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Citations:

Bluebook 21st ed.

Guy Noyes, Kicking Start-ups out of Online Financial Markets: Why the FTC Should Regulate Websites to Supplement the SEC, 19 INTELL. PROP. L. BULL. 29 (2014).

ALWD 6th ed.

Noyes, G. ., Kicking start-ups out of online financial markets: Why the ftc should regulate websites to supplement the sec, 19(1) Intell. Prop. L. Bull. 29 (2014).

APA 7th ed.

Noyes, G. (2014). Kicking start-ups out of online financial markets: Why the ftc should regulate websites to supplement the sec. Intellectual Property Law Bulletin, 19(1), 29-48.

Chicago 7th ed.

Guy Noyes, "Kicking Start-ups out of Online Financial Markets: Why the FTC Should Regulate Websites to Supplement the SEC," Intellectual Property Law Bulletin 19, no. 1 (Fall 2014): 29-48

McGill Guide 9th ed.

Guy Noyes, "Kicking Start-ups out of Online Financial Markets: Why the FTC Should Regulate Websites to Supplement the SEC" (2014) 19:1 Intellectual Property L Bull 29.

MLA 8th ed.

Noyes, Guy. "Kicking Start-ups out of Online Financial Markets: Why the FTC Should Regulate Websites to Supplement the SEC." Intellectual Property Law Bulletin, vol. 19, no. 1, Fall 2014, p. 29-48. HeinOnline.

OSCOLA 4th ed.

Guy Noyes, 'Kicking Start-ups out of Online Financial Markets: Why the FTC Should Regulate Websites to Supplement the SEC' (2014) 19 Intell Prop L Bull 29

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Kicking Start-ups Out of Online Financial Markets: Why the FTC Should Regulate Websites to Supplement the SEC

GUY NOYES*

INTRODUCTION

Crowdfunding currently plays a central role in many businesses. For some founders, the ability to raise monetary contributions from a large number of people¹ represents a novel means of investment that works in conjunction with other investment opportunities to get a company off the ground. Conversely, other fundraisers view crowdfunding as a way to circumvent the traditional venture capital system to reach consumers and get a product to market.² The crowdfunding model is adaptable enough to encompass these contrary goals. Crowdfunding works as a means of raising money by soliciting contributions from a large number of people over the internet.³ The concept of soliciting funds for a new product from a large number of people, rather than securing loans from banks or moneylenders, has existed for a long time. For example, the Encyclopedia of Didero reached seventeen volumes by the year 1772 due to the support of the 4,000 subscribers who funded the work before it was published.⁴ People seeking capital contributions for projects (“founders”) can reach a broad audience by soliciting support from patrons on the Internet.⁵ Each individual contribution can be quite small, yet with numerous potential supporters the aggregate sum may be very large.⁶

Various web-based services have emerged providing crowdfunding

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1. See *Crowdfunding*, WIKIPEDIA, <http://en.wikipedia.org/wiki/Crowdfunding> (last modified Dec. 1, 2014).

2. See John O’Loughlin, *Top 10 Ways to Avoid Being Disrupted*, LINKEDIN (Aug. 31, 2014), <https://www.linkedin.com/pulse/article/20140831203846-79420601-top-10-ways-to-avoid-being-disrupted> (“Entrepreneurs and creators are using the connective power of the internet and crowdfunding to ignore and circumvent traditional gatekeepers.”).

3. Crowdfunding, 78 Fed. Reg. 66427, 66428 (Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240, 249). The term “crowdfunding” traces its origins to crowdsourcing, a portmanteau from outsourcing and crowd. See Jeff Howe, *The Rise of Crowdsourcing*, WIRED (June 2006), <http://archive.wired.com/wired/archive/14.06/crowds.html>.

4. *Cinco Curiosos Casos de “Crowdfunding” de la Era Pre-Internet*, EXPERIENSENSE, <http://www.experiensense.com/crowdfunding-preinternet/> (last visited Oct. 12, 2014).

5. *Id.*

6. See *id.*

platforms. The most famous is Kickstarter.⁷ Recently, Kickstarter announced that users have pledged nearly \$1.5 billion through its crowdfunding service.⁸ Kickstarter-users pledged more than half of \$1 billion in the twelve months preceding March 2014, reflecting the platform's growing popularity.⁹ The most successful Kickstarter project to date was the Pebble smartwatch,¹⁰ which raised over \$10 million.¹¹

Since online sites like Kickstarter process large volumes of cash flow it seems irresponsible for Congress to completely avoid regulating crowdfunding. Crowdfunding has the potential to improve the economy by enabling new companies to emerge; thus, increasing the number of job opportunities.¹² The intrigue brought by the large amounts of money generated through crowdfunding may also entice the development of fraudulent businesses or poorly planned ventures.¹³ If users of crowdfunding begin to view the model as too risky it will ultimately hurt the sustainability of the technology.¹⁴

This Article considers the manner of regulation most appropriate for online crowdfunding sites like Kickstarter.¹⁵ The framework used for regulation can impact the success of the technology as much as the substance of the rules. Crowdfunding services resemble securities transactions, but are also potentially similar to marketplace transactions involving the sale of goods to consumers.¹⁶ The Securities and Exchange Commission (SEC) administers securities law, which generally governs businesses that offer a share of the company's profits in exchange for an

7. KICKSTARTER, <https://www.kickstarter.com/?ref=nav> (last visited Sept. 20, 2014).

8. *Kickstarter Stats*, KICKSTARTER, <https://www.kickstarter.com/help/stats?ref=footer> (last visited Dec. 10, 2014).

9. Denver Nicks, *Kickstarter Hits \$1 Billion In Pledges*, TIME (Mar. 3, 2014), <http://time.com/12011/kickstarter-hits-1-billion-in-pledges/>.

10. *Discover Pebble*, PEBBLE, <https://getpebble.com/discover> (last visited Sept. 20, 2014) (explaining that the Pebble smartwatch allows you to control music, monitor fitness, set alarms, receive notifications, etc.).

11. Will Mitchell, *Top 10 Most Successful Kickstarter Projects [INFOGRAPHIC]*, STARTUPBROS, <http://www.startupbros.com/top-10-most-successful-kickstarter-projects-infographic/> (last visited Oct. 13, 2014).

12. John C. Haltiwanger, Ron S. Jarmin & Javier Miranda, *Who Creates Jobs? Small vs. Large vs. Young 2* (NBER Working Paper Series, Paper No. 16300, 2010), available at <http://www.nber.org/papers/w16300>.

13. Gregory J. Wright, *Crowdfunding Isn't Like Shopping Retail*, AICPA INSIGHTS, <http://blog.aicpa.org/2014/05/crowdfunding-isnt-like-shopping-retail.html#sthash.uiGBs1q8.dpbs> (last visited Oct. 13, 2014).

14. See Brad Jackson, *Is Crowdfunding Too Risky for the Average Investor?*, RED STATE (Apr. 26, 2012), http://www.redstate.com/diary/tex_whitley/2012/04/26/is-crowdfunding-too-risky-for-the-average-investor/.

