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Abstract

Securities crowdfunding is premised on two core policy goals: inclusivity and efficiency. First, crowdfunding is conceived as an inclusive system where all entrepreneurs are given a chance to pitch their idea to the "crowd." Second, crowdfunding is supposed to be an efficient way to channel funds from public investors to promising startup companies. There is a fundamental tension between these two policy goals, however. A totally inclusive system would ensure that platforms list any and every company that wants to participate. But platforms need to curate and select the companies they list in order to establish a reputation as a reliable market for investors. This gatekeeping function aids efficiency, but is exclusive by its nature. Hence, the tension between inclusive and efficient crowdfunding.

This Article provides a theoretical and an empirical analysis of inclusivity versus efficiency in crowdfunding. It also compares the American crowdfunding system with its counterpart in New Zealand using original research collected by the author during a six-month residency in that country. This research reveals that crowdfunding in New Zealand is much more financially successful

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than in the United States. This Article explains this outperformance on the basis that New Zealand's system is focused solely on efficiency, even at the expense of inclusivity. In the United States, by contrast, we closed our eyes to the tension between efficiency and inclusivity and tried to achieve both at the same time. In practice, and perhaps as could have been expected, this has led to only minor success on both fronts.

Broadening the analysis out, we see that inclusive crowdfunding is a luxury that only certain countries can manage, depending on their existing systems for entrepreneurial finance. The United States has a huge and sophisticated venture capital industry and thus can afford to sacrifice some efficiency in our crowdfunding system in order to advance inclusivity. But New Zealand has long had very little venture capital investment and hence a real need to develop crowdfunding as an effective new means for efficiently channeling capital to the country's startup companies. The need to consciously trade off inclusivity and efficiency is an important lesson from the present research.

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I. Introduction

Securities crowdfunding—a new form of Internet-based public stock market modelled on Kickstarter and other reward crowdfunding websites[1]—has a contradiction at its core. On the one hand, crowdfunding seeks to create an *inclusive* system where any and all entrepreneurs, regardless of who they know or where they are from, are invited to pitch their company directly to "the crowd" (the broad public).[2] On the other, crowdfunding is supposed to be an *efficient* system where capital-starved startups and small businesses can get the funding they need to grow, create jobs, and contribute to the economy.[3]

These policy goals are in tension. A totally inclusive system would impose a legal requirement on crowdfunding platforms—websites that act like online stock exchanges—to include any and every company that wants to list on their site.[4] Reward

1. *See infra* Part II.B (detailing the parallels between securities crowdfunding and ordinary crowdfunding).

2. Andrew A. Schwartz, *Inclusive Crowdfunding*, 2016 UTAH L. REV. 661, 672 [hereinafter Schwartz, *Inclusive Crowdfunding*].

3. *See id.* at 666 (observing that the "rich academic literature" on securities crowdfunding "largely focuses on questions of efficiency and efficacy").

4. *See id.* at 671 ("An inclusive environment, broadly defined as one in which 'all people feel valued and respected and have access to the same opportunities,' can generate positive effects.").

crowdfunding generally follows this model: Kickstarter does not screen, curate, or vet the projects before presenting them to the crowd; *anyone* with an idea can take a shot.[5]

But securities crowdfunding platforms have a clear business need to exclude at least some of the companies who seek to participate, in order to establish a reputation as a reliable place for people to invest.[6] Imagine a law that required the New York Stock Exchange to list on its Big Board any company that asked! Just as with traditional securities markets, some sort of gatekeeping function for the platform seems vital for the system to function effectively—or maybe at all.[7] Yet gatekeeping necessarily implies including some companies and excluding others, a direct affront to the goal of inclusivity and unmediated access to the crowd.[8] Hence the tension between inclusivity and efficiency in securities crowdfunding.[9]

The Securities and Exchange Commission (SEC) has struggled to resolve this tension from the earliest days. The initial regulations, proposed by the SEC in 2013, adopted a radical version of inclusivity that would have required online crowdfunding platforms to list any company that asked to be included, regardless of the platform's view of its prospects or the price of the securities.[10] Public commenters, however, pilloried that

5. *See Kickstarter Basics*, KICKSTARTER, https://www.kickstarter.com/help/faq/kickstarter%20basics (last visited Jan. 11, 2018) (answering basic questions about Kickstarter and its policies) (on file with the Washington and Lee Law Review).

