CROWDFUNDING AND THE PUBLIC/PRIVATE DIVIDE IN U.S. SECURITIES REGULATION©

Joan MacLeod Heminway*

I. INTRODUCTION

The origination and expansion of crowdfunding as a capital-raising tool has been a hot topic on the street and in the media and the academy for a few years now. In less than ten years, this fusion of social media and traditional corporate finance—a mode of corporate finance through which firms raise investment capital by reaching out over the Internet to a broad, undifferentiated mass of potential investors[1]—grew from a creative impulse to a movement that catalyzed federal legislative action.[2] Its socio-legal bounds are as yet relatively untested. It seems that crowdfunding offers something to nearly everyone.

Of course, U.S. securities law has something to say about crowdfunding when the firms using this capital-raising method are participating in an offering of securities.[3] Specifically, Section 5 of the Securities Act of 1933, as amended (the 1933 Act),[4] provides that offers and sales of securities are required to be registered—a process that includes the filing and revising

---

* W.P. Toms Distinguished Professor of Law, The University of Tennessee College of Law. New York University School of Law, J.D. 1985; Brown University, A.B. 1982. Work on this article was supported by a summer research grant from The University of Tennessee College of Law. This article benefitted from feedback received from Ann Lipton and the participants in a discussion group convened at the Southeastern Association of Law Schools 2014 annual conference.

** The information provided in this article speaks as of the summer of 2015 and does not take into account the adoption of final agency rules under the CROWDFUND Act, which occurred late in the fall of 2015 and went into effect in May 2016.

[1] In essence, this is the definition of crowdfunding that I will be working with in this article. Broader definitions of crowdfunding also exist and can be useful in other contexts. *See*, *e.g.*, THOMAS ELLIOTT YOUNG, THE EVERYTHING GUIDE TO CROWDFUNDING 14 (2013) ("Crowdfunding is the process of soliciting funds from the general public to create projects or fund businesses."); Thaya Brook Knight et al., *A Very Quiet Revolution: A Primer on Securities Crowdfunding and Title III of the Jobs Act*, 2 MICH. J. PRIV. EQ. & VENTURE CAP. L. 135, 135 (2012) ("At its most basic level, crowdfunding means using a method of mass communication, typically the Internet, to solicit funds from the community at large, with the project creator receiving small individual amounts of funding from a large number of donors or investors."). This article focuses most directly on crowdfunding that involves the offer and sale of securities, which typically is referred to as securities crowdfunding, investment crowdfunding, or crowdfund investing.

[2] *See* SHERWOOD NEISS ET AL., CROWDFUND INVESTING FOR DUMMIES 33–38 (2013).

[3] *See generally* C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1 (2012) (identifying and describing various securities regulation issues relating to securities crowdfunding); Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879 (2011) (explaining the offering registration issues arising out of securities crowdfunding).

[4] 15 U.S.C. § 77(e) (2012).

of a disclosure document called a registration statement—unless they comply with an exemption from registration. Crowdfunding efforts sometimes run afoul of the registration requirement, in particular when the financial interests being offered constitute investment contracts rather than equity or debt securities.[5] Prior to the 2012 adoption of the Jumpstart Our Business Startups Act (the JOBS Act),[6] registration exemptions for crowdfunded securities offerings were not readily available.[7] Moreover, at that time, potential securities crowdfunding websites were concerned that they might be required to register as regulated intermediaries under the Securities Exchange Act of 1934, as amended (the 1934 Act).[8] Crowdfunding advocates became frustrated with the impediment represented by federal securities regulation (in particular, the offering registration requirement) and lobbied for change in the nation's capital.[9]

The resulting federal legislation, the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act (the CROWDFUND Act), Title III of the JOBS Act, adds a new exemption from registration to the 1933 Act. In the process, the CROWDFUND Act also creates a new type of financial intermediary regulated under the 1934 Act[10] and amends the 1934 Act in other ways. Important among these additional changes is a provision exempting holders of securities sold in crowdfunded offerings from the calculation of shareholders that requires securities issuers to become reporting companies under the 1934 Act.[11] The registration exemption provided in the CROWDFUND Act is not self-effectuating. Rulemaking by the U.S. Securities and Exchange Commission (the SEC), as well as the Financial Industry Regulatory Authority (the FINRA), is required to implement the exemption. At the time work on this article was completed, these regulatory efforts were in process but not yet completed.

The CROWDFUND Act and the JOBS Act (of which it is a part) cover significant doctrinal ground and include provisions beloved by some and disdained by others. This article focuses narrowly on the CROWDFUND Act as a reaction to two historically significant public/private distinctions in U.S. federal securities law: the line between public offerings and private offerings and the division between public companies and private companies—ways of understanding and categorizing business associations for purposes of U.S. federal securities regulation. The regulatory boundary between public offerings and private placement transactions is a basic building block among the varied legal aspects of corporate finance. Along the same lines, the distinction between public companies and private companies

---

[5] *See* Heminway & Hoffman, *supra* note 3, at 882-86 (explaining that early academic and regulatory interest in crowdfunding stemmed from concern that entrepreneurs were violating the federal securities laws by crowdfunding interests in businesses and projects that constitute securities because they are investment contracts); *see also* Joan MacLeod Heminway, *What is a Security in the Crowdfunding Era?*, 7 OHIO ST. ENTRPREN. BUS. L.J. 335, 360 (2012) (noting that "[t]he use of investment contracts . . . became more prominent in the crowdfunding environment that existed in the year or two before the U.S. federal government began to take an interest in crowdfunding").

[6] Pub. L. No. 112-106, §§ 301–305, 126 Stat. 306, 315–321 (2012) (codified in scattered subsections of 15 U.S.C. §§ 77, 78).

[7] Heminway & Hoffman, *supra* note 3, at 911–21.

[8] 15 U.S.C. §§ 78a–78oo.

[9] *See* NEISS ET AL., *supra* note 2, at 34–38.

[10] *See* §§ 302, 304, 126 Stat. at 315–21, 321–22 (codified at 15 U.S.C. §§ 77d-1(a), 78c(a)(80)).

[11] *See id.* § 303, 126 Stat. at 321 (codified at 15 U.S.C. § 78*l*(g)).

(together with related concepts like the registration of classes of securities under the 1934 Act and the listing of securities on national securities exchanges) is fundamental to U.S. federal securities regulation, but it also can be significant for reasons that extend well beyond securities regulation. For example, the divide between public and private companies is implicated in other areas of federal regulation[12] and is even incorporated into some state laws.[13]

The very notions of a crowdfunded offering and issuer of securities challenge pre-existing public-private distinctions. The archetypal business or project that desires to engage in crowdfunding—including securities crowdfunding—is intent on seeking 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. Similarly, a crowdfunded issuer of securities is likely to have many holders of financial interests and other constituents to manage and inform. This type of issuer of securities looks and feels like a public company and, depending on the markets in which its securities are offered and sold, its total assets, and the number of equity holders it has, it would have been regulated as a public company before the JOBS Act was signed into law.

Until the JOBS Act became law, the dividing lines between public and private offerings and companies had been well understood—even if somewhat under-studied.[14] Public offerings are those made to investors who do not need the benefits of the regulatory system created in the 1933 Act—investors who can fend for themselves because they are able to independently assess or bear the risk of their transactions.[15] And, as commonly understood, U.S. public companies are those that are required by federal law to publicly disclose information on a regular basis.[16] The nature (form and content) of any public disclosures and process through which they must be made are the subject of pages upon pages of statutory and regulatory provisions.[17] Public issuers typically file these required disclosures with the SEC.[18]

---

[12] *See*, *e.g.*, 12 U.S.C. § 5221(c)(3) (referring to "common or preferred stock of which is not registered pursuant to the Securities Exchange Act of 1934"); 26 U.S.C. § 162(m)(2) ("For purposes of this subsection, the term 'publicly held corporation' means any corporation issuing any class of common equity securities required to be registered under section 12 of the Securities Exchange Act of 1934.").

