initial and Ongoing Disclosure Requirements*, DORSEY & WHITNEY LLP (Nov. 19, 2015), <https://www.dorsey.com/newsresources/publications/client-alerts/2015/11/crowdfunding-initial-ongoing-disclosure-req>; Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,537 (final rule § 227.201 – "Disclosure Requirements"). *But cf.* Damico, *supra* note 177 ("The type of information that a company pursuing a crowdfunding offering that has to be disclosed to a non-accredited investor is typically going to be less than what would have to be disclosed during a conventional offering.").

201. See MINN. STAT. § 80A.461, subdiv. 4 (titled "Required disclosures to prospective MNvest offering purchasers").

202. See *id.* (illustrating the relatively minute differences in the MNvest disclosure requirements compared to the federal requirements).

203. Andrew J. Foley, *SEC Adopts Final Rules for Crowdfunding*, HARV. L. SCH. F. CORP. GOVERNANCE & FIN. REG. (Nov. 16, 2015), <https://corpgov.law.harvard.edu/2015/11/16/sec-adopts-final-rules-for-crowdfunding> (emphasis added).

## 2. Investor Restrictions

One of the most fundamental differences between MNvest's Section 3(a)(11)-based intrastate model and the general crowdfunding regime under Regulation Crowdfunding is the confinement of offers and sales only to residents of the state. The regulatory theory behind allowing relaxed<sup>204</sup> restrictions for entirely intrastate offerings holds that resident investors will more easily be able to monitor their investments if the company is close by.<sup>205</sup> Although Rule 147 as proposed increases the pool of available issuers,<sup>206</sup> thereby increasing the pool of potential investment opportunities, the possibility exists for investor confusion when a company's out of state rules under the corporate internal affairs doctrine<sup>207</sup> conflict with the corporate rules of the state of the offering. It may be possible to resolve this regulatory worry by pointing to the fact that, although the possibility for confusion is arguably increased, it is balanced by the cost savings in regulatory enforcement actions due to the proximity of companies to the regulatory agencies themselves.<sup>208</sup>

To obtain the safe harbor under Rule 147 as proposed, Minnesota model issuers must use a state exemption that limits in some way the amount of securities "[a]n investor may purchase in such offering (*as determined by the appropriate*

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204. See *supra* Part II.C.1 (discussing surrounding analysis). It is not entirely clear that MNvest's requirements are any more "relaxed" than those of Regulation Crowdfunding. The biggest difference is the increased fundraising limit. *Id.*

205. See Rule 147 Proposal, 80 Fed. Reg. at 69,790 ("The Section 3(a)(11) intrastate offering exemption allows businesses to raise money within the state from investors who are more likely than those outside the state to be familiar with the issuer and its management.").

206. See *id.* at 69,817 (defining a company's "place of business" under the proposed Rule 147, which would have the effect of re-patriating companies organized in another state, like Delaware, back into the state where their main business activities take place); see also *id.* at 69,790-91 ("2. Elimination of Residence Requirement for Issuers.").

207. See Frederick Tung, *Before Competition: Origins of the Internal Affairs Doctrine*, 32 J. CORP. L. 33, 33 (2006) (explaining that under this doctrine, a corporation's internal business affairs are governed according to the law of the state of *incorporation*, and that this need not necessarily be the same as the place where a corporation *conducts* its business).

208. Otherwise, the Minnesota securities administrator might have difficulty monitoring and prosecuting fraud for companies headquartered in, say, Delaware.

*authority in such state*).”<sup>209</sup> The annual limit under MNvest for an individual non-accredited investor is \$10,000 in any single offering, regardless of actual income or net worth (assuming they are still low enough to remain non-accredited).<sup>210</sup> Many critics attack individual investor limits as paternalistic in nature, both over- and under-inclusive.<sup>211</sup> For instance, an accredited investor’s other investments could be so illiquid that allowing an additional \$10,000 only exacerbates liquidity issues. On the other hand, individual investors that do not technically meet the accredited investor income or net worth thresholds may otherwise have sophisticated market knowledge and sufficient savings that regulatory agencies need not worry about protecting them from the dangers of fraudsters or business failures.<sup>212</sup> On balance, and to the extent that at least *some* investor protection is explicitly a securities regulation agency’s mission,<sup>213</sup> Minnesota’s limit seems neither clearly arbitrary nor unreasonable.