6. *Infra* notes 275–278 and accompanying text.

7. *See infra* Part IV.A.1 (discussing the integral role of gatekeepers, or lack thereof, in the success of crowdfunding operations).

8. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 662 ("Inclusivity is core to the nature of crowdfunding as a distinct form of capital raising.").

9. The present work is focused solely on inclusivity as it applies to entrepreneurs. Inclusivity as it applies to investors, while beyond the scope of the current work, is apparent from the fact that the general public is invited to participate on the investor side. *See* Andrew A. Schwartz, *The Digital Shareholder*, 100 MINN. L. REV. 609, 611 (2015) [hereinafter Schwartz, *Digital Shareholder*] ("Once crowdfunding begins, anybody with a startup will be able to go online and offer a piece of the action to the American people. And the community of investors . . . will be inclusive and diverse as well.").

10. *See infra* Part II.D (analyzing the SEC's proposed rule for inclusion of companies on its site listings).

proposal as being overly harmful to efficiency.[11] In the end, the SEC relented, and the final version of its crowdfunding regulations (operative since 2016) do allow platforms to pick and choose which companies to list on their sites.[12] This episode, described in Part II.D below, neatly encapsulates crowdfunding's inherent tension between efficiency and inclusivity.

Securities crowdfunding, while born in the United States, has become a worldwide phenomenon,[13] with New Zealand leading the charge.[14] As Part III describes, that country was one of the earliest foreign jurisdictions with a functioning legal regime for crowdfunding, having launched its equity crowdfunding market in 2014,[15] two years ahead of the United States.[16] Since then, New Zealand has become an international leader in the field, making it an ideal destination for an academic study of this emerging area in securities regulation.[17]

The author accordingly spent the first half of 2017 on the ground in New Zealand to study its crowdfunding law and

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11. *See infra* Part II.D (highlighting the effect of public comments on the final rule).

12. *See infra* Part II.D (discussing the SEC's final rule regarding company listings on platforms).

13. *See* KIM WALES, PEER-TO-PEER LENDING AND EQUITY CROWDFUNDING: A GUIDE TO THE NEW CAPITAL MARKETS FOR JOB CREATORS, INVESTORS, AND ENTREPRENEURS 21–54 (2018) (describing securities crowdfunding laws recently enacted in dozens of nations around the world).

14. *See infra* Part III (discussing New Zealand's recent, and quick, development in the field of crowdfunding).

15. New Zealand's system is called "equity" crowdfunding because it is limited to the issuance of shares of stock. *See* Joseph J. Dehner & Jin Kong, *Equity-Based Crowdfunding Outside the USA*, 83 U. CIN. L. REV. 413, 418 (2014) ("The equity model offers investors the possibility of sharing in the increase over time in the value of a business, as well as the potential for dividends distributed from net annual profits of the venture."). Our domestic system is called "securities" crowdfunding because United States law permits any type of security, not just equity, to be crowdfunded. *See* Andrew A. Schwartz, *Crowdfunding Securities*, 88 NOTRE DAME L. REV. 1457, 1458 (2013) [hereinafter Schwartz, *Crowdfunding Securities*] ("The new federal CROWDFUND Act authorizes the 'crowdfunding' of securities, defined as the sale of unregistered securities over the Internet to large numbers of retail investors, each of whom only invests a small dollar amount.").

16. *See infra* Part IV.A (noting the time difference between New Zealand and the United States).

17. *See infra* Part IV.B (suggesting that New Zealand is more successful with crowdfunding because it is willing to focus on efficiency instead of inclusivity).

marketplace, conducting local research and interviewing entrepreneurs, platform operators, investors, lawyers, academics, and government officials (including the Minister of Commerce). This Article is based on this original research and analyses of the United States and New Zealand crowdfunding markets in terms of inclusivity and efficiency.[18]

In my research, I found that New Zealand never really had to grapple with the tension between inclusivity and efficiency, simply because they are not trying to achieve both goals.[19] Rather, as Part III.C shows, their statute and regulations were designed for efficiency, and efficiency only.[20] Indeed, key components of New Zealand's crowdfunding law help achieve efficiency at the direct expense of inclusivity.[21] Platforms are empowered to, and do, take their role as gatekeepers very seriously, and have always had the clear power to exclude anyone they wish.[22] In the end, they are rather exclusive, especially the leader, Snowball Effect, which lists only 2% of the hundreds of companies that ask to be included on the site.[23]