[13] *See*, *e.g.*, CAL. CORP. CODE § 1501 (West 2016) (referring to "a corporation with an outstanding class of securities registered under Section 12 of the Securities Exchange Act of 1934"); DEL. CODE ANN.. tit. 8, § 203(b)(4)(i) (West 2016) (referring to a corporation that "does not have a class of voting stock that is . . . [l]isted on a national securities exchange"); N.Y. BUS. CORP. LAW § 512(b) (McKinney 2016) (referring to "redeemable common shares . . . registered under a statute of the United States such as the Securities Exchange Act of 1934, as amended").

[14] *See generally* Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 339 (2013) [hereinafter *JOBS Act*] (asserting that "the public-private divide has long been an entirely under theorized aspect of securities regulation.").

[15] *See* Sec. & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119 (1953).

[16] *See infra* notes 25–27 and accompanying text.

[17] *See* 15 U.S.C. §§ 78m(a), (e), 78n(a), (e) (2012) (providing for the filing of quarterly and annual reports and proxy, going private, and tender offer statements); *see also* Joan MacLeod Heminway, *To Be or Not to Be (A Security): Funding for-Profit Social Enterprises*, 25 REGENT U. L. REV. 299, 318–19 (2013) (observing that "public company status under the 1934 Act obligates issuers to periodic and transactional reporting"); Robert B. Thompson, *Corporate Federalism in the Administrative State: The SEC's Discretion to Move the Line Between the State and Federal Realms of Corporate Governance*, 82 NOTRE DAME L. REV. 1143, 1147 (2007) (noting that the 1934 Act

The JOBS Act has brought new attention to the legal conception of the public offering and the public company as reflected in the 1933 Act and the 1934 Act. By making it easier for firms to engage in public offerings of securities while, at the same time, allowing more issuers (including those engaging in crowdfunded offerings of securities) to avoid public company status, the JOBS Act changes and blurs the lines between public offerings and private offerings and between public companies and private companies. Recent scholarly works—in particular, two coauthored articles by Professors Don Langevoort and Bob Thompson[19] and three articles authored by Professor Hillary Sale[20]—have begun to explore this indistinct zone at the intersection of public and private and have made significant analytical progress. These works also have given fellow scholars and practitioners much food for thought.

In these discussions, the CROWDFUND Act has thus far had a relatively small, cameo appearance. This article attempts to shed more light on the way in which the CROWDFUND Act, as yet unimplemented (due to a delay in necessary SEC rulemaking), interacts with public offering status under the 1933 Act and public company status under the 1934 Act. Using the analytical framework offered by Professors Langevoort and Thompson, along with insights provided in Professor Sale's work, this article explores in three brief parts how the CROWDFUND Act impacts and is impacted by the public/private divide in U.S. securities regulation. First, Part II summarizes the foundational scholarship of Professors Langevoort, Thompson, and Sale on the public/private divide in U.S. securities regulation. Next, Part III undertakes an analysis of the CROWDFUND Act using key elements from this emergent body of work. Finally, the article concludes in Part IV with both a summary of the analysis of the CROWDFUND Act undertaken in Part III and related broad-based observations about U.S. securities regulation at the public/private divide.

II. THE FACT AND NATURE OF PUBLIC OFFERINGS AND PUBLIC COMPANY STATUS

When securities lawyers describe a public offering of securities under the 1933 Act, they point first to Section 5 of the 1933 Act, which provides in essence that no one can offer or sell securities without registering the transaction under the 1933 Act, absent compliance with an applicable exemption.[21] Registration involves the creation of a registration statement and filing that registration statement with the SEC.[22] The registration statement is a disclosure document

---

regulates insider trading, proxy solicitations, tender offers, and going-private transactions, usually through disclosure regulation).

[18] *See* sources cited *supra* note 17.

[19] Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573 (2013) [hereinafter *Redrawing*]; Langevoort & Thompson, *JOBS Act*, *supra* note 14.

[20] Hillary A. Sale, *J.P. Morgan: An Anatomy of Corporate Publicness*, 79 BROOK. L. REV. 1630 (2014) [hereinafter Sale, *J.P. Morgan*]; Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012 (2013) [hereinafter Sale, *Governance*]; Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137 (2011) [hereinafter Sale, *New Corporation*].

[21] 15 U.S.C. § 77e (2012).

[22] *See generally* Heminway & Hoffman, *supra* note 3, at 908 ("[A]n issuer must file a registration statement that includes operating and financial disclosures about the issuer, information about the securities being offered and sold, and details about the plan of distribution of those securities.").

that includes a prospectus used for marketing the offering and subjects the filer, known as an issuer, to (among other obligations and subject to conditions) strict liability for misstatements and misleading omissions of material fact in the registration statement.[23] Commonly used exemptions have included those for private placements and limited offerings (historically, under $5,000,000 in the aggregate).[24]

And when securities lawyers talk about a public company, they typically are referring to a firm with a class of equity securities registered under Section 12 of the 1934 Act[25] or reporting responsibilities under Section 13 or Section 15(d) of the 1934 Act.[26] The CROWDFUND Act uses the latter definition.[27] A hallmark of public company status is mandatory disclosure—responsibilities for public periodic disclosure and event-oriented or transaction-based disclosure.[28] Since 2002, the public company's enhanced accountability for public disclosure comes with additional layers of regulation that more pervasively and directly impact firm governance.[29]

In their 2013 article in the *Cornell Law Review*, Professors Langevoort and Thompson address the public/private divide in and under the 1933 Act.[30] They begin with the observation that the primary objective of the 1933 Act is to regulate capital financing transactions (while the primary objective of the 1934 Act is to regulate secondary trading transactions)[31] and continue by noting two boundaries that are important to the public/private divide under the 1933 Act: registered versus exempt offerings and regulated transactions under the 1933 Act versus regulated firms and transactions under the 1934 Act.[32] In this context, the article sets forth four key features of the 1933 Act. These four features are: mandatory disclosure; SEC review; restrictions on sales pressure; and liability.[33] The main body of the article comprises an analysis of three recent securities regulation issues that change or blur the boundary lines between public and private companies: reform efforts under the JOBS Act, reverse mergers, and private investment in public equity ("PIPE") transactions. Importantly, given the time at which the article was published, it offers only a preliminary assessment of the CROWDFUND Act.

The second of the two articles written by Professors Langevoort and Thompson on the

---

[23] *See generally id.* ("False and misleading registration statements are actionable under Section 11 of the Securities Act, false and misleading prospectuses or oral communications may result in liability under Section 12(a)(2) of the Securities Act, and fraudulent conduct in connection with the offer and sale of securities may be enforced (at least by the SEC) under Section 17(a) of the Securities Act.").

[24] *See id.* at 911–21.

[25] 15 U.S.C. § 78*l*.

[26] *Id.* §§ 78m, 78o(d).

[27] Pub. L. No. 112-106, § 302(b), 126 Stat. 306, 321 (2012) (codified at 15 U.S.C. § 77d- 1(f)(2)).

[28] *See* Sale, *J.P Morgan*, *supra* note 20, at 1630 ("[P]ublicly held corporations . . . must file public documents and . . . make public statements on an ongoing basis. These documents and statements, such as earnings calls, press releases, and public announcements, are the stories corporations tell to the world at large.").

[29] *See* Sale, *Governance*, *supra* note 20, at 1013.

[30] *See* Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1574.

[31] *See id.* at 1574–75.

[32] *See id.* at 1575.