15. Though crowdfunding exists offline, its nature is different enough that the same analysis should not apply to both.

16. A third possibility is to view crowdfunding as a form of online gambling, since users often contribute money with low chances of any kind of return. However, this Article limits the discussion of regulation to securities and consumer protection law. Analogizing crowdfunding to gambling does not fit with the analysis of regulation through securities or consumer protection. Founders often find crowdfunding useful to raise capital for a venture, but generally not as a source of revenue itself, unlike gambling operations.

investment.¹⁷ Crowdfunding services are similar to securities transactions and may implicate this body of law when the founders of crowdfunding projects seek capital to start up or expand their company. Alternatively, the Federal Trade Commission (FTC) enforces various consumer protection laws that helps keep marketplace conditions understandable and fair to consumers.¹⁸ Crowdfunding often resembles a marketplace transaction when a user's reward for contributing is one or more units of the developed product.

Congress's strategy to regulate crowdfunding gives authority to the SEC, which amounts to treating crowdfunding like securities offerings. Congress passed the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012 (the "CROWDFUND Act") as part of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"),¹⁹ which gives authority to the SEC and regulates crowdfunding through securities law.²⁰ The CROWDFUND Act amends the 1933 Securities Act ("1933 Act") and the 1934 Securities Exchange Act ("1934 Act").²¹ The CROWDFUND Act imposes certain requirements on "funding portals"²² to ensure that offerings on crowdfunding websites are not fraudulent.²³

The problem with the CROWDFUND Act is that it regulates crowdfunding websites differently based on how they operate. The CROWDFUND Act applies to websites that offer securities through their crowdfunding platform, but does not regulate websites that prohibit securities offerings. The CROWDFUND Act does not require registered funding portals to register as securities brokers or dealers in order to issue securities in a company.²⁴ However, the CROWDFUND Act imposes several requirements on the funding portal and on the company offering the securities; mostly relating to the company's finances, corporate structure, and key officers.²⁵ This allows companies to issue securities in a number of small offerings, where each contribution may be limited to a few dollars. By contrast, the CROWDFUND Act has no effect on crowdfunding websites that prohibit founders from offering securities through the website. Many crowdfunding websites will not take advantage of the CROWDFUND Act's reduced regulation of securities providers because the provisions require the crowdfunding website to make a substantial

17. *The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, U.S. SEC. & EXCH. COMM'N (June 10, 2013), <http://www.sec.gov/about/whatwedo.shtml#U3VEkSjLK4o>.

18. *What We Do*, FED. TRADE COMM'N, <http://www.ftc.gov/about-ftc/what-we-do> (last visited Oct. 13, 2014).

19. H.R. 3606, 112th Cong. (2012). This portion of the Act is also known as the "CROWDFUND" Act.

20. *Id.*

21. *Id.* § 101(a)-(b).

22. *Id.* § 304(b)(80) (defining the term 'funding portal' as "any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others").

23. *Id.* § 4A(a)(5).

24. *Id.* § 304(a)(1).

25. *Id.* § 4A(b)(1)(A)-(I).

effort to police its website. Without greater efforts to investigate project founders, donors receive less information, which could lead to an inefficient marketplace.

This Article argues that regulating crowdfunding solely through securities law is inadequate. Rather, consumer protection law enforced by the FTC is necessary to supplement the SEC's authority under the CROWDFUND Act. Under the proposed model, the SEC would continue regulating crowdfunding websites that allow for securities, but Congress should pass a new law specifically authorizing the FTC to regulate non-securities crowdfunding.

Part I describes how the crowdfunding website Kickstarter operates, and provides empirical data illustrating the popularity of the site. Part II investigates the purpose and effects of the CROWDFUND Act on crowdfunding websites and examines the CROWDFUND Act's legislative history. Part II further explains that Kickstarter is one of the crowdfunding platforms that does not allow founders to provide securities offerings. Part III asserts that the burdensome regulatory requirements of the CROWDFUND Act deter Kickstarter and other crowdfunding websites from offering securities. Part IV discusses the FTC as an alternative regulatory authority and examines current legislation that gives the FTC enforcement authority over the sale of goods. Part IV further argues that the current law governing the FTC does not precisely cover crowdfunding websites, and proposes legislation to give the FTC authority to regulate crowdfunding websites that do not issue securities. Part IV concludes that without complementary regulation by the FTC, SEC regulation under the auspices of the CROWDFUND Act will be largely irrelevant because few crowdfunding websites will elect to submit to the requirements of the CROWDFUND Act.

I. KICKSTARTER—THE ONLINE CROWDFUNDING TRENDSETTER

A. HOW KICKSTARTER FUNCTIONS

Many crowdfunding platforms take advantage of widespread Internet access to fuel new ventures.²⁶ Of these websites, Kickstarter is the most well-known.²⁷ Kickstarter began operations on April 28, 2009,²⁸ offering crowdfunded financing for creative projects, including films, videogames, and works of art.²⁹ Projects usually aim to create a tangible product, such as

26. See, e.g., Chance Barnett, *Top 10 Crowdfunding Sites for Fundraising*, FORBES (May 5, 2013), <http://www.forbes.com/sites/chancebarnett/2013/05/08/top-10-crowdfunding-sites-for-fundraising/>.

27. See, e.g., Sally Outlaw, *10 Top Crowdfunding Websites*, ENTREPRENEUR.COM (Oct. 10, 2013), <http://www.entrepreneur.com/article/228534>.

28. Mitchell, *supra* note 11.

29. *Our Rules*, KICKSTARTER, <https://www.kickstarter.com/rules> (last visited Oct. 13, 2014) (listing the following as categories of projects: "Art, Comics, Dance, Design, Fashion, Film & Video, Food, Games, Music, Photography, Publishing, Technology, and Theater"). See also Carlye Adler, *How Kickstarter Became a Lab for Daring Prototypes and Ingenious Products*, WIRED (Mar. 18, 2011),

a book, but others may seek to develop an intangible work, such as a theatrical play.

Kickstarter's website hosts projects, which are defined as "finite work[s] with a clear goal that you'd like to bring to life."³⁰ Projects are only hosted on Kickstarter for a limited time, after which the crowdfunding period for the project ends.³¹ While Kickstarter is open to donors all over the world, project creation is currently only available to citizens in ten specific countries.³² Amazon handles payments to Kickstarter, and the two companies take a cut of any payments made through the website.³³ Project creators use the Kickstarter website in an attempt to raise money to meet a specified goal.³⁴ To encourage Kickstarter-users to contribute, project creators often offer rewards to users who contribute a certain amount of money.³⁵ Creators typically create multiple tiers of awards at differing price levels.³⁶ If the monetary goal of a project is met during the funding period, Amazon charges the donors for the amount they pledged and transmits the balance of the payments to the project creator—after Amazon and Kickstarter receive their fee.³⁷ Conversely, if a project cannot meet its goal, the donor will not be charged and neither Amazon nor Kickstarter receive any fee.³⁸

To launch a Kickstarter project, an individual must register and set up an account on the website.³⁹ Kickstarter has multiple guidelines for projects hosted on its site.⁴⁰ Two of the most prominent are that the project must have a clear end that creates something to share with others, and the

http://www.wired.com/2011/03/ff_kickstarter/all/.