With a laser-like focus on efficiency, New Zealand has established a crowdfunding market that is orders of magnitude more financially successful than its counterpart in the United States.[24] Data presented in Part IV.A compares the first year of crowdfunding in New Zealand (2014–2015) with the first year of crowdfunding in the United States (2016–2017).[25] The numbers

18. Other aspects of my research are reported and discussed in other articles, including Andrew A. Schwartz, *Equity Crowdfunding in New Zealand*, 2018 N.Z. L. REV. (forthcoming) [hereinafter Schwartz, *Crowdfunding in New Zealand*].

19. *See infra* Part III.C (noting that New Zealand prefers to focus on efficiency).

20. *See infra* Part III.C (stating that New Zealand seeks the utmost efficiency).

21. *See infra* Part III.C (noting that New Zealand is willing to risk inclusivity to promote efficiency).

22. *See infra* Part IV.A.1 (discussing how New Zealand promotes efficiency by allowing platforms to exclude who they want).

23. *See infra* Part IV.A.1 (describing the exclusivity of crowdfunding platforms in New Zealand).

24. *See infra* Part IV.A (detailing New Zealand's success in the use of crowdfunding and the efficiency of its use).

25. *See infra* Part IV.A (comparing New Zealand and the United States' first years of crowdfunding).

are astounding: Scaled for the size of its economy,[26] and focusing on the first year in each jurisdiction, New Zealand had *thirteen times as many crowdfunding campaigns* which collectively raised about *thirty times as much capital*, and the success rate for New Zealand crowdfunding campaigns was about 80%, compared with 50% in the United States.[27] In other words, freed from a quest for inclusivity, New Zealand has succeeded in creating a much more efficient system for channeling capital to startup companies and small businesses than has the United States.

But the United States had two policy goals, both inclusivity and efficiency, so it should come as no surprise that New Zealand, which focused solely on the latter, would outperform on that front.[28] This raises the question of how inclusive the American system is in practice, and that issue is taken up in Part IV.B, which analyzes the empirical evidence from crowdfunding's recently concluded first year. As will become clear, the data suggests that American crowdfunding is relatively inclusive, as platforms seem to exercise their gatekeeping function in a more flexible manner than in New Zealand.[29]

In the United States, very young startups that lack revenue, and that lack pre-existing supporters, are not screened out, but rather are often given a chance—for better or worse—to pitch their ideas to the crowd.[30] In the United States, the average age of a crowdfunding company is just two years and almost none have previous investors; however, in New Zealand, the average age is eight years and it is common to have pre-existing investors.[31] In terms of demographic inclusiveness, the picture is mixed.[32] Finally, the notably lower success rate for crowdfunding

26. New Zealand's GDP is about 1% that of the United States.

27. *See infra* Part IV.A (detailing New Zealand's success).

28. *See infra* Part IV.A (demonstrating why New Zealand has been more successful than the United States).

29. *See infra* Part IV.B (stating New Zealand is more stringent with its gatekeeping).

30. *See infra* Part IV.A (demonstrating the United States' willingness to include more companies on their crowdfunding platforms).

31. *See infra* Part IV.A (comparing the average age of crowdfunding startups in the United States and New Zealand).

32. *See infra* Part IV.B (discussing demographics of entrepreneurs raising money through securities crowdfunding).

campaigns in the United States (50%) compared with New Zealand (80%) also indicates that the American system is more open and inclusive of entrepreneurs, and more likely to let a highly speculative startup at least try to convince the crowd.[33]

What explains the different approaches to crowdfunding in America and New Zealand? It is not because New Zealand cares little for inclusivity, and only about efficiency. Rather, it appears to stem from the very different levels of other types of startup capital in each country. The United States has long had the largest and most mature system of venture capital (VC) and angel financing in the world, and could afford to use crowdfunding as a complementary system more focused on inclusive opportunities for entrepreneurs.[34] New Zealand has long had a much thinner pool of VC and angel financing, even for its size, and had a national interest in using crowdfunding as a substitute for those forms of startup finance.[35] It could not afford to be distracted by a secondary goal of inclusivity.