[33] *See id.* at 1578–80.

public/private divide in U.S. securities regulation, also released in 2013, focuses attention on the 1934 Act and, more specifically, "when a private enterprise should be forced to take on public status."[34] Published in the *Georgetown Law Journal*, the article identifies two key dimensions—a broad one and a narrow one—that characterize the regulation of public firms under the 1934 Act.[35] The broad dimension consists of three values imposed on powerful institutions through the 1934 Act: "transparency, accountability, and openness."[36] The narrow dimension hones in on the manifestation of those values in rules imposed by the securities regulation framework on certain issuers of securities.[37] The article concentrates on exploring the latter dimension.[38]

In this second Langevoort/Thompson collaboration, the coauthors observe that the narrow dimension of publicness is deeply and directly connected to the broader values associated with publicness.[39] From this observation, they intuit two key "breakpoints" in the 1934 Act: "the threshold point at which companies must undertake basic public disclosure obligations"[40] and "the extent to which Congress has articulated public company responsibility and accountability with the implicit image of the large issuer in mind."[41] The article explores these two breakpoints and concludes by offering the coauthors' reflections on the informal, reactive regulatory process that governs the actions of securities issuers, intermediaries, and investors in the United States and the way in which technological innovations in securities trading relate to that process.

Professor Sale's articles on publicness are synchronistic with those of Professors Langevoort and Thompson, and they cite to her ideas and her scholarship in both of their articles. Her work extends beyond the legal requirements associated with the public nature of firms and into the realm of public beliefs about and reactions to that public nature. Specifically, in her first two articles, published in 2011 in *Law and Contemporary Problems* and 2013 in the *George Washington Law Review*, she exposes and examines the relationship between a firm's public nature and its governance.[42]

> Publicness is both a process and an outcome. When corporate actors lose sight of the fact that the companies they run and decisions they make impact society more generally, and not just shareholders, they are subjected to publicness. Outside actors like the media, bloggers, and Congress demand reform and become involved in the debate. Decisions about governance move from Wall Street to Main Street.[43]

In her recent *Brooklyn Law Review* article, Professor Sale uses J.P. Morgan Chase & Co.'s

---

[34] *See* Langevoort & Thompson, *JOBS Act*, *supra* note 19, at 338.

[35] *See id.* at 340–41.

[36] *See id.* at 340.

[37] *See id.* at 340–41.

[38] *See id.* at 340.

[39] *See id.* at 341.

[40] *Id.*

[41] *Id.* at 342.

[42] *See* Sale, *Governance*, *supra* note 20, at 137; Sale, *New Corporation*, *supra* note 20, at 1013.

[43] Sale, *New Corporation*, *supra* note 20, at 1013.

reaction to the London Whale incident as case study that illustrates how the public nature of a firm both drives firm behavior and reflects the consequences of that behavior.[44]

Professor Sale's two-way relationship between publicness and governance has an ascertainable, if not definitive, flow.

> Corporations make choices . . . . Once corporations communicate these choices to the world, the public develops an understanding of how the corporations have chosen to delegate power and responsibilities, as well as about where the gaps and weaknesses in governance might be. When public actors outside of the corporation reframe and retell the stories, those actors come to play a role in the corporation. Arguably, these outside actors can even become part of the governance rubric, creating pressure for changes in the decision-making structure or the allocation of power within the corporation.[45]

This theory of publicness is a dynamic, progressive, iterative one. Publicness leads to more publicness, which leads to more publicness, and so on.

This body of work produced by Professors Langevoort, Thompson, and Sale provides important touchstones for the analysis of a—if not *the*—critical, lynchpin dichotomy in modern U.S. securities regulation: the line between public and private. These articles also demonstrate a number of ways in which market behaviors and regulation have become co-dependent and otherwise intertwined in ways that may not consciously reflect—or provide outcomes consistent with—articulated policy objectives. Additional work needs to be done to further illuminate these themes. As the most recent addition to the regulatory arsenal that operates at the public/private divide, the CROWDFUND Act provides a logical exemplar for further analysis using the framework established by Professors Langevoort and Thompson and the theoretical and practical reflections provided by Professor Sale.

III. THE CROWDFUND ACT AND PUBLIC OFFERING AND PUBLIC COMPANY STATUS

The public/private divide under the 1933 Act and the 1934 Act is the very genesis of the CROWDFUND Act. Proponents of securities crowdfunding pressed for adoption of the CROWDFUND Act as a direct response to the regulation of public offerings and public companies.[46] Prior to the CROWDFUND Act, securities crowdfunding was a non-exempt public offering of securities under the 1933 Act;[47] investors in the amorphous, disaggregated, diverse crowd could not necessarily fend for themselves, and no limited offering exemption

---

[44] *See* Sale, *J.P. Morgan*, *supra* note 20, at 1636 ("[T]he Company's handling of the Whale losses and ensuing events were not only caused by publicness but also resulted in publicness.").

[45] *Id.* at 1632.

[46] *See* NEISS ET AL., *supra* note 2, at 34–37 (generally noting securities crowdfunding issues under the 1933 Act and the 1934 Act and describing the ways in which the Startup Exemption Regulatory Framework addressed those issues).

[47] *See* Heminway & Hoffman, *supra* note 3, at 912.

from 1933 Act registration was available.[48] Once an issuer files a registration statement under the 1933 Act, the provisions of Section 15(d) of the 1934 Act make that issuer a public company by requiring the issuer to become a 1934 Act reporting company, at least temporarily.[49] Moreover, registered or unregistered crowdfunded offerings of equity securities could result in the issuer of the securities becoming a public company under Section 12(g) of the 1934 Act, which then (prior to the CROWDFUND Act) provided for the mandatory registration of a class of equity securities held by at least 500 people if the issuer had at least $10,000,000 in total assets.[50] In these ways, before the CROWDFUND Act was passed and signed into law in April 2012, crowdfunded offerings of securities implicated both public offering status and public company status under the 1933 Act and the 1934 Act.

As a result, in response to public outcry, extensive lobbying efforts, and a perceived political need for the U.S. Congress to do something—anything—bipartisan in nature to better serve small businesses in the lingering shadows of the recent global financial crisis (especially something promoted as a potential means of helping rescue what then was a somewhat stagnant economy), the CROWDFUND Act addressed both the public offering and public company issues raised by crowdfunded offerings of securities. Specifically, the CROWDFUND Act added a new transactional exemption from registration under the 1933 Act[51] and exempted securities sold in crowdfunded securities offerings from the 500-shareholder threshold (which itself was amended in another part of the JOBS Act) that triggered public company status under the 1934 Act.[52] It is these amendments to the 1933 Act and the 1934 Act that bear scrutiny as regulation at the public/private divide in U.S. securities regulation.

A. The CROWDFUND Act and Public Offering Status under the 1933 Act

In addressing the new 1933 Act registration exemption adopted in the CROWDFUND Act as a matter important to the public/private divide, Professors Langevoort and Thompson relate a brief history of the adoption of the CROWDFUND Act as part of the JOBS Act and make a number of basic salient points with general regard to the four key 1933 Act features they identify in their article (mandatory disclosure, SEC review, restrictions on sales pressure, and liability).

> First, regarding the so-called wisdom of crowds: There are actually two ideas at work here, somewhat in tension. One is that exposing an entrepreneur's idea to an open forum allows for communication among interested parties, allowing the crowd's collective reaction to elicit new information - someone with knowledge, for example, sharing that an otherwise exciting vision risks a patent violation. Yet nothing in the legislation insists on any such openness. That is actually a harder issue than it seems

---

[48] *Id.* at 912–21 (evaluating the potential use of each private and limited offering exemption for crowdfunded offerings of securities and finding each to be inapplicable).

[49] *See* 15 U.S.C. § 78o(d) (2012).

[50] *See id.* § 78*l*(g)(1); 17 C.F.R. § 240.12g-1 (West 2016).

[51] Pub. L. No. 112-106, § 302(a), 126 Stat. 306, 315 (codified at 15 U.S.C. § 77d(a)(6)).

[52] *Id.* § 303(a), 126 Stat. at 321 (codified at 15 U.S.C. § 78*l*(g)(6)).