Under the final rules of Regulation Crowdfunding,

an investor will be limited to investing: (1) the greater of: \$2,000 or 5 percent of the lesser of the investor’s annual income or net worth if either annual income or net worth is less than \$100,000; or (2) 10

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209. See Rule 147 Proposal, 80 Fed. Reg. at 69,831 (illustrating proposed rule § 230.147 (a)(2)(ii)) and identifying the Minnesota Department of Commerce as securities regulator).

210. See MINN. STAT. § 80A.461, subdiv. 3(7) (2015) (“[N]o single purchaser may purchase more than \$10,000 in securities of the MNvest issuer under this exemption in connection with a single MNvest offering unless the purchaser is an accredited investor”). Note that accredited investors, as defined under Minnesota law, are not restricted in their investment. *Id.* Theoretically, this means a single “angel” accredited investor could fund the bulk of a project while unaccredited investors make up the rest of the investment.

211. See Comm’r Michael S. Piwowar, *Dissenting Statement at Open Meeting on Crowdfunding and Small Business Capital Formation*, U.S. SEC. & EXCH. COMM’N (Oct. 31, 2015), <https://www.sec.gov/news/statement/piwowar-regulation-crowdfunding-147-504.html> (asserting that requiring limits on crowdfunding at a federal level does not adequately allow states to protect their citizens, particularly given the vast difference in size between states like California and Wyoming, for example).

212. A paradigmatic example would be a law school professor who teaches a course on securities regulation. Presumably, this qualified individual has the kind of market sophistication to fully appreciate the inherent risks of investing, even though her salary or net worth may not qualify her for accredited investor status.

213. *E.g.*, 15 U.S.C. § 77b(b) (2012) (“[When making rules,] the [SEC] shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.”).

percent of the lesser of the investor's annual income or net worth, not to exceed an amount sold of \$100,000, if both annual income and net worth are \$100,000 or more.<sup>214</sup>

This contrasts with MNvest's limits in two ways: (1) creating a maximum investment even for accredited investors,<sup>215</sup> and (2) creating a tiered system for non-accredited investors. As accredited investors are not the target audience of securities crowdfunding (because they have other simpler investment options, like private placements), we will not consider the first difference. In the second difference, as compared to MNvest, Regulation Crowdfunding basically cuts the maximum possible yearly investment in half for non-accredited investors with either annual income or net worth under \$100,000.<sup>216</sup> However, for non-accredited investors with net worth / annual income just below the \$1,000,000 / \$200,000 thresholds (but each over \$100,000), the annual investment limit is effectively double the MNvest limit.<sup>217</sup> Compared side by side with MNvest, Regulation Crowdfunding can sometimes be a more attractive option, especially for issuers seeking to minimize the number of overall crowdfunding investors.<sup>218</sup>

Under Rule 147 as proposed, and MNvest by extension, a security sold pursuant to the exemptions must come to rest within the state for a period of nine months after sale.<sup>219</sup> Such

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214. Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,394 (including an illustrative chart describing some possible scenarios).

215. This reflects a concern of the SEC that even investors with substantial net worth may still not be able to weather the financial hit if the crowdfunding securities became worthless. *Cf. id.* ("We are concerned about the number of households where there is a sizeable gap between net worth and annual income, and the ability of these households to withstand the risk of loss. According to Commission staff analysis of the data in the 2013 Survey of Consumer Finances, approximately 20% of U.S. households with net worth over \$100,000 have annual income under \$50,000.")

216. For example, even if a person's annual income and net worth were just \$.01 shy of the \$100,000 threshold, their maximum investment per year would be just shy of \$5,000 (i.e., 5% of almost-\$100,000).

217. In other words: 10% of the lesser of net income or annual worth (i.e., almost-\$200,000, in this example) would be just shy of \$20,000 (double the MNvest non-accredited individual investor limit).

218. It is important to remember that, to adapt an iconic phrase from an iconic artist, "mo' investors, mo' problems." See Damico, *supra* note 177 ("More investors mean more people have a say in a company, which could be a concern [later] for venture capital firms.")