This comparison between the United States and New Zealand holds a broader lesson that is especially important to the many other countries currently drafting (or reforming[36]) their own crowdfunding laws: Inclusive crowdfunding is a luxury.[37] As Part V explains, jurisdictions with low levels of VC and angel financing (e.g., Italy and Spain) may wish to ignore inclusivity and just focus on creating an efficient system for crowdfunding.[38] Jurisdictions that already have abundant VC and angel funding (e.g., Israel and the United States) can afford to employ crowdfunding as a way to

33. *See infra* Part IV.B (considering the success rates of crowdfunding companies in New Zealand and the United States).

34. *See infra* Part IV.B (discussing the United States' prowess for venture capitalism, especially in Silicon Valley).

35. *See infra* Part IV.B (discussing New Zealand's general lack of venture capitalism and use for crowdfunding).

36. The United States, through the Financial Choice Act of 2017, is seeking to amend its current crowdfunding law. *See, e.g.*, H.R. 10, 115th Cong. §§ 476–479 (2017) (amending the federal crowdfunding law).

37. *See infra* Part V (noting how inclusivity provides greater opportunity and is a policy not followed everywhere else).

38. *See infra* Part V (elaborating on the trade-off between inclusivity and efficiency and why a country may choose to focus on one over the other).

promote entrepreneurial participation among a broad segment of society.[39]

II. Securities Crowdfunding in the United States

This Part introduces the concept of securities crowdfunding, as well as the domestic legal authority and policy behind it. Authorized by a federal statute in 2012 and implemented through SEC regulations in 2016, securities crowdfunding has two primary policy goals: First, it seeks to give promising entrepreneurs an efficient means of gathering seed capital from the public.[40] Second, it aims to create an inclusive form of entrepreneurial finance that would give anyone and everyone the opportunity to pitch their idea to the public.[41]

These two goals are in fundamental tension, however, because a fully inclusive system that excluded no one would be hopelessly inefficient.[42] This tension played itself out during the regulatory process, as the SEC initially adopted a radically inclusive rule but ended up issuing final regulations that prioritized efficiency at the expense of inclusivity.[43]

A. Precursor: Reward Crowdfunding

Securities crowdfunding evolved out of the prior concept of "reward crowdfunding," which is practiced on Kickstarter and other similar websites.[44] Reward crowdfunding, in turn, describes

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39. *See infra* Part V (finding that Israel and the United States have other opportunities for companies to start outside of crowdfunding, allowing for crowdfunding platforms to be less selective).

40. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 666 (noting that new literature is discussing the efficiencies of crowdfunding).

41. *See id.* at 673 ("[A] fundamental and express goal of retail crowdfunding is to break down the differential treatment of accredited investors and everyone else.").

42. *See infra* Part II.D (discussing the tension between inclusivity and efficiency in crowdfunding).

43. *See infra* Part II.D (discussing the final rule eventually implemented by the SEC).

44. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 663 (noting that securities crowdfunding was built from reward crowdfunding); *Building Rewards*,

an Internet-based marketplace for the financing of entrepreneurial projects.[45] In a typical Kickstarter campaign, an artist or entrepreneur posts to a dedicated website a description of the project she wants to pursue, the amount of money she needs to fund it, and usually promises some sort of reward or benefit to those who provide funding.[46] Members of the public—the "crowd"—peruse the various projects available on the website, decide which one(s) they want to support, and then pledge their money to the cause.[47] If a given project reaches its target amount, the money is collected and transmitted to the entrepreneur; if a project fails to meet its target, then the deal is off and no money changes hands.[48]

For example, a rock band that wants to record an album might post the idea along with a sample track and ask the crowd to contribute $20 per person. In return, the band promises to send a copy of the CD once it is completed. The band uses the money collected upfront to rent a recording studio, hire a producer, et cetera. This simple idea has grown in less than a decade into a multi-billion dollar market: Kickstarter alone reports that over $3 billion has been contributed on its website since its founding in 2009.[49]

KICKSTARTER, https://www.kickstarter.com/help/handbook/rewards (last visited Jan. 11, 2018) (discussing common rewards offered in crowdfunding) (on file with the Washington and Lee Law Review).

45. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 663 ("In reward crowdfunding, financial backers of a project receive its fruits, such as a book, CD, or video game.").

46. *See id.* (noting different types of rewards offered in exchange for financial backing).

47. *See id.* at 672 ("[T]he very concept is to invite 'the great mass of people'—the crowd—to invest in whichever startup companies and small businesses they choose.").