30. *Kickstarter Basics: Kickstarter 101*, KICKSTARTER, https://www.kickstarter.com/help/faq/kickstarter+basics?ref=faq_subcategory#Kick (last visited Oct. 13, 2014).

31. *Creator Handbook: Funding*, KICKSTARTER, <https://www.kickstarter.com/help/handbook/funding> (last visited Dec. 10, 2014) (stating that funding periods for projects range from one to sixty days).

32. *Creator Questions: Getting Started*, KICKSTARTER, https://www.kickstarter.com/help/faq/creator+questions#faq_41823 (last visited Oct. 13, 2014) ("[P]roject creation is currently available to individuals in the US, UK, Canada, Australia, New Zealand, the Netherlands, Denmark, Ireland, Norway and Sweden. . .").

33. *Creator Questions: After Your Project Ends*, KICKSTARTER, https://www.kickstarter.com/help/faq/creator+questions?ref=faq_category (last visited Oct. 13, 2014).

34. *Kickstarter Basics: Kickstarter 101*, KICKSTARTER, https://www.kickstarter.com/help/faq/kickstarter+basics?ref=faq_subcategory#Kick (last visited Oct. 13, 2014).

35. *Kickstarter Lesson #8: Reward Levels*, STONEMAIER GAMES (Feb. 3, 2013), <http://stonemaiergames.com/kickstarter-lesson-8-reward-levels/>.

36. Fred Benenson & Yancey Strickler, *Trends in Pricing and Duration*, KICKSTARTER BLOG (Sept. 21, 2010), <https://www.kickstarter.com/blog/trends-in-pricing-and-duration>.

37. *Creator Questions: After Your Project Ends*, KICKSTARTER, https://www.kickstarter.com/help/faq/creator+questions?ref=faq_category (last visited Oct. 13, 2014).

38. *Fees for the United States*, KICKSTARTER, <https://www.kickstarter.com/help/fees> (last visited Dec. 10, 2014).

39. *Creator Questions: Getting Started*, KICKSTARTER, https://www.kickstarter.com/help/faq/creator+questions#faq_41823 (last visited Oct. 13, 2014).

40. *Our Rules*, KICKSTARTER, https://www.kickstarter.com/help/guidelines?ref=help_nav (last visited Oct. 13, 2014) ("Kickstarter is a funding platform for creative projects. These are our guidelines.").

creation must fall into one of the approved categories.⁴¹ Another guideline states, “Creators cannot offer equity or financial incentives (ownership, share of profits, repayment/loans, cash-value equivalents, etc.).”⁴² This guideline prohibits Kickstarter projects from offering securities.⁴³ When a project creator initiates a Kickstarter project, the website asks for a description of the project, incentives offered, the respective minimum pledge value for each incentive, and also to provide information about the project founder and state any risks or challenges.⁴⁴ Kickstarter also requires the project creator to state an estimated delivery date.⁴⁵

Kickstarter claims that it does little more than check to make sure incoming projects meet these guidelines.⁴⁶ This practice may be problematic, because it shows that Kickstarter does very little to investigate the possibility of poorly managed projects that may fail to fulfill their obligations to their backers. Kickstarter has an integrity team that uses algorithms to detect suspicious activity, and may suspend projects.⁴⁷ However, Kickstarter’s business model depends on projects reaching their funding goals, so there may be conflicting interests in Kickstarter’s self-policing mechanisms. Kickstarter’s decision to avoid making value judgments about the projects⁴⁸ is a feature that may heighten its attractiveness to unscrupulous creators. Presently, Kickstarter has not been held liable for any wrongdoing stemming from a project hosted on its website.⁴⁹

B. DATA ON KICKSTARTER

Of the projects created on Kickstarter, over 75,000 have succeeded in meeting their specified goals.⁵⁰ This number is about 38% of the total projects launched on the website.⁵¹ Ethan Mollick’s study examining the time period from the website’s creation in April 2009 to July 2012, found

41. *Id.*

42. *Id.*

43. *See infra* Part II.B.

44. Mike Mesnick, *Kickstarter Introduces New Rules To Try To Limit Disappointment*, TECHDIRT (Sept. 21, 2012), <http://www.techdirt.com/articles/20120921/13281620462/kickstarter-introduces-new-rules-to-try-to-limit-disappointment.shtml>.

45. *Our Rules*, KICKSTARTER, https://www.kickstarter.com/help/guidelines?ref=help_nav (last visited Oct. 13, 2014).

46. *Creator Questions: Getting Started*, KICKSTARTER, https://www.kickstarter.com/help/faq/creator+questions#faq_41823 (last visited Oct. 13, 2014).

47. *Trust and Safety*, KICKSTARTER, <https://www.kickstarter.com/trust?ref=footer> (last visited Oct. 12, 2014).

48. *Id.* (“Kickstarter doesn’t evaluate a project’s claims . . . backers decide what’s worth funding and what’s not.”).

49. Zachary Strebeck, *Who is Liable When a Kickstarter Project Goes Wrong?*, IND13 (Apr. 29, 2014), <http://ind13.com/who-is-liable-when-a-kickstarter-campaign-goes-wrong/>.

50. *Kickstarter Stats*, KICKSTARTER, <https://www.kickstarter.com/help/stats?ref=footer> (last visited Dec. 10, 2014). Kickstarter updates its statistics daily, thus this information is likely to be inaccurate in the near future.

51. *Id.*

that 48.1% of the projects created on the site succeeded.⁵² The study also found that failed projects tended to fail by large margins, whereas successful projects succeed by slim margins.⁵³

To investigate fraud on the site, the study reviewed the likelihood that a creator delivered on their obligations at the time specified during fundraising efforts.⁵⁴ The sample, which only consisted of projects in the design and technology categories with delivery dates prior to July 2012, concluded that complete non-delivery on an obligation was uncommon.⁵⁵ Approximately 3.6% of the sampled projects suggested that non-delivery was the result of fraudulent behavior.⁵⁶ Conversely, almost 25% of the projects were delivered on time, and deliveries on 33% of the projects were merely delayed as of July 2012.⁵⁷ The delayed projects did not exhibit non-responsive behavior toward the backers, which suggests that the delay was due to unforeseen difficulties in the project rather than intentional fraud.⁵⁸

A survey of videogame-related Kickstarter projects showed that around 33% of all the successfully funded projects between 2009 and 2012 were fully delivered by December 2013, while approximately 50% were partially delivered by that time.⁵⁹ Mollick's study found that both projects that were substantially overfunded and projects that collected more than \$50,000 were more likely to deliver rewards later than the promised date.⁶⁰ Creators of the top fifty Kickstarter projects having delivery dates of November 2012 or earlier cited difficulties in making the requisite manufacturing changes necessary to accommodate the increased scale of projects as a major contributor to the delays.⁶¹

The low incidence of outright fraud on Kickstarter is encouraging for regulators, but the high occurrence of delay presents a problem. Prior to making an investment, venture capitalists traditionally weed out projects that are poorly planned or managed.⁶² However, often times on Kickstarter poorly organized projects receive funding because Kickstarter avoids making value judgments on projects. The delay in reward may cause consumers to refrain from investing in online crowdfunding projects. Donors may be especially wary if they realize that a project's presence on

52. Ethan R. Mollick, *The Dynamics of Crowdfunding: An Exploratory Study*, 29 JOURNAL OF BUSINESS VENTURING 1, 4 (2014).