219. See Rule 147 Proposal, 80 Fed. Reg. at 69,831-32 (proposed § 230.147(f)).

a restriction gives rise to criticisms that lack of freedom to resell within that time period impairs the investor's liquidity interests.<sup>220</sup> This restriction makes sense when satisfying the statutory requirements to qualify an offering as truly intrastate, but perhaps not anywhere else. Twenty-first century investors expect to be able to trade their securities if they become dissatisfied with their investment.<sup>221</sup> The SEC responds to those criticisms by asserting their mandate to protect all investors from securities fraud on the part of issuers.<sup>222</sup> In effect, however, this gives an issuer a nine-month statutory window in which to gamble risk-free with investor money.<sup>223</sup> Investors will not have significant voting or control interests as a result of their crowdfunding purchases.<sup>224</sup> In the absence of a meaningful vote on corporate affairs, the investor's main tool to express distaste with management's decisions would be to vote with their dollars and sell out. If market price

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220. See, e.g., Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,439 n.731 (noting the SEC Investor Advisory Committee's suggestion for development of a sample crowdfunding investor guide highlighting the "lack of liquidity" for securities sold in these transactions).

221. See generally Scott Shane, *Will Equity Crowdfunding Buyers Be Able to Sell Their Shares?*, ENTREPRENEUR: READY TO LAUNCH (June 30, 2015), <https://www.entrepreneur.com/article/247832> (discussing the struggles equity crowdfunders may encounter when attempting to sell in a secondary market). This expectation may be particularly true of crowdfunding's target small investor/investment class, whose previous experience with securities ownership might be limited to highly liquid stocks or mutual funds traded on high-volume national exchanges. See generally *id.*

222. E.g., 15 U.S.C. § 77b(b) (2012) ("[When making rules,] the [SEC] shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.").

223. See, e.g., Antone Johnson, *The Great Crowdfunding Train Wreck of 2013*, GUST (Mar. 19, 2012), <http://blog.gust.com/crowdfunding-train-wreck> (discussing the classic principal-agent problems triggered when small investors—as in crowdfunding—do not individually have the economic power to compel strong attention from their fiduciaries).

224. See *id.* It is unrealistic to believe that issuers under crowdfunding statutes will want to give away significant control of the company during the issue any more than companies conducting traditional securities offerings. In fact, some proposed crowdfunding transactions use novel securities-conversion features that eventually remove any control features from the investment. See Robb Mandelbaum, *Should You Crowdfund Your Next Business?*, INC.COM (May 2014), <http://www.inc.com/magazine/201405/robb-mandelbaum/jobs-act-crowdfunding-problems.html> (describing investor confusion when a prospective issuer explained the conversion features to potential members of the "crowd").

for resale will truly reflect an “efficient market,”<sup>225</sup> and the security’s value will decrease the same amount in nine months regardless of the beneficial owner, then it makes no more sense to lock in an initial investor for some time period than it does to lock in someone after a bad blind date.

To the extent that Regulation Crowdfunding prevents resale of crowdfunded securities for one year<sup>226</sup> it is not any better than those states using the Minnesota model. In fact, stretching out the time restriction actually increases the window where the first owner becomes stuck with a bad egg, no matter how early they discover it. Coming to rest within a state at least helps satisfy the statutory exemption requirement for intrastate offerings; such a restriction on resale for securities offering under the federal model seems less justified at best and potentially more harmful to initial investors at worst. Investors might therefore find the MNvest model a more attractive investment vehicle.

### 3. Intermediary/Portal Restrictions

The paradigmatic crowdfunding operation processes investment through an internet based intermediary, sometimes called a portal, and MNvest is no exception.<sup>227</sup> A portal can be roughly analogized to a broker-dealer in classic securities transactions.<sup>228</sup> In order to avoid registration requirements at a federal level under Rule 147 as proposed, an issuer has two options: register at the state level, or conduct the offer and sale

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225. See generally COX ET AL., *supra* note 32, at ch. 3 (description and critiques of the “efficient capital market hypothesis”).

226. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,475–76 (outlining the rationale behind resale restrictions). Note that resale restrictions in general are slightly different than “coming to rest” requirements for intrastate deals in particular, but they have much the same effect.

227. See MINN. STAT. § 80A.461, subdiv. 3(3) (2015) (requires sales “exclusively through a MNvest portal”). While both MNvest and Regulation Crowdfunding technically allow for traditional dealer-brokers to process transactions, it is the use of internet portals that most closely resembles the rewards-based platforms (like Kickstarter) which first inspired securities crowdfunding.

228. In Minnesota, however, a portal operator does have different registration requirements as broker-dealers. Compare MINN. STAT. § 80A.461, subdiv. 7 (MNvest portal operator requirements), with MINN. STAT. § 80A.61 (“Registration by Broker-Dealer . . .”).

pursuant to a state law exemption like MNvest.<sup>229</sup> Because avoiding potentially prohibitive registration costs is one of the main goals of crowdfunding issuers, it would appear that the second of the two options—which in Minnesota implies the use of a portal<sup>230</sup>—is preferable.