48. This description is known as an "all-or-nothing" model, which is the type practiced on the leading reward crowdfunding website, Kickstarter. *See Kickstarter Basics*, *supra* note 5 (stating a project must achieve its monetary fundraising goals in order to receive the funds). Other reward crowdfunding websites, including Indiegogo, do not follow this model and allow the entrepreneur to collect however much money is pledged. *See How it Works for Entrepreneurs*, INDIEGOGO, https://www.indiegogo.com/how-it-works (last visited Jan. 11, 2018) (describing "flexible funding") (on file with the Washington and Lee Law Review).

49. *See Kickstarter Stats*, KICKSTARTER, https://www.kickstarter.com/help/stats (last updated Feb. 17, 2018, 8:50 AM) (last visited Jan. 11, 2018)

Most importantly for present purposes, Kickstarter and other reward crowdfunding websites are totally inclusive platforms where anyone with an idea can post their project and ask the crowd for funding. Kickstarter does not pre-screen, curate or vet the projects prior to presenting them to the crowd. Rather, *anyone* with a project can participate.[50]

Many reward crowdfunding projects fail to reach their targets, of course; on Kickstarter, for example, more than 350,000 projects in total have been posted, yet only 124,000 of those have been successfully funded.[51] But the crowd is fickle and as such gives its financial support to certain projects, but not others.[52] Indeed, the huge amount of failed projects is itself an indication of the reward crowdfunding's inclusive nature: All entrepreneurs are invited, not just those with clearly great ideas or those that are likely to get funded.[53]

(highlighting over $3 billion pledged, 130,000 funded projects, 14,000,000 backers, and almost 43,000,000 pledges on Kickstarter, alone) (on file with the Washington and Lee Law Review).

50. Kickstarter does have certain prohibitions. It can only be used to fund "projects," rather than to raise money for charity or to sell investments. *See Creator Questions*, KICKSTARTER, https://www.kickstarter.com/help/faq/creator+questions (last visited Jan. 11, 2018) (noting that only certain projects are allowed) (on file with the Washington and Lee Law Review). Additionally, certain items are specifically barred. *See Prohibited Items*, KICKSTARTER, https://www.kickstarter.com/rules/prohibited (last visited Jan. 11, 2018) (prohibiting medical treatments, pornographic material and other "illegal, heavily regulated, or potentially dangerous" projects) (on file with the Washington and Lee Law Review). But the key point is that Kickstarter would not exclude a project because it thinks it is a poor idea, or because it doubts the capabilities of the entrepreneur. *See Creator Questions*, KICKSTARTER, https://www.kickstarter.com/help/faq/creator+questions (last visited Jan. 11, 2018) ("[W]e do not investigate a creator's ability to complete their project.") (on file with the Washington and Lee Law Review). Moreover, many of the types of campaigns that are barred from Kickstarter, such as charitable donations, would be welcome on other crowdfunding sites. *See, e.g.*, GOFUNDME, https://www.gofundme.com (last visited Jan. 11, 2018) (noting that it is a crowdfunding site that welcomes charitable campaigns) (on file with the Washington and Lee Law Review).

51. *See Kickstarter Stats*, *supra* note 49 (presenting total activity on Kickstarter).

52. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 672 (noting that the crowd donates to whichever companies it wants, but not necessarily every company will receive funding).

53. *See id.* at 662 ("Retail crowdfunding is the most *inclusive* form of securities crowdfunding, in the sense that everyone is invited regardless of who

This inclusive nature of reward crowdfunding introduces certain costs. Because only 35% of the projects posted on Kickstarter succeed and obtain funding, this means that a large majority of the projects posted end up as a waste of time and resources for the creators and backers.[54] To post a project takes time and effort; creators commonly produce a video, draft copy, promote the project, and so on.[55] And backers who review and pledge their support spend time and energy researching their choices. But if the project fails to reach its target fundraising amount, all of those resources go down the drain, with nothing to show for it.[56] To date, about $340 million has been pledged on Kickstarter to projects that ultimately failed.[57]

On the other hand, the costs of reward crowdfunding are pretty modest overall. The cost of creating and posting a project proposal is generally pretty low, due to the simple online format.[58] The market is almost totally unregulated; thus, the compliance costs are de minimis. Given that the whole market takes place on the Internet, the research effort expended by backers who invest in failed projects is probably small in most instances. Moreover, even a project that does not reach its target may still benefit the company by, for instance, forcing the founders to concretize and document their ideas for the business. Finally, just because 65% of projects fail, this does not necessarily imply that market participants spent 65% of their time and energy on that group. Rather, the 35% of successful projects may well have commanded

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they are.").