53. *Id.*

54. *Id.* at 12.

55. *Id.* at 4.

56. *Id.* at 11.

57. *Id.* at 12.

58. *Id.* at 12–13.

59. *Kickstander: Only Around A Third of Kickstarted Video Game Projects Fully Deliver To Their Backers*, EVIL AS A HOBBY (Jan. 18, 2014), <http://evilasahobby.com/2014/01/18/kickstander-only-around-a-third-of-kickstarted-video-game-projects-fully-deliver-to-their-backers/>.

60. Mollick, *supra* note 52, at 12–13.

61. Julianne Pepitone, *Why 84% of Kickstarter's Top Projects Shipped Late*, CNN MONEY (Dec. 18, 2012), <http://money.cnn.com/2012/12/18/technology/innovation/kickstarter-ship-delay/index.html>.

62. J.D. Kern, *Courting Venture Capital*, JOURNAL OF ACCOUNTANCY (June 2011), available at <http://www.journalofaccountancy.com/Issues/2011/Jun/20113746.htm>.

Kickstarter is not an indicator of its reliability.

II. THE CROWDFUND ACT DOES NOT APPLY TO CROWDFUNDING SITES LIKE KICKSTARTER

The CROWDFUND Act attempts to regulate crowdfunding websites like Kickstarter using securities law. Ironically, regulating online crowdfunding providers through securities law creates an incentive for these services to circumvent the CROWDFUND Act by prohibiting project founders from offering securities, as Kickstarter currently does.⁶³ If an online crowdfunding site does not offer securities as a reward option it is not regulated under the CROWDFUND Act. This leaves crowdfunding donors without consumer protection, and could reduce user confidence in the efficacy of the system. Due to the CROWDFUND Act's cumbersome regulations, creators of crowdfunding projects may be less likely to offer securities for their projects, even if it would be beneficial for the overall funding goal.

A. THE MECHANICS AND LEGISLATIVE HISTORY OF THE CROWDFUND ACT

In 2012, the depressing economic conditions in the United States unified a notoriously deadlocked Congress.⁶⁴ Though the effects of the "Great Recession" of 2008 showed signs of ending, recovery was slow.⁶⁵ The unemployment rate remained high, and newly created job opportunities fell short of the number economists had projected.⁶⁶ Many of the jobs that were created came from new companies and existing small businesses.⁶⁷ Additionally, startups both big and small accounted for most of the net job growth.⁶⁸ Though large corporations employ more people, it seemed that they did not create as many new jobs.⁶⁹

Larger companies have the resources to establish lobbyist groups to impress their interests upon policy makers.⁷⁰ Small companies typically do not have this ability, so policy makers needed to investigate what these

63. *Our Rules*, KICKSTARTER, <https://www.kickstarter.com/rules?ref=footer> (last visited Oct. 10, 2014) ("Projects can't promise to donate funds raised to a charity or cause, and they can't offer financial incentives like equity or repayment.").

64. Richard Cowan & Thomas Ferraro, *Deadlocked Congress Running Out of Time to Take Big Steps*, REUTERS (July 30, 2012), <http://www.reuters.com/article/2012/07/30/us-usa-Congress-inaction-idUSBRE86T1FP20120730>.

65. Zunaira Zaki, *It's a Slow Economic Recovery, More Data Show*, ABC NEWS (Sept. 28, 2012), <http://abcnews.go.com/blogs/business/2012/09/its-a-slow-economic-recovery-more-data-show/>.

66. Timothy R. Homan, *U.S. Employers Add 69,000 Jobs, Fewer Than Forecast*, BLOOMBERG (June 1, 2012), <http://www.bloomberg.com/news/2012-06-01/employment-in-u-s-increased-69-000-in-may.html>.

67. J.D. Harrison, *Who Actually Creates Jobs: Start-Ups, Small Businesses or Big Corporations?*, WASHINGTON POST (Apr. 24, 2013), http://www.washingtonpost.com/business/on-small-business/who-actually-creates-jobs-start-ups-small-businesses-or-big-corporations/2013/04/24/d373ef08-ac2b-11e2-a8b9-2a63d75b5459_story.html (stating that small businesses, defined as firms employing 500 employees or fewer, created two thirds of the new jobs).

68. *Id.*

69. *Id.*

70. *Id.*

companies need. If small companies and startups, taken together, create more new jobs than established large companies, one solution to increase job growth is to pass legislation that encourages the development of small companies and startups. Congress subscribed to this reasoning and consequently passed the JOBS Act,⁷¹ which includes the provisions of the CROWDFUND Act.⁷²

1. Legislative Intent

Congress cited two issues that inspired the terms of the CROWDFUND Act: (1) its desire to create jobs by allowing companies to raise capital through online investors, and (2) the need for preventive measures to reduce the chance of fraud that might occur during online capital fundraising.⁷³ While drafting the JOBS Act, one House Report discussed the need to open up financial markets to emerging companies.⁷⁴ However, during Congress's consideration of the not yet enacted bill, the securities crowdfunding site ProFounder announced it would be ceasing its operations.⁷⁵ A little more than a year earlier, the California Department of Corporations had prohibited ProFounder from offering equity on its website, which was ProFounder's primary business.⁷⁶ A few weeks later, Congress passed the final version of the JOBS Act, including the CROWDFUND Act.⁷⁷

2. The CROWDFUND Act

The CROWDFUND Act regulates within the securities law framework to govern online crowdfunding by amending the 1933 and 1934 Acts.⁷⁸ The amendments to the prior acts fall into two categories. One set of amendments creates exemptions for online funding portals from securities registration,⁷⁹ and the other defines new terms used in connection with the created exemptions.⁸⁰ To best understand the exemptions the relevant terms must be examined.

Section 304 of the Act defines the term 'funding portal.'

The term 'funding portal' means any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others . . . that does not—

- (A) offer investment advice or recommendations;
- (B) solicit purchases, sales, or offers to buy the securities offered or

71. H.R. 3606, 112th Cong. (2012) (enacted).

72. Reopening American Capital Markets to Emerging Growth Companies Act of 2011, H.R. REP. NO. 112-406.

73. 158 CONG. REC. S1778 (daily ed. Mar. 19, 2012) (statement of Sen. Landrieu).