MNvest provides several requirements for portal operators regarding recordkeeping<sup>231</sup> and verification of investor residency.<sup>232</sup> Regulation Crowdfunding also requires similar actions by portal operators.<sup>233</sup> To the extent that this kind of information would necessarily be collected by the portal operator as part of any sale of crowdfunded securities, these identity verification and additional storage requirements do not seem particularly onerous, and certainly not very useful for distinguishing the two models.<sup>234</sup>

In Minnesota, at least, portal operators are supposed to be extremely neutral in their intermediary activities. They are not allowed to provide investment advice.<sup>235</sup> While the restriction on investment advice means that investors may have to visit another vendor's site before purchasing, investors and issuers are thereby protected from unscrupulous portal operators who might otherwise favor one campaign over another.<sup>236</sup>

MNvest portal operators are further restricted in the calculation of the fees they charge to issuers, specifically in that they cannot charge a fee based on the amount of securities

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229. See Rule 147 Proposal, 80 Fed. Reg. at 69,831–32 (proposed § 230.147(a)(1) & (2)).

230. MINN. STAT. § 80A.461, subdiv. 3(3).

231. See MINN. STAT. § 80A.461, subdiv. 7(e) (mandating a MNvest portal operator keeps certain information about all potential investors, the offering, and certain people connected with the issuer).

232. See MINN. STAT. § 80A.461, subdiv. 6 (prescribing the content for a residency declaration that must be provided before an investor can access the offers section of a MNvest portal).

233. See generally Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,542–45 (final rules §§ 227.300–.305).

234. See generally *id.* at 71,443.

235. See MINN. STAT. § 80A.461, subdiv. 7(c)(1) (prohibition on offering investment advice or recommendations).

236. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,430, n.613 (noting certain industry group concerns that financially-interested intermediaries would be otherwise incentivized to promote certain projects over others).



offered for sale through their site.<sup>237</sup> This is in slight contrast to the federal Regulation Crowdfunding rules which do not place a restriction for fees-calculation based on amount of securities sold.<sup>238</sup> A portal operator might therefore prefer, and an issuer might thus have more luck convincing the portal operator, to run an offering under Regulation Crowdfunding instead of MNvest. Finally, even though the MNvest prohibition on fees based on amount of the offering will initially cause some confusion as to the appropriate market price for portal operators' services, this is nothing that market forces cannot solve quickly via trial and error.

It is likely that some portals will only operate in local or regional markets, while others will choose to operate exclusively on a national scale.<sup>239</sup> To the extent that cost differences arising between nationally-operating portals and more targeted regional or topic-specific portals are driven by market differences rather than by the different needs of federal or state crowdfunding models, companies seeking crowdfunding support may not have much meaningful guidance when choosing between models. All other factors being equal, a portal which can be used to reach a national audience will by default have more options to recoup startup capital (i.e., more potential securities issuer clients) than a portal tailored specifically to one state's intrastate model.

#### 4. Other Important Considerations

Certain other requirements common to both of the state and federal crowdfunding models may impact whether securities crowdfunding is the most desirable route at all for companies. Under Regulation Crowdfunding, an issuer must have a "business plan."<sup>240</sup> Although not stated explicitly in the

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237. See MINN. STAT. § 80A.461, subdiv. 7(c)(3) (fees can be either based on length of listing time on portal, or a flat fee, or some combination of the two).

238. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,539 (final rule § 227.501(o)).

239. Indeed, such regional and topic specialization has become the norm in the rewards- and donation-based model portals. Compare KICKSTARTER, [www.kickstarter.com](http://www.kickstarter.com) (last visited Oct. 11, 2016) (national), with POWER2GIVE, [power2give.org](http://power2give.org) (last visited Oct. 11, 2016) (Broward County, FL), and REALTY MOGUL, [www.realtymogul.com](http://www.realtymogul.com) (last visited Oct. 11, 2016) (real estate investing).

240. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,537–38 (particularly § 227.100); see also *id.* at 71,398 ("The final rules also

statutory or regulatory language, MNvest also appears to assume that only companies able to provide a business plan to investors will be able to meet the MNvest issuer disclosure requirements.<sup>241</sup> This requirement may come as an unwelcome obstacle for those familiar with the more laissez-faire project descriptions and updates which accompany many rewards-based crowdfunding campaigns.<sup>242</sup> Furthermore, it is clear that companies with very innovative products or business models may be extremely uncomfortable disclosing potential trade secret information with investors, even assuming the use of confidentiality agreements.<sup>243</sup> Assuming that a company is committed to raising funds through crowdfunding, however, they will be stuck with at least some kind of disclosure requirement.

As a final positive aspect, both the Section 3(a)(11) model under Rule 147 as proposed and the Regulation Crowdfunding model are nonexclusive methods of exempt fundraising.<sup>244</sup> This means that even if an issuer reached the limit under one model during a twelve-month period it could supplement with an offering under another exemption.<sup>245</sup> Issuers using either

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exclude an issuer that has no specific business plan or has indicated that its business plan is to engage in a merger or acquisition with an unidentified company or companies.”).

241. See MINN. STAT. § 80A.461, subdiv. 5(1) (2015) (requiring disclosure of “the material facts of its business plan and its capital structure”). It is also common sense to note that investors are unlikely to entrust an untested company with substantial sums of money without first proving the concept in a business plan.

242. See, e.g., Kevin & Robin Brown, *Soft Animal/Hideous Heart in Fringe*, GOFUNDME, <https://www.gofundme.com/r893tu9g> (last visited Oct. 11, 2016) (showing only some pictures and a brief description of the project, without any of the financial information that would be required under securities crowdfunding regulation).

243. See Damico, *supra* note 177 (“For an emerging company, that information is going to be publicly available, so that potentially could put them at some disadvantage with competitors being able to know their business plan.”).

244. See Regulation Crowdfunding Final Rules Release, 80 Fed. Reg. at 71,391 (“Capital raised through other means would not be counted in determining the aggregate amount sold in reliance on Section 4(a)(6).”); see also Rule 147 Proposal, 80 Fed. Reg. at 69,795 (“As proposed, offers and sales made pursuant to Rule 147 would not be integrated with . . . [s]ubsequent offers or sales of securities that are . . . [e]xempt from registration under section 4(a)(6) of the [Securities] Act.”).

245. See sources cited *supra* note 244 (identifying other exemptions available; under Regulation A, etc.).

equity crowdfunding model should be relieved to hear that the capital gap can be filled in many ways simultaneously.

### III. CONCLUSION

The major differences, and there are only a few of great relevance, between the federal Regulation Crowdfunding model and Minnesota model state laws revolve around the investment limits for individual investors and the ability of issuers to reach groups of potential investors out of state. The state-based model may have a slight cost-savings edge when it comes to the costs of ongoing reporting, though it will be difficult to make firm conclusions until businesses start wading through the complex regulatory web. For truly local businesses with a dedicated following and modest capital needs, the state-model may offer a sensible alternative to traditional securities exemptions. This becomes doubly true when the potential investors have high enough net-worth and income to clear the \$100,000 mark but are not quite “accredited” under the regulatory parameters.

On the other hand, the allowance of sales across state lines will likely make the federal model more attractive to companies with larger capital needs, or that do not have the targeted name recognition of other crowdfunders. The federal model may also attract more players in the intermediary role, as the restrictions on how intermediary fees are calculated appear less onerous under Regulation Crowdfunding than the Minnesota model. Finally, when push comes to shove, an issuer completing a crowdfunding campaign under either model will always have other exempt offering options available to them. It may indeed be the competition with options like private placements and Rule 504 (assuming increased offering limits) that ultimately dictates the success of Regulation Crowdfunding.

Much of how the securities crowdfunding situation shakes out will turn on how the SEC decides to deal with Rule 147. Should the SEC decide to keep the rule as a safe harbor instead of making a new exemption, a serious statutory issue may need to be fixed before state models can comfortably use the internet to advertise. Until this tension is resolved, however, crowdfunding participants—particularly those interested in Minnesota model statutes—are caught between a rock and a hard place. Hopefully, participants in the crowdfunding market

will not have to wait *another* 1000 days to figure out how these models will work in practice.