54. *See Kickstarter Stats*, *supra* note 49 (finding that the failure rate on Kickstarter is over 35%).

55. *See Kickstarter Basics*, *supra* note 5 (noting some things project creators often do to attempt to create a successful project).

56. However, some reward crowdfunding sites, like Indiegogo, do not follow an all-or-nothing model, and thus, any amount that is pledged is ultimately collected by the creator. *See Choose Your Funding Type: Can I Keep My Money?*, INDIEGOGO, https://support.indiegogo.com/hc/en-us/articles/205138007-Choose-Your-Funding-Type-Can-I-Keep-My-Money- (last visited Jan. 11, 2018) (stating that a project can keep the money donated to it even if it does not achieve its goal) (on file with the Washington and Lee Law Review).

57. *See Kickstarter Stats*, *supra* note 49 (noting the statistics of failed projects).

58. *See infra* Part II.B (discussing the efficiencies of crowdfunding).

90% of the market's attention. All in all, reward crowdfunding seems like a fairly efficient way to raise capital.

B. Crowdfunding Under the JOBS Act[59]

Securities crowdfunding takes the concept of reward crowdfunding and extends it to investments.[60] It works just like reward crowdfunding except that, instead of receiving a tangible reward, like a CD from a band, the financial backers get a share of stock or some other financial interest, such as a share in the band's profits on the sale of the CD.[61]

This novel method of online investing holds great promise, but it also violates the usual legal rules for making a public offer of securities.[62] For, under the federal Securities Act of 1933,[63] an entrepreneur is legally required to "register" any shares of stock, bonds, or other securities before offering them to the public.[64] This registration process calls for copious public disclosure about the

59. This Section is adapted from a similar discussion in, Andrew A. Schwartz, *Crowdfunding Social Enterprise in New Zealand*, *in* THE CAMBRIDGE HANDBOOK OF SOCIAL ENTERPRISE LAW (Joseph Yockey & Benjamin Means eds., Cambridge Univ. Press forthcoming 2018) [hereinafter Schwartz, *Crowdfunding Social Enterprise*].

60. *See* 158 Cong. Rec. S1,824-02 (daily ed. Mar. 20, 2012) (statement of Sen. Merkley) (explaining that securities crowdfunding is based on reward crowdfunding of the sort practiced on Kickstarter); Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 663 (noting that securities crowdfunding was spurred by reward crowdfunding).

61. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 663 ("Securities crowdfunding takes the concept one step further by providing backers with a security, such as a share of stock, without registering the securities with the authorities.").

62. *See id.* ("Selling securities in this way does not violate the federal securities laws (which generally mandate that one register securities with the SEC before offering them to the public) because legal 'exemptions' have been put into place. . . .").

63. Pub. L. 73-22, 48 Stat. 74. (codified as amended at 15 U.S.C. §§ 77a–aa (2012)).

64. *See* Joan MacLeod Heminway & Shelden Ryan Hoffman, *Proceed at Your Peril: Crowdfunding and the Securities Act of 1933*, 78 TENN. L. REV. 879, 918 (2011) (noting that, under the Securities Act of 1933, a company had to register its stock before issuing it).

company, the securities to be offered, et cetera, and it is a legal mandate for all public offerings.[65]

The securities laws expressly allow for "exemptions" to the registration requirement, however, and a new exemption for crowdfunding was created by the federal government in Title III of the Jumpstart Our Business Startups Act of 2012[66] (JOBS Act). This statute was passed with bipartisan support, and many states, including Colorado and Georgia, have since followed with similar legislation.[67] The enthusiasm for securities crowdfunding is primarily based on the widely shared view that the traditional initial public offering (IPO) process in the United States had become so onerous and expensive that many worthwhile companies either cannot or choose not to obtain funding from the public—to the detriment of us all.[68]

One reason why IPOs are so expensive is the high cost of complying with securities laws and regulations.[69] Under traditional securities laws, all securities must be first registered with the SEC or similar agency before being offered for sale to the public.[70] This registration process generally requires that the company provide full and clear disclosure of the risks of investing in the IPO, and then provide ongoing disclosures once the company is public.[71] Over the years—the American statute dates from the

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65. *See id.* at 884 (stating that securities must be registered).

66. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified at 15 U.S.C. §§ 77a–77r, 78a–78o (2012)); *see* Scwhartz, *Inclusive Crowdfunding*, *supra* note 2, at 663 ("Retail crowdfunding is exempt under Title III of the new JOBS Act, accredited crowdfunding is exempt under Title II of the JOBS Act, and intrastate crowdfunding is exempt under the longstanding intrastate exemption.").

67. *See* Scwhartz, *Inclusive Crowdfunding*, *supra* note 2, at 669 ("[R]oughly one-third of states have adopted legislation authorizing securities crowdfunding within their borders, including Colorado, Georgia, Massachusetts, Michigan, Tennessee, and Texas.").

68. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1458 ("[T]he costs associated with crowdfunding securities will be so much lower than costs in a traditional IPO. . . .").

69. *See id.* at 1467 ("By offering starkly lower compliance and promotion costs than a traditional IPO, crowdfunding greatly reduces the cost of raising capital from the public for small entrepreneurs.").

70. *See* Heminway & Hoffman, *supra* note 64, at 918 (noting that ordinary securities must be registered before distributed).

71. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1466 ("[R]equir[ing] that the issuer provide full and clear disclosure of the risks and

1930s—these disclosure requirements have become increasingly demanding thanks to the accumulation of legislative amendments and regulatory commands, to the point that the process of going public costs several million dollars in legal, accounting, and other fees.[72] This has discouraged all but the largest and most successful companies to conduct an IPO.[73]

Securities crowdfunding responds to this problem by exempting crowdfunded offerings from the usual registration and disclosure requirements for public offerings.[74] By eliminating the substantial attorney costs, underwriting costs, printing costs, and accounting costs associated with the preparation of a registration statement, this allows for much lower compliance costs than a traditional IPO.[75] The company likewise need not comply with the ongoing (and costly) reporting requirements for public companies.[76]

In addition to lower compliance costs, securities crowdfunding also offers a much less expensive means of promoting an offering of stock.[77] An important component of conducting a traditional IPO is the so-called "road show."[78] This is a series of in-person meetings and presentations to potential investors and which requires the hiring of public relations, catering, travel, printing, and many

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potential rewards of investing in the securities, and then provide ongoing, regular, and event-based disclosures.").

72. *See id.* at 1467 ("[T]oday, the process of going public costs millions of dollars in legal, accounting, and other fees and, in a potentially related development, the number of companies electing to do so has shrunk to an all time low.").

73. *See id.* at 1468 ("[A] registered public offering is just too expensive for all but the largest issuers.").

74. *See id.* at 1460 (noting that the CROWDFUND Act exempts crowdfunding entrepreneurs from the registration requirement).

75. *See id.* at 1458 (noting that those costs associated with crowdfunding are lesser than those associate with a traditional IPO).

76. *See id.* at 1470 (showing that crowdfunding securities are exempt from the costly registration and promotion fees of the traditional IPO).

77. *See id.* at 1467 (noting that crowdfunding greatly reduces the cost of raising capital).

78. *See id.* at 1470 (discussing the "carefully choreographed procedure called a 'road show'").

other types of consultants and specialists.[79] In other words, it is expensive.[80]

In securities crowdfunding, by contrast, there is no need for a physical road show, because it will take place entirely over the Internet.[81] In this way, the cost of promoting a crowdfunded offering will be much lower than an IPO.[82] Even so, American securities crowdfunding is not entirely free of regulatory red tape and the associated cost of compliance.[83]

The JOBS Act authorized securities crowdfunding, but also imposed many limits and rules on the practice.[84] There are hard monetary limitations both for companies and for investors.[85] Companies are only allowed to raise up to $1 million each year and,[86] for investors, the law provides a limit on the amount of crowdfunded securities that any one investor may purchase per year. The maximum amount an investor may contribute is premised on a sliding scale based on income and net worth; for most people this will calculate out to about $2,000–$5,000.[87] The purpose of this investment cap is to protect investors from putting more at risk than they can reasonably afford.[88]

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79. *See id.* ("The road show is not a legal requirement, but is a practical one, given the norms of the major banks that orchestrate IPOs. This is an expensive endeavor that calls for public relations, catering, travel, printing, and many other types of specialists, each of whom command premium fees.").