74. Reopening American Capital Markets to Emerging Growth Companies Act of 2011, H.R. REP. NO. 112-406.

75. C. Steven Bradford, *Crowdfunding and the Federal Securities Law*, 2012 COLUMBIA BUS. L. REV. 1, 24 n.100 (2012).

76. *Id.*

77. H.R. 3606, 112th Cong. (2012) (enacted).

78. *Id.*

79. *Id.* § 302(a).

80. *Id.* § 303(b).

- displayed on its website or portal;
- (C) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal;
- (D) hold, manage, possess, or otherwise handle investor funds or securities; or
- (E) engage in such other activities as the Commission, by rule, determines appropriate.⁸¹

This definition categorizes funding portals as online intermediaries facilitating transactions involving securities, but do not have a direct relationship to any of the securities offered. Kickstarter would fall under this definition if it offered securities.

B. KICKSTARTER DOES NOT DEAL IN THE SECURITIES THAT THE CROWDFUND ACT COVERS

Donors on Kickstarter commonly receive rewards for their contributions in the form of a preorder for the item being created by the project.⁸² The CROWDFUND Act regulates the use of online crowdfunding to issue securities by allowing funding portals to offer securities when it was previously illegal. The CROWDFUND Act subjects funding portals and securities offerors to disclosure requirements that are somewhat less demanding than those required for regular securities registration.⁸³ Whether a site offered securities in the past, or plans to offer securities in the future determines if it is governed by the CROWDFUND Act. The law of securities is quite complicated; thus, it is necessary to understand the concept of a security. Once security is defined, it appears that none of the rewards Kickstarter allows project founders to offer constitute securities.

1. What is a Security?

The 1933 and 1934 Acts both define securities using similar language.⁸⁴ A security is:

[A]ny note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security . . . or, in general, any interest or instrument commonly known as a "security," . . .⁸⁵

The 1933 and 1934 Acts fail to further define these enumerated types of securities.⁸⁶ Though instruments like stocks and bonds have clearly

81. *Id.* § 304.

82. Preordering is a practice where consumers reserve copies of a good from a retailer when the retailer does not have the good in stock, but may have ordered additional copies.

83. H.R. 3606, 112 Cong. § 304(a)(1) (2012).

84. Joan Heminway, *What is a Security in the Crowdfunding Era*, 7 OHIO ST. ENTREPREN. BUS. L.J. 335, 353–54 (2012).

85. 15 U.S.C. §§ 77b(a)(1), 78c(a)(10) (2012).

86. Heminway, *supra* note 84, at 353–54.

established meanings in the field of business transactions, the definition for “investment contract” has been left open for court interpretation.⁸⁷ The Supreme Court’s decision in *Sec. & Exch. Comm’n v. W.J. Howey Co.*,⁸⁸ is particularly influential in defining what constitutes an investment contract. In *W.J. Howey Co.*, the Court held that an investment contract is:

[A] contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party, it being immaterial whether the shares in the enterprise are evidenced by formal certificates or by nominal interests in the physical assets employed in the enterprise.⁸⁹

This definition is sufficiently broad and could be interpreted to encompass new investment incentive methods, such as Kickstarter rewards, that do not fall into the conventional understanding of securities. Since the definition of investment contract could potentially encompass online crowdfunding rewards, this Article analyzes the types of rewards crowdfunding sites have offered, identifies the rewards Kickstarter allows on its website, and determines if any of these rewards are considered securities under the definitions provided by *W.J. Howey Co.* or the 1933 and 1934 Acts.

2. Are the Types of Incentives Offered Through Crowdfunding Websites Securities?

One structure for crowdfunding websites is the donation model.⁹⁰ Under the donation model, a donor does not receive anything in return for their contribution.⁹¹ Pure donation sites most likely do not fall under the definition of offering securities because they do not offer any returns on the investment.⁹² Thus, to the extent that a crowdfunding site allows donations, it cannot be viewed as offering securities within the meaning of the 1933 and 1934 Acts.⁹³ However, pure donation crowdfunding sites make up only a minimal portion of the online crowdfunding efforts.⁹⁴ Kickstarter’s project creators rarely use the pure donation model. Anything more than small tokens of appreciation removes the purity of this donation category. Even relatively inconsequential rewards such as stickers or post cards will make the transaction different from a pure donation.

Two other structures crowdfunding founders use are the pre-purchase model and the reward model.⁹⁵ The pre-purchase model offers in exchange

87. *Id.* at 355.

88. *Sec. & Exch. Comm’n v. W.J. Howey Co.*, 328 U.S. 293 (1946).

89. *Id.* at 298–99.

90. Bradford, *supra* note 75, at 14.

91. *Id.* A donation made through crowdfunding may be a charitable donation deductible from the donor’s federal income taxes, but only if the donee is an eligible non-profit. Donations made to for-profit companies will not be tax deductible.

92. *Id.* at 15.

93. *Id.* at 32.

94. See Paul Belleflamme, Thomas Lambert & Armin Schwiendbacher, *Crowdfunding: Tapping the Right Crowd*, 29 J. BUS. VENTURING 585, 588 (2014).

95. Bradford, *supra* note 75, at 14.

for a donation a copy of the product being developed.⁹⁶ Typically the donation amount to receive this reward is less than the expected retail price once the product is fully developed.⁹⁷ The reward model is similar in that it offers a specific item to incentivize contributions, but differs from the pre-purchase model because the item offered is not the one being developed.⁹⁸

Rewards, under these models, are most likely not investment contracts because they do not offer any share of the company's profits. Contributors may argue that they have an interest in the success of the company because they could only obtain the reward if the company is successful. However, this reasoning does not equate to the donors retaining an interest in the founder's profits. Profit and success are separate, and contributors are typically concerned with receiving their reward.⁹⁹ Thus, most contributors do not care if a company actually generates a profit after the funding period ends.¹⁰⁰

The reward and pre-purchase models are the most popular methods of soliciting donations used in online crowdfunding.¹⁰¹ A study of online crowdfunding efforts found that 66.7% involved the right to receive the product.¹⁰² Since these two models do not entitle contributors to share the company's profits, it can be concluded that a majority of crowdfunding involves transactions that would not qualify as securities.¹⁰³

Kickstarter encourages project founders to offer pre-purchase model rewards.¹⁰⁴ The website's reward guidelines prohibit offerings based on a securities model because it states that "Projects can't promise to donate funds raised to a charity or cause, and they can't offer financial incentives like equity or repayment."¹⁰⁵ Kickstarter's primary reliance on the pre-purchase model means that none of its projects offer securities.

A fourth model used for online crowdfunding is the lending model.¹⁰⁶ Lending websites allow participants to lend others money.¹⁰⁷ Some loan

96. *Id.* at 16.

97. *Id.*

98. *Id.*

99. See, e.g., Angus Loten, *When a Kickstarter Campaign Goes Very Wrong*, WALL STREET JOURNAL (Sept. 10, 2014), <http://online.wsj.com/articles/big-kickstarter-campaign-overwhelms-radiate-athletics-1410394283>.