<b>Appendix: Issuer Disclosure Documents</b>		
<b>Regulation Crowdfunding vs. MNvest</b>		
<b>Type of Disclosure Required</b>	<b>Regulation Crowdfunding<sup>246</sup></b>	<b>MNvest<sup>247</sup></b>
<b>Submission to Appropriate Regulatory Agency</b>	Required; can cross-reference with other required disclosures	Required
<b>Issuer Demographics &amp; Current Business Description</b>		
<b>Identity of Issuer</b>	Name, Address, Legal status (entity type, etc.), Website	Type of entity, the address and telephone number of its principal office
<b>Directors &amp; Officers of Issuer</b>	3 year history; Name, Positions, Previous business experience	Names, titles, relevant experience of executive directors, officers, governors, managers, members
<b>Beneficial Ownership of Issuer</b>	Names of holders of 20%+ voting equity interests	Names of holders of 10%+ voting equity interests
<b>Business of the Issuer</b>	Description of current business, future business plans	Formation history for the previous five years; summary of the material facts of its business plan
<b>Employees of Issuer</b>	Current number of employees	(Not explicitly mentioned)
<b>Debt Obligations of Issuer</b>	Material terms, including amount, interest rate, and maturity date	(Not explicitly mentioned)
<b>Previous Exempt Offerings (previous 3 years)</b>	Date, type of exemption, type and amount of securities offered	(Not explicitly mentioned)
<b>Issuer's Financial Condition</b>	Including material, liquidity, capital resources and historical results of operations	(Not explicitly mentioned)

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246. Adapted from 17 C.F.R. § 227.201 (2016) (Subpart B – Requirements for Issuers; Disclosure Requirements).

247. Adapted from MINN. STAT. § 80A.461, *subdiv.* 4 (2015) (Required disclosures to prospective MNvest offering purchasers).

<b>Financial Statements</b>	Taxable income \$0-\$100,000: certified by CEO; Taxable income \$100,001-\$500,000: reviewed by accountant; Taxable income > \$500,000: audited by accountant	If offering less than \$1,000,000, no audit or review requirement; larger offering, up to \$2,000,000, requires audit or review by certified professionals under Minn. Stat. Ch. 326A
<b>Capital Structure</b>	Description of all securities currently outstanding, including voting rights/limits, valuation, risks of additional securities offerings	Summary of the material facts of its capital structure
<b>Material Terms &amp; Risks of the Crowdfunding Offering</b>		
<b>Risk Factors of the Potential Investment, including as minority owners</b>	Required; including explanation of minority limitations	Disclosure that future issuance may result in dilution; statement of the material risks unique to the MNvest issuer and its business plans
<b>Offering Amount: Min/Max Targets &amp; Deadlines</b>	Required; including whether issuer will accept investments in excess of target; including how to cancel, if desired	Date of expiration (not more than 12 months after start); min/max; percentage ownership of company offered;
<b>Intended Use &amp; Allocation of Offering Proceeds</b>	“Reasonably detailed description”	Summary required, including any amounts paid or payable to “an owner, executive officer, director, governor, manager, member . . . .”
<b>Events Upon a Material Change in the Offering</b>	Instructions on how to reconfirm investment interest, and consequences if not reconfirmed	Description of possible exit strategies
<b>Terms of the Offering</b>	Price; valuation methodology	“terms and conditions” of the offering
<b>Other Statutory &amp; General Securities Law Requirements</b>		

<b>Resale Restrictions</b>	Required notice to purchasers	Statement that the securities have not been registered under federal or state securities law and that the securities are subject to limitations on resale
<b>Information about the Offering Intermediary</b>	Name, SEC number, CRD number, any transaction-dependent financial interests of the intermediary	Disclosure must include a copy of the escrow agreement; description of intermediary payment terms
<b>“Interested” Transactions (previous 12 months)</b>	Description of any transactions with director, officer, 20%+ voting equity holder, or family members thereof, over 5% of aggregated crowdfunding amounts	(Not explicitly mentioned)
<b>Executive Bad Actor Disqualification &amp; Pending Issuer-Related Litigation</b>	Identification of matters which would have DQ’ed certain executives, if after May 16, 2016; exercise of “reasonable care” required during issuer diligence	Any pending material litigation, legal proceedings, or regulatory action involving the MNvest issuer or any executive officers, directors, etc.
<b>Offering Progress Updates</b>	Required if the offering is already in progress	(Not explicitly mentioned)
<b>Availability of Issuer’s Annual Report</b>	Identification of location on issuer’s website	(Not explicitly mentioned)
<b>Previous Compliance with Mandated Reporting Requirements</b>	History of compliance or failure to comply with reporting requirements	(Not explicitly mentioned)