> because the wisdom-of-crowds literature stresses that open communication may also have a downside, introducing the risk of anchoring crowdmembers' beliefs and undermining the averaging effect of many independent beliefs. Suffice it to say that the final compromise version of section 4(a)(6) has none of the mechanisms built in that might make equity crowdfunding resemble the kinds of markets that have emerged in other contexts. Indeed, the final compromise version makes the exemption available to an issuer that uses either a funding portal or a broker-dealer firm to raise the capital. The latter obviously raises a serious sales pressure concern - a marginal issuer can find a marginal broker to do cold-call telephone solicitations and invoke the exemption from mandatory disclosure and state regulation. Obviously, this is far distant from the vision said to justify crowdfunding; those cold calls (or e-mail spam) will be exposed to neither a crowd nor much likelihood of any wisdom.
>
> Finally, note that the JOBS Act contains an interesting reversal of *Gustafson* for cases of crowdfunding fraud or misrepresentation. Liability for material misstatements or omissions in crowdfunding tracks the negligence-based standard of section 12(a)(2), as Congress chose to make it "as if the liability were created under section 12(a)(2)." Liability is shared not just by the issuer but also by directors, partners, and principal executive and financial officers, an extension of liability that can be expected to increase the level of due diligence in these offerings. In this sense, Congress was acting well within the familiar template of securities regulation strategies in response to the sales pressure concerns.[53]

These observations are helpful and take us part of the way down the road in looking at securities crowdfunding under the CROWDFUND Act as a regulation of publicness.

In the year after Professors Langevoort and Thompson published these observations, the SEC issued its rule-making proposal under the CROWDFUND Act.[54] Accordingly, we now have additional information to work with in assessing the CROWDFUND Act's effects on the distinction between public and private offerings and forms under the 1933 Act. In light of the release of the SEC's rule-making proposal, how does the regulation of offerings under the CROWDFUND Act map to the four features of the 1933 Act identified by Professors Langevoort and Thompson?

1. Mandatory Disclosure

The U.S. Congress expressly provided for mandatory disclosure, the first of the four features recognized by Professors Langevoort and Thompson,[55] under the CROWDFUND

---

[53] Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1606–08 (footnotes omitted).

[54] Crowdfunding, SEC Release Nos. 33-9470; 34-70741, 78 Fed. Reg. 66428 (proposed Nov. 5, 2013), http://www.gpo.gov/fdsys/pkg/FR-2013-11-05/pdf/2013-25355.pdf.

[55] *See* Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1579 (noting the required "creation of a registration statement, a public disclosure document that reveals a great deal of information about the issuer and its capital-raising plans.").

Act.[56] The disclosure obligations come in two types: disclosures made at the time of the offering and those required on an annual basis after completion of the offering.[57] The SEC's rulemaking proposal carries this scheme forward by providing for specific line-item disclosure requirements founded on familiar concepts in existing mandatory disclosure rules.[58] These disclosures are proposed to be made on Form C. The proposed SEC rules also call for the use of specially designated variants of the form for amendments, progress updates, annual reporting, and termination of reporting, all as set forth in the proposal release.[59]

The mandatory disclosure provisions of the CROWDFUND Act and the SEC's rulemaking proposal for implementing them acknowledge and confirm a type of relationship that pre-existed the CROWDFUND Act: the relationship between the registration requirements of Section 5 of the 1933 Act and the continuing public reporting obligations imposed on issuers based on those registration requirements through the operation of Section 15(d) of the 1934 Act. However, the CROWDFUND Act treats these mandatory disclosure obligations all as part of a unified continuing whole—part of the bargain of raising capital through crowdfunding—rather than addressing ongoing periodic disclosure following the offering as a separate, temporary requirement based on unique criteria. In other words, the CROWDFUND Act merges offering status and company status in a novel way.[60]

Yet, crowdfunded offerings exempt from registration under the CROWDFUND Act are not registered public offerings, and the periodic reporting required of the issuers engaged in those offerings, as currently proposed, is not the equivalent of that required for public companies.[61] The level of disclosure under the proposed rules is significantly lower in each case (at the time of the offering and as a matter of periodic reporting), and most of the additional responsibilities of public company status—apart from a scaled-down version of mandatory reporting—do not apply to (and are not imposed by the CROWDFUND Act on) crowdfunding issuers. Although Regulation A had earlier blurred the line between public and private offerings for mandatory disclosure under the 1933 Act by requiring limited offering disclosures structured to look like the disclosures used in registered public offerings[62] and Regulation D requires disclosures for certain registration exemptions,[63] the CROWDFUND Act, as implemented through the SEC rules as currently proposed, appears to create an integrated offering and issuer status somewhere between public and private by combining concepts from each regime. Only with final SEC rulemaking will we be able to fully assess exactly where the mandatory disclosure obligations for crowdfunded offerings are situated on

---

[56] § 302(b), 126 Stat. at 315–20 (codified at 15 U.S.C. § 77d-1(b)(1), (4)).

[57] *Id.*

[58] Crowdfunding, 78 Fed. Reg. at 66437–52.

[59] *Id.* at 66452–54.

[60] Professors Thompson and Langevoort note and comment on the trend toward integration of the disclosures compelled by the 1933 Act and the 1934 Act. *See* Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1581–83.

[61] *Compare* Crowdfunding, 78 Fed. Reg. at 66554 (providing, in proposed Rule 202 of Regulation Crowdfunding, the proposed annual reporting requirements under the CROWDFUND Act), *with* U.S. Sec. & Exch. Comm'n, Form 10-K Annual Report Pursuant to Section 13 or 15(d) of The Securities Exchange Act of 1934, https://www.sec.gov/about/forms/form10-k.pdf (providing, in Form 10-K under the 1934 act, the annual reporting requirements for U.S. public company issuers).

[62] 17 C.F.R. §§ 230.252–253 (West 2016).

[63] *Id.* §§ 230.502(b)(1), 230.505(b)(1), 230.506(b)(1).

the public-private continuum.

2. SEC Review

The second feature of the 1933 Act identified by Langevoort and Thompson is SEC review—pre-review of an issuer's disclosure documents as a condition to the issuer's ability to legally conduct a securities offering. They note that the 1933 Act "provides for review of the registration statement by the SEC staff to ensure its quality and completeness. This review is . . . powerful . . . because the issuer cannot lawfully sell its securities until the registration statement becomes 'effective,' the timing of which is largely under bureaucratic control."[64] This control may prevent issuers from being able to take advantage of market windows, but it also slows the pace of offerings that may be moving at an unwarranted and unwise speed. As such, the review requirement may act as a circuit breaker of sorts in preventing the damage to investors and the market that fraudulent and other injurious offerings may cause.

Neither Congress nor the SEC provided for pre-offering review of the offering disclosures mandated under the CROWDFUND Act. This is where the observations made by Professors Langevoort and Thompson about crowd wisdom[65] become important. A principal commentator in this area has posited that the wisdom of the crowd depends on engaging participants with diverse ideas who think independently and make decisions in a decentralized environment featuring effective information aggregators.[66] If crowd wisdom is to limit the need for either mandatory disclosure or SEC review, then Congress, the SEC, and market participants should foster these crowd-wisdom attributes in crowdfund investment groups and tailor mandatory disclosure obligations accordingly. Assuming the requisite diversity, independence, and decentralization, the SEC's proposed rules under the CROWDFUND Act require that investors in crowdfunded offerings conducted under the exemption be permitted to cancel their investment commitments until 48 hours prior to the termination of the offering (as established by the issuer in its offering materials), which may afford time for a diverse, independent, decentralized group of crowdfunding investors to act with collective wisdom.[67] Nevertheless, given the constraints placed by Congress on CROWDFUND Act offerings, the cautionary tale told by Professors Langevoort and Thompson has validity and significant traction.

The SEC noted in its rulemaking proposal that it does intend to use the filings on Form C to monitor issuer compliance and regulatory efficacy.[68] But *ex post* data gathering and analysis is a far cry from pre-offering reviews of mandatory disclosures, even if those reviews

---

[64] Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1579 (footnotes omitted).

[65] *See supra* note 53 and accompanying text.