100. This is not to say that contributors do not care at all about the profitability of the company. The recent acquisition of Oculus Rift by Facebook for \$2 billion did prompt discussion of how the company's Kickstarter backers had no say in the arrangement, and received none of the compensation. Issie Lapowsky, *Why Kickstarter Doesn't Want You to Profit From Your Donations*, WIRED (May 5, 2014), <http://www.wired.com/2014/05/kickstarter-equity/>.

101. See Bradford, *supra* note 75, at 16.

102. *Id.* at n.52.

103. *Id.*

104. See *Creator Handbook: Rewards*, KICKSTARTER, <https://www.kickstarter.com/help/handbook/rewards> (last visited Oct. 12, 2014). The first two suggested rewards, "copies of the thing" and "limited edition," are pre-purchase rewards. *Id.*

105. *Our Rules*, KICKSTARTER, https://www.kickstarter.com/help/guidelines?ref=help_nav (last visited Oct. 13, 2014).

106. See Bradford, *supra* note 75, at 14.

107. *Id.* at 20.

websites allow lenders to charge interest in some instances depending on the particular crowdfunding platform's policies.¹⁰⁸ Whether the offerings on a lending-based crowdfunding site are considered securities is more difficult to determine.¹⁰⁹ However, a clear dividing line exists for sites that offer interest-free lending versus those that allow interest to accrue.¹¹⁰ Websites allowing lenders to charge interest on a loan are more likely to be viewed as offering securities than sites that do not.¹¹¹ Kickstarter does not allow founders to solicit loans of any sort.¹¹²

The fifth reward model, the equity model, clearly involves dealing in securities because the project founders promise donors a share of the profits of the company, or alternatively issue stock.¹¹³ These types of rewards are clearly defined as securities under both the 1933 and 1934 Acts.¹¹⁴ Since ProFounder ceased its operations, no websites based in the United States offer equity-based crowdfunding to the general public.¹¹⁵ However, some websites allow private equity offerings to sophisticated accredited investors.¹¹⁶ Kickstarter does not allow private securities offerings, and its guidelines explicitly prohibit project founders from offering equity or a share in the profits as a reward.¹¹⁷

In sum, most incentives that crowdfunding websites offer are not securities. Further, interest-based loans may be considered securities, but interest-free loans likely will not. Equity-based crowdfunding plainly offer securities, and the CROWDFUND Act may govern these offerings.¹¹⁸ Since Kickstarter and other similar websites do not offer securities, the CROWDFUND Act does not apply to the majority of online crowdfunding transactions in the United States.

III. REGULATION BY THE SEC IS NOT APPROPRIATE FOR ONLINE ENTITIES LIKE KICKSTARTER

The relaxed securities regulation by the SEC has clearly not encouraged Kickstarter to offer securities.¹¹⁹ This suggests that the CROWDFUND Act will not achieve its goals of increasing a startup's access to capital while simultaneously providing a safer marketplace for

108. *Id.*

109. *Id.* at 34.

110. *Id.* at 35.

111. *Id.*

112. *Our Rules*, KICKSTARTER, https://www.kickstarter.com/help/guidelines?ref=help_nav (last visited Oct. 13, 2014).

113. *See* Bradford, *supra* note 75, at 32.

114. *Id.*

115. *Id.* at 25.

116. *Id.*

117. "Kickstarter is a funding platform for creative projects. These are our guidelines." *Our Rules*, KICKSTARTER, https://www.kickstarter.com/help/guidelines?ref=help_nav (last visited Oct. 13, 2014).

118. Bradford, *supra* note 75, at 44.

119. Lapowsky, *supra* note 100.

potential investors.¹²⁰ The heightened scrutiny necessary to become a funding portal likely deters Kickstarter, and other online crowdfunding platforms, from expanding its services to include securities crowdfunding.

A. PROPOSED REGULATIONS

The proposed regulations by the SEC are not, for the most part, excessively burdensome and allow significant flexibility, which recognizes the nature of crowdfunding efforts. The CROWDFUND Act requires the SEC to create regulations for funding portals and provide them with exemptions to traditional securities registration.¹²¹ The first proposed regulation clarifies that the \$1 million limit on offerings exempted under § 4(a)(6) should not be constrained by offerings relying on other exemptions.¹²² This means that the \$1 million limit is only applicable when a founder offers securities that rely solely on the § 4(a)(6) registration exemption.

The SEC also proposed a regulation that the individual investment limitations of \$2,000, or 5% of an individual's annual income, be applied only to investors whose net worth and annual income were less than \$100,000.¹²³ This regulation would open securities crowdfunding to a broader portion of the population by allowing individuals with either a high income or high net worth to invest more than \$2,000 a year. The SEC also proposed that founders must limit their crowdfunding efforts to one funding portal or broker.¹²⁴ This restriction was proposed so that the benefits of crowdfunding—the creation of a community that shares information about the issuer—would not be fragmented amongst several different crowdfunding platforms.¹²⁵ Another introduced regulation requires any issuers that rely on the § 4(a)(6) exemption to disclose information regarding the particular business; including a business plan, intended use of funds received, the capital structure of the company, and the company's financial situation.¹²⁶

Investors can use this information to determine the reliability and viability of a company. Thus, this proposed disclosure requirement would help protect investors from fraud or poor investment decisions. These rules would help maintain investor confidence in the integrity of the market, and may ultimately lead to increased investment. These regulations are only

120. H.R. REP. NO. 112-406 (2012).

121. Crowdfunding, 78 Fed. Reg. 66427, 66430 (Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240, 249). The SEC closed the period for comment on its proposed regulations on February 3, 2014. *Id.* at 66468.

122. *Id.* at 66431.

123. *Id.* at 66430.

124. *Id.* at 66435.

125. For a discussion of the positive effects of social media on crowdfunding websites to detect fraud, see *How the Crowd Detects Fraud*, CROWDFUND CAPITAL ADVISORS, <http://crowdfundcapitaladvisors.com/resources/26-resources/120-crowd-detects-fraud.html> (last visited Oct. 13, 2014).

126. Crowdfunding, 78 Fed. Reg. 66427, 66468–69 (Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240, 249).

intended to protect investors who plan to invest in crowdfunding projects that offer securities.

The SEC also proposed regulations that would govern funding portals.¹²⁷ The proposed regulations state that funding portals would be considered brokers under the Securities Exchange Act, thus are required to either register as a broker or as a funding portal in order to provide securities offerings.¹²⁸ To be exempt from regulations applying to securities brokers, funding portals must reasonably believe that any issuers of securities on its website comply with the requirements in the statute.¹²⁹ Funding portals must also conduct background checks on each securities issuer, including the officers of the company, its directors, and owners holding a share of 20% or more.¹³⁰ Funding portals would need to provide investors with educational materials discussing the risks of participating in crowdfunding, when an issuer may cancel an investment commitment, and other types of information.¹³¹

Once a website qualifies as a funding portal, it is exempt from other duties the regulations impose on securities brokers.¹³² As a result, founders using funding portals may offer securities on the website without registering the securities. This exemption's looser disclosure requirements may heighten the number of small-scale investments. However, the first major hurdle is enticing the crowdfunding websites to offer securities despite the Act's additional enforcement requirements.

B. ONLY IMPOSING REGULATIONS ON INTERMEDIARIES ISSUING SECURITIES WILL BE INEFFECTIVE

The requirements for funding portals set forth in the SEC's proposed regulations are, for the most part, reasonable and allow crowdfunding sites flexibility in how they may comply. However, the choice between being regulated versus no regulation is likely to discourage crowdfunding websites from offering securities. One likely deterrent is the increased costs incurred in complying with the regulations. Crowdfunding websites currently have no obligation to investigate the founders of crowdfunding projects. Staff only review basic information related to the project to check if it adheres to the website's guidelines. If a crowdfunding website must comply with SEC regulations it must devote more time and resources into investigating the reliability of a potential project founder.

The regulations also subject crowdfunding websites to certain

127. *Id.* at 66559–63.

128. *Id.* at 66560. To qualify for the exemption, a funding portal would need to remain subject to the authority of the SEC, be a member of a national securities association, as well as be subject to other requirements of the SEC, including allowing access to records that the SEC would require the funding portal to keep. *Id.* at 66559–62.

129. *Id.* at 66562.

130. *Id.* at 66531.

131. *Id.* at 66465–66.

132. *See id.* at 66430.

liabilities. Currently, crowdfunding websites are not held liable if a founder uses the website fraudulently or fails to deliver on their obligations.¹³³ Under the proposed regulations, a crowdfunding website's ability to act as a platform that facilitates securities offerings is contingent upon its reasonable belief that the securities issuer complies with the SEC regulations. If the crowdfunding website unreasonably relies upon the issuer, it is no longer exempt as a funding portal and the website could be liable for acting as an unregistered securities broker.

Crowdfunding websites that register as funding portals also effectively preclude themselves from acquiring project founders who do not offer securities. If a platform is registered with the SEC and must comply with certain disclosure requirements the registered funding portal still competes with crowdfunding websites, like Kickstarter, that are not registered with the SEC.¹³⁴ Since the unregistered site is not subject to any requirements, entrepreneurs with projects that can receive funding without offering securities will likely prefer the less regulated option, since it requires less work. Few websites would enter the niche market of securities crowdfunding when only a few project founders are willing to make the necessary disclosures.¹³⁵ Affirming this conclusion, Kickstarter's CEO has already announced that Kickstarter will not take advantage of the exemptions provided by the CROWDFUND Act.¹³⁶ Securities crowdfunding will be relegated to a corner of the industry, while other websites will continue to offer exclusively reward or pre-order based incentives. This will weaken the potential of the CROWDFUND Act to improve access to capital for small businesses.

Additionally, securities crowdfunding is attractive when there is informational asymmetry between the investor and the project founder about product quality.¹³⁷ When the investor knows little about the product it is difficult to solicit contributions for a pre-order reward.¹³⁸ The result of the CROWDFUND Act will be to undermine this information asymmetry, which will consequently decrease the number of projects that would wish to take advantage of the crowdfunding exemption to securities registration.

A lack of securities crowdfunding is devastating because studies have shown a positive correlation between securities crowdfunding and higher quality products.¹³⁹ Securities crowdfunding could also help companies that are at an earlier stage in product development, since pre-order style crowdfunding typically requires that a prototype of the product is already

133. Strebeck, *supra* note 49.

134. See Lapowsky, *supra* note 100.

135. Even in countries that allow crowdfunding securities, the share of the market is quite small. Around 15% of the crowdfunding sites worldwide allow offering securities. Belleflamme, Lambert & Schwienbacher, *supra* note 94, at 588.

136. Lapowsky, *supra* note 100.

137. Belleflamme, Lambert & Schwienbacher, *supra* note 94, at 601.

138. *Id.*

139. *Id.*

created.¹⁴⁰ At an early developmental stage, securities crowdfunding could be used to fund research efforts since the investors are not necessarily contributing to become consumers of the product.¹⁴¹

IV. FTC PARALLEL REGULATION COULD CLOSE THE REGULATORY GAP

Congress should give the FTC the authority to regulate non-securities crowdfunding websites in order to promote consumer protection and to encourage registration as funding portals under the CROWDFUND Act. Under this proposal, the SEC would continue to regulate securities crowdfunding websites and funding portals, but the proposal recognizes that it is inappropriate for the SEC to regulate non-securities crowdfunding.

The FTC has expertise in handling online transactions involving the transfer of goods or services, which are essentially the underlying activities of crowdfunding websites like Kickstarter. While the FTC may have the authority to regulate non-securities crowdfunding, the current laws are insufficient to protect consumers using non-securities crowdfunding websites. Therefore, legislators should use the CROWDFUND Act as a model to draft new legislation granting the FTC regulatory authority, thus facilitating better regulation of non-securities crowdfunding websites.

A. EXISTING LAW COULD BE APPLICABLE TO CROWDFUNDING WEBSITES

Currently, the Federal Trade Commission Act (FTC Act)¹⁴² could be interpreted to grant the FTC the authority to regulate non-securities crowdfunding websites like Kickstarter. The FTC Act empowers the FTC to investigate businesses and punish the use of unfair trade practices.¹⁴³ The FTC may also create rules, including those that define an unfair or deceptive trade practice.¹⁴⁴ However, this power is meaningless because outright intentional fraud on crowdfunding websites is rare.¹⁴⁵ Though the FTC may prescribe rules to prevent practices it determines are unfair or deceptive, it may not prescribe rules about standards setting or certification activity.¹⁴⁶ This prohibition effectively prevents the FTC from regulating standards set by crowdfunding websites. Basically, the FTC has no authority to promulgate rules regulating non-securities crowdfunding websites, unless it determines that the current practices of crowdfunding websites constitute unfair trade practices.

One feature of Kickstarter that the FTC could reasonably determine

140. *Id.*

141. *Id.*

142. 15 U.S.C. §§ 41–58 (2012).

143. 15 U.S.C. § 45(a)(1)–(2) (2012).

144. *Id.*

145. *See Mitchell, supra* note 11.

146. 15 U.S.C. § 57(a)(1)(B) (2012) (“[T]he Commission shall not develop or promulgate any trade rule or regulation with regard to the regulation of the development and utilization of the standards and certification activities pursuant to this section.”).

constitutes a deceptive trade practice is the fact that its employees pick the “project of the day.”¹⁴⁷ The project of the day is selected by Kickstarter’s staff who review videos posted on various project pages, and then select the one they find most compelling.¹⁴⁸ Kickstarter displays the project of the day on its homepage, and also presents additional employee project selections in a separate section.¹⁴⁹ To consumers these featured projects may appear to be specifically endorsed by Kickstarter.¹⁵⁰ However, the Kickstarter staff do not evaluate a project’s reliability, and the prominent position on the Kickstarter homepage might confuse consumers into thinking that Kickstarter officially supports these projects. Kickstarter could easily ameliorate this confusion by automating the selection of the project of the day. However, other than this practice, it would be difficult for the FTC to find that Kickstarter engaged in other deceptive business practices.