[66] *See* JAMES SUROWIECKI, THE WISDOM OF CROWDS xviii, 23–83 (2005). For a more detailed analysis of the interaction between Surowiecki's work and crowdfunded securities offerings under the CROWDFUND Act, see Joan MacLeod Heminway, *Investor and Market Protection in the Crowdfunding Era: Disclosing to and for the "Crowd"*, 38 VT. L. REV. 827 (2014).

[67] Crowdfunding, SEC Release Nos. 33-9470; 34-70741, 78 Fed. Reg. 66428, 66476 (proposed Nov. 5, 2013), http://www.gpo.gov/fdsys/pkg/FR-2013-11-05/pdf/2013-25355.pdf (noting that "Under this approach, an investor could reconsider his or her investment decision with the benefit of the views of the crowd and other information, until the final 48 hours of the offering.").

[68] *See id.* at 66453.

do not ensure for investors the accuracy or adequacy of the disclosed information. While the assembled data can be analyzed and related studies can be done to improve applicable rules, only *ex ante* examinations of issuer disclosures enable regulators to act as true gatekeepers by most effectively spotting offering defects and delaying or terminating non-compliant or fraudulent offerings.[69]

3. Restrictions on Sales Pressure

As a third important feature of the 1933 Act, Professors Langevoort and Thompson point to aspects of the regulatory system for public offerings that help protect investors from marketing and sales tactics that are coercive or unfair.[70] Intermediation (through underwriters, dealers, and others) is a significant part of the public offering process, and the regulation of intermediaries therefore is important to public offering regulation.

> The '33 Act regulates the roles of various intermediaries in the selling process (e.g., underwriters, accountants, and, more indirectly, lawyers), anticipating enhanced due diligence that will protect investors. This marketing restriction is intensely complicated because it tries to balance two inconsistent goals in a very compressed time period: one, allowing the issuer and underwriters on the selling side to build a solid book of committed investors to price the securities accurately and limit the risk associated with the distribution and two, simultaneously giving to the investors on the buying side the practical ability to think through the disclosures (always a work in progress until the effective date) before committing to the deal.[71]

The regulation of intermediaries works with what has been an important aspect of issuer regulation instituted in the name of investor protection under the 1933 Act: gunjumping constraints. These statutory rules restrict certain issuer communications in connection with registered public offerings before a registration statement has been filed and in the period between the filing of the registration statement and its effectiveness.[72] This part of the regulatory system under the 1933 Act is designed to prevent the issuer from priming the market for an upcoming public offering of its securities by engaging in promotional communications outside the SEC-authorized channels. Although these rules have declined in strength (and, therefore, significance) since public offering reforms introduced by the SEC in 2005,[73] they remain an important part of the regulation of marketing and sales methods in connection with registered public offerings of securities under the 1933 Act. Because the

---

[69] *See*, *e.g.*, 15 U.S.C. § 77h(b)–(d) (2012) (providing the SEC with the authority to issue refusal orders and stop orders to delay or suspend the effectiveness of a registration statement under the 1933 Act).

[70] *See* Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1585–86 ("What makes a public offering special in terms of investor protection is the business-driven need to induce increased demand so as to absorb a large number of shares suddenly coming to market . . . . It is the combination of that need and the issuer's self-interest that justifies the registration requirement.").

[71] Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1579 (footnote omitted).

[72] *See* 15 U.S.C. § 77e(b)(1), (c).

[73] For a detailed summary of the ways in which these reforms impacted the gunjumping restrictions under the 1933 Act, see Joseph F. Morrissey, *Rhetoric and Reality: Investor Protection and the Securities Regulation Reform of 2005*, 56 CATH. U. L. REV. 561 (2007).

gunjumping rules constrain offers of securities made without registration or compliance with an applicable exemption, they operate on unregistered crowdfunding offers that fail to comply with the new statutory exemption adopted in the CROWDFUND Act.

The CROWDFUND Act specifically regulates marketing and sales efforts in crowdfunded offerings, but it does so in ways different from the ways in which the 1933 Act and the SEC regulations adopted under it otherwise regulate these activities in connection with public and private offerings of securities. In order to avail themselves of the CROWDFUND Act's exemption from offering registration, issuers must conduct their offerings of securities through a registered intermediary—either a funding portal (a new form of intermediary created in the CROWDFUND Act) or a broker.[74] An issuer is not permitted to "advertise the terms of the offering, except for notices which direct investors to the funding portal or broker"[75] and may not

> compensate or commit to compensate, directly or indirectly, any person to promote its offerings through communication channels provided by a broker or funding portal, without taking such steps as the Commission shall, by rule, require to ensure that such person clearly discloses the receipt, past or prospective, of such compensation, upon each instance of such promotional communication.[76]

The SEC's proposed rulemaking covers this matter in Rule 205 of Regulation Crowdfunding.[77] In the proposed rule, after repeating the statutory language, the SEC adds the following: "A founder or an employee of the issuer that engages in promotional activities on behalf of the issuer through the communication channels provided by the intermediary must disclose, with each posting, that he or she is engaging in those activities on behalf of the issuer."[78] The proposed SEC rule also prohibits an issuer from directly or indirectly compensating or committing to compensate any person to promote its offerings under the CROWDFUND Act, unless the promotion is limited to notices permitted by, and in compliance with, the advertising restrictions applicable to issuers.[79] The related text of the release clarifies the transparency rationale underlying these restrictions on compensated promotional activities in the anticipated crowdfunding context.[80]

The marketing efforts of intermediaries also are restricted, to varying degrees. No intermediary may "compensate promoters, finders, or lead generators for providing the broker or funding portal with the personal identifying information of any potential investor."[81] Registered funding portals are further restricted. The very concept of a funding portal, as defined in the CROWDFUND Act, excludes even ordinary securities offering marketing and

---

[74] Pub. L. No. 112-106, § 302(a), 126 Stat. 306, 315 (codified at 15 U.S.C. § 77d(a)(6)(C)).

[75] *Id.* § 302(b) (codified at 15 U.S.C. § 77d-1(b)(2)).

[76] *Id.* (codified at 15 U.S.C. § 77d-1(b)(3)).

[77] Crowdfunding, SEC Release Nos. 33-9470; 34-70741, 78 Fed. Reg. 66428, 66555 (proposed Nov. 5, 2013), http://www.gpo.gov/fdsys/pkg/FR-2013-11-05/pdf/2013-25355.pdf.

[78] *Id.* (Proposed Rule 205(a)).

[79] *Id.* (Proposed Rule 205(b)).

[80] *Id.* at 66456.

[81] § 302(b), 126 Stat. at 315 (codified at 15 U.S.C. § 77d-1(a)(10)).

sales support activities offered by other securities transactional intermediaries, since funding portals cannot (among other things):

> (A) offer investment advice or recommendations;
>
> (B) solicit purchases, sales, or offers to buy the securities offered or 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; [or]
>
> (D) hold, manage, possess, or otherwise handle investor funds or securities . . . .[82]

Professors Langevoort and Thompson note this differential burden on the two potential qualified intermediaries with disfavor (specifically, as to the ability of registered brokers to engage in promotional activities).[83] One might presume that liability considerations (about which more is said in the next subpart of this Part) and adverse reputational effects would constrain overzealous, non-fraudulent marketing and selling efforts undertaken by brokers, but may not be the case.

Overall, the marketing and selling constraints applicable to brokers and funding portals under the CROWDFUND Act are meaningful, but they are somewhat uneven and focused on specific practices that Congress anticipates may provide opportunities for abuse. Moreover, the restrictions imposed on funding portals all but remove any individualized marketing and selling expertise they may have from the offering process, except to the extent that expertise is focused on building an attractive crowdfunding platform that entices investors to come and shop for investment opportunities. Thus, the sell side in an offering conducted under the CROWDFUND Act principally (apart from solicitations made by brokers consistent with their legal and professional obligations) relies on the Internet and the crowd of onlookers, including prospective investors, for its power and would appear to protect investors in a relatively uneven and narrow way. Some issuers may receive more attention than others in the vast, irregular expanse of the Internet. In other words, as a general matter, a CROWDFUND Act offering, viewed through a marketing and sales lens, offers less sell-side (promotional) and buy-side (investor protection) benefit than a registered public offering. It is unclear that investors are adequately or consistently protected from abusive sales practices by the CROWDFUND Act's constrained marketing and sales regime, and that detriment may not be offset by benefits to the overall scheme of capital formation under the CROWDFUND Act.

---

[82] *Id.* § 304(b), 126 Stat. at 322 (codified at 15 U.S.C. § 78c(a)(80)). Although the CROWDFUND Act authorized the SEC to suggest additional restrictions on permitted funding portal activities, the SEC declined to exercise that authority. *See* Crowdfunding, 78 Fed. Reg. at 66458.

[83] *See* Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1607 ("[A] marginal issuer can find a marginal broker to do cold-call telephone solicitations and invoke the exemption from mandatory disclosure and state regulation.").

4. Liability

Professors Langevoort and Thompson identify the 1933 Act's unique liability features as a critical factor in its regulatory design.

> In addition to the SEC's tools to police compliance (e.g., refusals to declare a registration statement effective, stop orders, and enforcement actions), the '33 Act creates three extraordinarily powerful liability standards. Section 11 creates strict liability for the issuer if there are material misstatements or omissions in the registration statement when it becomes effective and due diligence-based liability for other offering participants. Section 12(a)(1) enforces the registration obligation and marketing restrictions, again strictly, against any seller. Section 12(a)(2) extends due diligence-like liability to any material misrepresentations or omissions in any selling efforts connected to the public offering. The public-offering context is well suited to class action treatment, both economically and legally, so that the threat to issuers and other participants in the distribution is particularly potent.[84]

Professors Langevoort and Thompson join others in noting that the strict and due diligence liability provided for in the 1933 Act may serve to compel issuers and intermediaries to be more cautious and careful in their mandatory disclosure in registered public offerings.[85] Professors Langevoort and Thompson also deliberate the effects of the 1933 Act liability regime on the care that intermediaries take in vetting a registered public offering, offering in this regard that "to the extent that liability . . . forces external due diligence, the selling process is affected . . . . If lawyers representing directors, placement agents, and brokers feel pressure to dig more deeply into issuer quality, innocent, careless, or willfully blind misrepresentation by salespeople presumably becomes less likely."[86]

While the CROWDFUND Act does not impose strict liability on crowdfunding issuers for misstatements of material fact or misleading omissions to state material fact, Congress did write into the law a liability provision that is likely to encourage due diligence by the issuer and, potentially, intermediaries.[87] That liability provision is based on Section 12(a)(2) of the 1933 Act and makes an issuer (and, as applicable, its directors, partners, principal executive officer or officers, principal financial officer, controller or principal accounting officer, and any similarly situated person) liable to a purchaser of its securities for making an untrue statement of a material fact or omitting to state a material fact required to be stated or necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading, as long as (a) the purchaser did not know of the untruth or omission and the (b) issuer does not sustain the burden of proof that it did not know, and in the exercise of reasonable care could not have known, of the untruth or omission.[88] The statute

---

[84] *Id*. at 1580 (footnotes omitted).

[85] *Id.* at 1582 (citing to "a long-standing concern that the quality of issuer disclosure diminishes under the '34 Act" and attributing this concern to differences in the liability provisions under the 1933 Act and the 1934 Act).

[86] *Id.* at 1586.

[87] Crowdfunding, 78 Fed. Reg. at 66537.

[88] Pub. L. No. 112-106, § 302(b), 126 Stat. 306, 315 (2012) (codified at 15 U.S.C. § 77d-1(c)).

defines issuers broadly—so broadly that the SEC has indicated intermediaries may be liable as issuers under the CROWDFUND Act's liability provision.

> Section 4A(c)(3) defines, for purposes of the liability provisions of Section 4A, an issuer as including ''any person who offers or sells the security in such offering.'' On the basis of this definition, it appears likely that intermediaries, including funding portals, would be considered issuers for purposes of this liability provision.[89]

The SEC anticipates that intermediaries will perform due diligence procedures to limit their liability risk.[90] Thus, as Professors Langevoort and Thompson note, Congress invoked standard 1933 Act investor protections by including this misstatements and omissions liability provision in the CROWDFUND Act.[91]

This is one area in which the regulation of crowdfunded offerings is treated in a manner substantially similar to the regulation of registered public offerings. Misstatements and omissions liability under the CROWDFUND Act does not include Section 11's strict liability protections, but it does incorporate a due diligence-like scheme based on Section 12(a)(2). The investor protection objectives of the 1933 Act are well served by these liability provisions in the CROWDFUND Act. In sum, this part of the CROWDFUND Act treats crowdfunded offerings almost as if they were public offerings.

B. The CROWDFUND Act and Public Company Status under the 1934 Act

In addressing publicness under the 1934 Act, Professors Langevoort and Thompson focus their attention on the key rules of the road that connect the central principles undergirding the 1934 Act's reporting provisions (transparency, accountability, and openness) to business firms that must comply with those provisions. In doing so, they essentially explain what a public company is under the 1934 Act and whether Congress had larger firms in mind when it tinkered with the historical 1934 Act definition of a public company in the JOBS Act. Their explanations, in brief? As to the first matter:

> [a] company becomes public for purposes of the 1934 Act by one of three distinct gateways: by making a registered public offering under the 1933 Act (section 15(d) of the 1934 Act); by listing on a national securities exchange (section 12(b)); or simply by having enough record shareholders and total assets (section 12(g)).[92]

They focus attention on the third of these thresholds. And as to the second matter (whether Congress focused its reform efforts on larger firms), Professors Langevoort and Thompson respond in the affirmative. After asserting that public company status—publicness—under the 1934 Act (and in U.S. federal securities regulation more generally) reflects and incorporates

---

[89] Crowdfunding, 78 Fed. Reg. at 66499; *see also* Joan MacLeod Heminway, *The New Intermediary on the Block: Funding Portals under the CROWDFUND Act*, 13 U.C. DAVIS BUS. L.J. 177, 201–04 (2013).

[90] Crowdfunding, 78 Fed. Reg. at 66499 (suggesting "steps intermediaries could take in exercising reasonable care in light of this liability provision").

[91] *See* Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1608.

[92] Langevoort & Thompson, *JOBS Act*, *supra* note 14, at 351.

social, political, and economic interests (as well as the more basic, standard policy objectives of investor protection and capital formation), Professors Langevoort and Thompson express their belief "that nearly all the examples of the melding of investor and broader social interests that have changed the meaning of publicness are reactions to highly salient (usually scandalous) events involving large public companies."[93]

The CROWDFUND Act interacts with these observations because it exempts holders of securities acquired in crowdfunded offerings conducted in compliance with the CROWDFUND Act registration exemption under the 1933 Act from the count of record shareholders required for public company status under the 1934 Act. Specifically, the CROWDFUND Act adds a new paragraph to Section 12(g) of the 1934 Act[94] that requires the SEC to engage in rulemaking to "exempt, conditionally or unconditionally, securities acquired pursuant to an offering made under section 4(6) of the Securities Act of 1933 from the provisions of this subsection."[95] The SEC's proposed rule, Rule 12g–6, provides a permanent exemption from the record holder count under Section 12(g) for holders of equity securities issued in offerings exempt from 1933 Act registration under the CROWDFUND Act.[96]

> This proposal delays the more extensive Exchange Act requirements until the issuer either sells securities in a registered transaction or registers a class of securities under the Exchange Act to reach a trading market. This allows an issuer to time the decision to become a reporting company without forcing it to become a reporting company through actions outside of its control (e.g., secondary market trading). By conditioning the more burdensome reporting requirements on the decision to raise new capital or to actively seek a liquid trading market, the benefits of increased disclosure would scale with the scope of investment in the issuer, thus improving efficiency.[97]

Neither the statutory exemption nor the SEC's related proposed rulemaking directly addresses or apparently supports, in and of itself, transparency, accountability, or openness, the three central 1934 Act regulatory values identified by Professors Langevoort and Thompson.