B. CONGRESS SHOULD PROPOSED NEW LEGISLATION SPECIFICALLY GRANTING
AUTHORITY TO THE FTC TO REGULATE CROWDFUNDING WEBSITES

Since the FTC’s authority to regulate crowdfunding is currently limited, Congress should pass new legislation granting authority to regulate. The details of this legislation should take into account the CROWDFUND Act’s strengths. The CROWDFUND Act’s proposed regulations are not unreasonably burdensome and could easily apply to both types of crowdfunding websites. The alternative of not regulating crowdfunding websites will ultimately weaken the technology’s benefits by reducing consumer confidence in the integrity of the system. However, Kickstarter has declared that it will not submit to the CROWDFUND Act’s regulation by becoming a funding portal and offering securities.¹⁵¹ If the FTC enacted rules that required non-security crowdfunding websites to investigate the reliability of project founders, Kickstarter would likely take the additional measures needed to register itself as a funding portal. The marginal cost of complying with the slightly more demanding requirements of the SEC’s funding portal registration would likely be more palatable if the FTC mandated its own investigative measures. Crowdfunding websites that register as funding portals receive the benefit of increased access to capital funding, which is what Congress envisioned when it proposed the CROWDFUND Act.¹⁵²

The new legislation granting authority to the FTC should also consider imposing different limitations on the amount of money that may be raised

147. *Creator Questions*, KICKSTARTER, <https://www.kickstarter.com/help/faq/creator+questions> (last visited Sept. 30, 2014).

148. *Id.*

149. *See Staff Picks*, KICKSTARTER, https://www.kickstarter.com/discover/recommended?ref=home_staff_picks (last visited Sept. 30, 2014).

150. Paul Dempsey, *Crowdfunding’s Geekquake*, ENGINEERING AND TECHNOLOGY MAGAZINE (Sept. 6, 2013), <http://eandt.theiet.org/blog/blogpost.cfm?threadid=54172&catid=367>.

151. Lapowsky, *supra* note 100.

152. H.R. REP. NO. 112-406 (2012).

using such a method. Limitations on the amount that can be raised via non-securities crowdfunding may be more effective if they are reduced. The CROWDFUND Act limits the amount of capital founders can raise while qualifying for the exemption to \$1 million.¹⁵³ Currently, only 83 Kickstarter projects have raised more than \$1 million, making the CROWDFUND Act's ceiling essentially meaningless for non-securities crowdfunding.¹⁵⁴ Moreover, few Kickstarter projects received more than \$20,000 in funding.¹⁵⁵ Projects that raised funds in excess of \$50,000 tended to have increased difficulty meeting the specified project timeline than those with more modest funding.¹⁵⁶ Thus, capping the amount of money a fundraiser can request through non-securities crowdfunding could reduce the rate of delayed delivery by excluding very large projects. Less than 1,650 projects have raised more than \$100,000.¹⁵⁷ Thus, implementing a \$50,000 funding limit would not severely limit the variety of Kickstarter projects. This restriction would not affect securities crowdfunding websites, and founders offering a mix of securities and non-securities rewards could raise slightly more than \$1.05 million between the two methods,¹⁵⁸ so long as they could adequately document which portion of the amount raised was attributable to securities. They would raise \$1 million using securities crowdfunding through the CROWDFUND Act and approximately \$50,000 through non-securities crowdfunding through the new legislation authorizing the FTC to regulate non-securities crowdfunding.

Another potential limitation on the amount of funding founders could receive through new legislation granting the FTC authority to regulate crowdfunding would be to limit the overfunding of projects. Currently, Kickstarter projects can keep raising money after surpassing their goals, though few receive more than 110% of their initial goal.¹⁵⁹ Highly successful Kickstarter projects have cited problems such as the increased manufacturing required to meet the higher demand as a key factor contributing to the delay.¹⁶⁰ Limiting project overfunding to 110% of the initial goal could reduce the difficulty founders face with overly successful projects. While around 50% of projects reach this benchmark, policy reasons support implementing the restriction.¹⁶¹ The reason Kickstarter projects have a specified monetary goal is to facilitate the website's all-or-

153. H.R. 3606, 112th Cong. § 302 (2012).

154. *Kickstarter Stats*, KICKSTARTER, <https://www.kickstarter.com/help/stats> (last visited Dec. 10, 2014).

155. *See id.*

156. Mollick, *supra* note 52, at 12–13.

157. *Kickstarter Stats*, KICKSTARTER, <https://www.kickstarter.com/help/stats> (last visited Dec. 10, 2014). The statistics are current as of the last visited date.

158. If a founder requests \$50,000, they may receive slightly more than this amount if they are allowed to receive more funds than they requested.

159. Mollick, *supra* note 52, at 6.

160. Pepitone, *supra* note 61.

161. Mollick, *supra* note 52, at 6.

nothing funding mechanism. This goal also helps founders by requiring them to assess the cost of their project ahead of time. While founders are unlikely to turn down extra money, if the obligations they incur as a result of this extra funding increase the scope of the project, even well-planned projects may have difficulty performing. Giving a 10% overfunding margin helps prevent projects from failing simply because of high consumer demand. The new legislation should allow for a 10% overfunding margin on non-securities crowdfunding by the FTC.

New laws should provide limited authority to the FTC in requiring certain disclosures. Specifically, any new laws should only require founders to disclose the corporate structure, officers of the corporation, and provide contact information. This information is valuable for consumers in determining if they want to do business with the company, and provides the information needed if they wish to pursue legal claims. Information on the ownership structure of the company is not as important to consumers engaging in non-securities crowdfunding transactions because they will not hold equity in the company.

New laws should also require that crowdfunding websites provide potential funders with clear and conspicuous information about the crowdfunding model, and the uncertain nature of the products promised. This notice should state that crowdfunding offerings do not represent an online store, and the products featured only have the potential to be developed. Consumers should also be notified that a project's estimated delivery date is not enforceable, and that delays are common.

CONCLUSION

Currently, neither traditional securities law nor the CROWDFUND Act is adequate to regulate non-securities crowdfunding sites. This regulatory gap leaves a majority of crowdfunding website users vulnerable to fraud and delayed performance. Presently, the most popular crowdfunding website, Kickstarter, does not fall under the scope of CROWDFUND Act's regulations because it does not allow project founders to offer securities. Kickstarter has already declared its intention to avoid becoming a funding portal under the meaning of the CROWDFUND Act, thereby circumventing the SEC's scrutiny.¹⁶² Legislators could fill this gap by crafting a statute allowing the FTC to regulate non-securities crowdfunding websites. In addition to filling the gap, this proposal may entice non-securities crowdfunding websites, like Kickstarter, to reconsider allowing project founders to offer securities. This would improve the effectiveness of the CROWDFUND Act by increasing the amount of websites voluntarily registering as funding portals. Overall, consumer protection in the context of online crowdfunding can only be fully achieved when all types of transactions are subject to an appropriate level of oversight.

162. Lapowsky, *supra* note 100.