In their work, Professor's Langevoort and Thompson expressly decline to analyze the effects of the CROWDFUND Act exemption from Section 12(g) compliance. But they are critical of the JOBS Act's increase, from 500 to 2000, in the number of shareholders triggering the assumption of public company status under Section 12(g) of the 1934 Act. In that context, they do signal their basic views on this aspect of the CROWDFUND Act in a footnote:

> We leave to the side Congress's . . . innovation . . . that shareholders obtained via the crowd-funding exemption in new section 4(6) of the 1933 Act are not counted for

---

[93] *Id.* at 374.

[94] 15 U.S.C. § 78*l*(g) (2012).

[95] Pub. L. No. 112-106, § 303, 126 Stat. 306, 321 (codified at 15 U.S.C. § 78*l*(g)(6)).

[96] *See* Crowdfunding, SEC Release Nos. 33-9470 34-70741, 78 Fed. Reg. 66498, 66536. (proposed Nov. 5, 2013), http://www.gpo.gov/fdsys/pkg/FR-2013-11-05/pdf/2013-25355.pdf.

[97] *Id.* at 66536.

> purposes of 1934 Act registration under section 12(g). This is bound up in the extraordinarily deregulatory thrust of section 4(6), which to us is the most aggressive feature of the JOBS Act but outside the scope of this Article. This connection between crowd funding and section 12(g) is fraught with ambiguity, as crowd-funded issuers will have to struggle with what it means for the shareholder to have "purchase[d] such securities in transactions described under section 4(6)." Does this also include downstream purchasers of those securities? What if those securities are exchanged for new ones? Suffice it to say for now, that nothing in the foregoing discussion would offer a principled basis for the crowd-funding exemption and its collateral effects. This is a pure trade-off of investor protection in the hope of job creation.[98]

The SEC's proposed rule does clarify the definitional ambiguity in this aspect of the CROWDFUND Act. Although the text of the rule simply provides that "the definition of held of record shall not include securities issued pursuant to the offering exemption under Section 4(a)(6) of the Securities Act,"[99] the proposal release indicates, in response to comments received in the rulemaking process, that the exemption travels with the security to subsequent holders.[100] However, the proposal release declines to exempt different securities issued to holders of crowdfunded securities in a restructuring, recapitalization, or similar transaction.[101]

The SEC identifies drawbacks of the rules it proposes under the CROWDFUND Act. Because the proposed ongoing reporting responsibilities under the CROWDFUND Act cease when an issuer voluntarily becomes a public company under the 1934 Act (i.e., without being required to do so under Section 12 of the 1934 Act):

> [i]t is possible that an issuer that sells securities in reliance on Section 4(a)(6) could become an Exchange Act reporting company, but then deregister and go dark with potentially thousands of investors . . . . Under such an outcome, a significant number of investors in an issuer might be unable to obtain important information about that issuer, which could affect the liquidity and pricing of the securities these investors hold.[102]

Without taking away from the overall substantive point or dramatic effect of the prose of Professors Langevoort and Thompson, I question whether the CROWDFUND Act's exemption of holders of crowdfunded securities from the shareholder count under Section 12(g) of the 1934 Act "is a pure trade-off of investor protection in the hope of job

---

[98] Langevoort & Thompson, *JOBS Act*, *supra* note 19, at 365 n.122 (citations omitted).

[99] Crowdfunding, 78 Fed. Reg. at 66565.

[100] *Id.* at 66498 ("An issuer seeking to exclude a person from the record holder count would have the responsibility for demonstrating that the securities held by the person were initially issued in an offering made under Section 4(a)(6).").

[101] *Id.* ("Section 303 of the JOBS Act does not extend the exemption from Section 12(g) to different securities issued in a subsequent restructuring, recapitalization or similar transaction, so we are not proposing to exempt such securities at this time").

[102] *Id*. at 66536.

creation."[103] Leaving aside the reference to a purported objective of job creation (a contention that is somewhat suspect but beyond the scope of this article), the few sentences in Professors Langevoort's and Thompson's footnote on the treatment of CROWDFUND Act investors for the purposes of 1934 Act publicness do not mention that Congress mandated a separate form of periodic public reporting for issuers availing themselves of the CROWDFUND Act registration exemption, less extensive than public company reporting.[104] "Title III provides for an alternative reporting system under which issuers would be required to file annual reports with the Commission."[105] Yet, as earlier noted in the context of mandatory disclosure under the CROWDFUND Act, mandatory disclosure requirements under the CROWDFUND Act are not the equivalent of those under the registration and reporting regimes for registered public offerings and public companies under the federal securities laws before the advent of the CROWDFUND Act.[106] The capacity for transparency, accountability, and openness appears to exist but be diminished.

It is in this context that Professor Sale's work sheds important light on the efficacy of the regulatory scheme under the CROWDFUND Act. In her first article on publicness, Professor Sale builds the case for a different, nonstatutory definition of publicness. "Public corporations," she writes, "are not just creatures of Wall Street. They are creatures of Main Street, the media, bloggers, Congress, and the government."[107] Given the genesis of the CROWDFUND Act as a grassroots effort to reform business finance grounded in social networking and ecommerce (i.e., the Internet) and in the desires of mainstream America (rather than Wall Street), crowdfunded companies may enjoy a new, special form of publicness. That publicness is created through an increased capacity, through the Internet, for relatively open inspection and through the ability of regulators and others external to the firm to react and effectively assert enforcement and governance privileges—a public response to the public nature of business challenges in Sale's new era and form of publicness, "defined by scrutiny and government."[108]

Perhaps the exclusion of crowdfunded securities from the shareholder threshold in Section 12(g) of the 1934 Act is warranted as a matter of federal securities regulation because investor protection is achieved through compliance with the CROWDFUND Act's alternative annual reporting scheme and the otherwise public nature of a business or project financed through crowdfunding, which together may force needed and appropriate changes in firm governance that adequately protect investors and market integrity while encouraging capital growth. Professor Sale labels this leveraging of mandatory disclosure an "information-forcing-substance regime."[109]

> Governance is not just about relationships between officers, directors, and shareholders. Public companies operate in a public sphere, making public disclosures

---

[103] Langevoort & Thompson, *JOBS Act*, *supra* note 19, at 365 n.122.

[104] *See supra* notes 58–60 and accompanying text.

[105] Crowdfunding, 78 Fed. Reg. at 66498.

[106] *See supra* note 61 and accompanying text.

[107] *See* Sale, *New Corporation*, *supra* note 20, at 137.

[108] *See id.* at 140–41.

[109] *Id.* at 143.

> on a regular basis. The SEC dictates what, when, why, and how much they must say. Corporations are also subject to media and blogging. So is the SEC. These factors combine to increase expectations about the SEC's role and pressure for the SEC to do something when things go wrong. That pressure shifts to corporations, their public disclosures, and their governance choices.[110]

In her subsequent writings on publicness, Professor Sale further explores this link between mandatory disclosure and the governance of the firm using the Sarbanes-Oxley Act of 2002,[111] the Dodd-Frank Wall Street Reform and Consumer Protection Act,[112] and the London Whale.[113] She clarifies her theory that publicness involves a series of chain reactions that operate like a feedback loop—public scrutiny of firm governance exposes failings, those failings lead to external criticisms and demands for change, changes are made, public scrutiny is invited, and the cycle continues . . . .[114] She therefore describes publicness as "both a process and an outcome."[115] If Professor Sale is right, the transparency, accountability, and openness historically fostered by the 1934 Act may instead now be achieved—or at least be achievable—in crowdfunded issuers through the disclosures mandated under the CROWDFUND Act and the issuer's Internet presence.

Yet, the extent to which this optimal transparency, accountability, and openness will be achieved in issuers offering securities under the CROWDFUND Act will depend in part on both the nature of the mandatory disclosure obligations eventually adopted by the SEC in its implementing rulemaking and the amount of attention a particular issuer receives from regulators and the public. As earlier noted, the proposed SEC rules for mandatory disclosure under the CROWDFUND Act call for the publication of more limited information than is available for public companies.[116] Moreover, as (if) securities crowdfunding becomes more popular, mainstream, and routinized, many small, less popular issuers of crowdfunded securities may be able to, in effect, hide in plain sight on the Internet. The computer algorithms that drive search engines may leave some of these crowdfunded issuers relatively unnoticed, much as other Internet-based securities fraud (e.g., pump-and-dump schemes) also flies under

---

[110] *Id.* at 144.

[111] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

[112] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[113] *See* Sale, *J.P. Morgan*, *supra* note 20, at 1636–42.

[114] *See* Sale, *J.P. Morgan*, *supra* note 20, at 1630–31, 1655; Sale, *Governance*, *supra* note 20, at 1013-14. In her most recent work, she describes the feedback loop in the following way:

> Corporations make choices, including, for example, choices about how the company handles certain events and how officers, directors, and shareholders interact with each other and the public. Once corporations communicate these choices to the world, the public develops an understanding of how the corporations have chosen to delegate power and responsibilities, as well as about where the gaps and weaknesses in governance might be. When public actors outside of the corporation reframe and retell the stories, those actors come to play a role in the corporation. Arguably, these outside actors can even become part of the governance rubric, creating pressure for changes in the decision-making structure or the allocation of power within the corporation.

Sale, *J.P. Morgan*, *supra* note 20, at 1630–31.

[115] *Governance*, *supra* note 20 at 1013; *see* text accompanying note 43 *supra*.

[116] *See supra* note 61 and accompanying text.

the radar, at least for a time.[117] Lighter mandatory disclosure obligations and less public attention for crowdfunded issuers will limit the positive monitoring effects associated with Professor Sale's conceptualization of publicness.

CONCLUSION

Sometimes, an individual event represents or catalyzes a sea change. Although changes to the nature of public offerings and public company status had been occurring incrementally over time for a number of years,[118] the JOBS Act, including the CROWDFUND Act, accelerated the pace of change and markedly blurred the boundaries between public and private offerings and public and private companies. The changes introduced in the JOBS Act are still new or, in the case of the CROWDFUND Act registration exemption provisions, as yet unimplemented. Studies are beginning to emerge, but it will be a number of years before we have data sufficient in amount and quality to test the efficacy of the rules Congress and the SEC have been writing into and under the JOBS Act.

It is likely that securities crowdfunding under the CROWDFUND Act will soon be implemented. This part of the JOBS Act includes innovative regulation at the public/private divide. Specifically, the CROWDFUND Act: (a) institutes a new exemption from registration under the 1933 Act for crowdfunded offerings of securities conducted in accordance with detailed requirements set forth in the Act and related SEC rules; and (b) exempts holders of equity securities acquired in an offering made in compliance with the statutory exemption from 1933 Act registration referenced in clause (a) from the count of shareholders under Section 12(g) of the 1934 Act (for purposes of determining, among other things, the applicability of the registration and reporting requirements under the 1934 Act). These changes to the registration requirements under the 1933 Act (which define public offerings) and the registration requirements under the 1934 Act (which represent a threshold to public company status) change the historical balance between publicness and privateness in U.S. federal securities regulation.

Important recent scholarship coauthored by Professors Don Langevoort and Bob Thompson enables us to begin to analyze these important changes under the 1933 Act and the 1934 Act. Specifically, these two legal scholars establish frameworks for analysis of the core meanings of public offering and public company status in the context of U.S. federal securities regulation. An analysis of the CROWDFUND Act using their ideas offers information important to the nascent regulation of securities crowdfunding in the United States.

Although SEC rulemaking is not yet complete, the expected changes to public offering regulation under the 1933 Act would represent a decreased emphasis on mandatory disclosure and SEC review, potentially uneven constraints on the sales pressure that may be used in the

---

[117] *See generally* Peter Swire, *No Cop on the Beat: Underenforcement in E-Commerce and Cybercrime*, 7 J. TELECOMM. & HIGH TECH. L. 107, 126 (2009) (noting the difficulty in achieving securities fraud enforcement on the Internet given evolving strategies).

[118] *See* Langevoort & Thompson, *JOBS Act*, *supra* note 14, at 343–51 (recounting the history of the line between public and private companies under the 1934 Act); Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1588–1604 (describing and illustrating how the integration of the regulatory frameworks under the 1933 Act and the 1934 Act fostered transactional structures that avoided registered public offerings under the 1933 Act).

solicitation of investors, and relatively strong misstatement and omissions liability.[119] The result of this hodge-podge may be the regulatory over-privatization of an offering that, under longstanding public policy and consistent with relevant theory, should be subject to rules closer to those involved in public offering regulation. Yet, the relative strength of the sales pressure restraints and liability regime may be enough to prevent and investor crisis or a significant lapse in market confidence, allowing for efficient capital formation.[120]

Changes to public company regulation under the 1934 Act also offer us cause for pause. By exempting holders of securities purchased in offerings under the CROWDFUND Act from the shareholder count under Section 12(g) of the 1934 Act, the U.S. Congress has seemingly traded off the transparency, accountability, and openness of public company status under the 1934 Act for other objectives in a rather significant way.[121] However, in the CROWDFUND Act, Congress did require issuers engaging in CROWDFUND Act offerings to file ongoing periodic reports after conclusion of the offering.[122] These filings put the CROWDFUND Act issuer in a public disclosure position between a public company issuer and an issuer in a private placement of securities.

Having said that, it may be that the CROWDFUND Act creates a new form of public company altogether—one created by and interconnected with "a public-private dialectic that derives from the increasingly visible nature of corporations."[123] The kinds of transparency, accountability, and openness associated with this type of public issuer may serve the policy objectives underlying federal securities regulation. A securities issuer that enjoys an open, public identity may invite regulatory and other public attention that results in externally imposed reforms or instigates self-regulation. The work of Professor Hillary Sale offers important insights along these lines.

An analysis of the regulation of offerings of securities under the CROWDFUND Act as a puzzle at the public/private divide exposes new and emerging complexity in distinguishing between public and private offerings under the 1933 Act and between public and private companies under the 1934 Act. The recognition of this complexity is important to SEC rulemaking and enforcement efforts under the CROWDFUND Act. The SEC should reflect on its initial and ongoing rulemaking under the CROWDFUND Act in the overall context of the strengths, weaknesses, and significance of salient regulatory categories and descriptors—including publicness and privateness. Regardless, the observations made may create new, more

---

[119] *See supra* Part II.A.

[120] Professors Langevoort and Thompson intuit that sales pressure limitations and liability protections will be the most important of the four central investor protection features of the 1933 Act. Thompson & Langevoort, *Redrawing*, *supra* note 19, at 1586. Specifically, they observe as follows:

> Were we to restate the law of public versus private offerings, we would say that the '33 Act is about regulating issuer or affiliate sales that are likely to result in a "dump" that will require special soliciting efforts, with the potential for abuse that entails. And if that is right, then we will need to pay special attention to the third and fourth features of the '33 Act: sales-practice regulation and liability.

Id.

[121] *See supra* note 98 and accompanying text.

[122] *See supra* notes 105–107 and accompanying text.

[123] Sale, *J.P. Morgan*, *supra* note 20, at 1631.

finely tuned, categories of offerings and issuers that reflect the important values underlying preexisting, simpler taxonomies of offerings and issuers. As a result, U.S. federal securities regulation may move away from instructive, albeit somewhat outdated, facile, binary systems of classification like the public/private distinction and toward more nuanced classification systems that hold more descriptive power.