80. *See id.* (noting the extreme cost of a traditional IPO).

81. *See id.* ("Another important factor is the lower cost of promoting a crowdfunded issue via the Internet as opposed to an in-person road show.").

82. *See id.* (noting that the internet saves both time and money for crowdfunding companies).

83. *See* Robert B. Thompson & Donald C. Langevoort, *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising*, 98 CORNELL L. REV. 1573, 1605 (2013) (stating it is still difficult to navigate the compliance matters in JOBS).

84. *See id.* (noting that instead of creating "a regulation-free zone," the JOBS Act imposed "a quite heavy and costly set of responsibilities on both issuers and any intermediaries that assist them").

85. *See id.* at 1604 (stating that there is no need to register securities, but there are limitations on what can be raised).

86. *See id.* (noting that an issuer can raise only up to one million dollars in a transaction).

87. *See id.* ("[T]he main investor protection would have come through wealth- and income-based limits on how much any single investor could invest. . . .").

88. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1461 (stating

Under the JOBS Act, transactions must be executed via a financial intermediary registered with the SEC; thus they cannot be consummated directly between issuer and investor.[89] The financial intermediaries (also known as "platforms" or "portals") have numerous responsibilities under the law, including that they ensure that each investor reviews certain educational information and positively affirms certain statements, such as that they are risking the loss of their entire investment.[90] Companies may not advertise the offering themselves; any solicitations must go through the intermediary.[91]

Any private domestic company (except "investment companies") may invoke the JOBS Act's crowdfunding exemption.[92] Public companies, such as those that trade on the New York Stock Exchange, as well as foreign companies, are thus excluded.[93] Companies must provide numerous disclosures to investors, intermediaries and the SEC, including the name, address, and website of the company; the names of directors, officers, and substantial investors; a description of the business and the anticipated business plan; a description of the issuer's financial condition (which varies based on amount raised); a description of the purpose and intended use of the proceeds; the price of the securities; and a description of the ownership and capital structure of the issuer.[94]

The JOBS Act provides that companies must state a target for their fundraising goal, and are to receive the money only if the

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that the caps are for the protection of investors from losing too much money in investments with fewer regulations).

89. *See id.* at 1462 (noting how financial intermediaries act for the protection of the investor and issuer).

90. *See id.* at 1462–63 (detailing the responsibilities intermediaries have in the process).

91. *See id.* at 1464 ("Issuers are prohibited from advertising the offering themselves, and any solicitation of the offering must go through the registered funding portal.").

92. *See* Thompson & Langevoort, *supra* note 83, at 1575 ("[S]ome offerings of securities are exempt from '33 Act requirements because they are 'private' or otherwise limited in terms of size, scope, or nature of investors being solicited.").

93. *See id.* (noting that only private companies can be exempt).

94. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1464 ("Although the purpose of the Act is to lower the cost of capital for startups by alleviating burdensome disclosure requirements, a crowdfunding business must provide some very basic disclosures to the SEC. . . .").

target is met or exceeded.[95] During the pendency of an offer, all investors have the right to cancel their order at any time.[96] If the funding campaign succeeds, the company must provide annual reports to investors and the SEC for as long as the securities remain outstanding.[97] Also, crowdfunded securities cannot be transferred or sold by investors for one year after the date of purchase, unless being transferred to the issuer, as part of an offering registered by the SEC, or to an accredited investor or family member.[98]

Finally, to protect investors, the JOBS Act specifically authorizes civil actions for fraud against issuers, directors, and officers of companies that mislead crowdfunding investors.[99] State and federal government authorities, including the SEC, likewise are empowered to take action against wrongdoers.[100]

The JOBS Act created the basic framework for securities crowdfunding in 2012, but many issues were delegated to the SEC to flesh out through rulemaking.[101] Perhaps because the SEC was very busy with other matters, it took the agency several years to propose and finalize the regulatory framework for crowdfunding.[102]

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95. *See id.* at 1463 ("The intermediary cannot deliver the proceeds of the offering to the company until the target amount has been reached or exceeded. . . .").

96. *See id.* (noting that the intermediary "must allow investors the opportunity to cancel investment commitments before then").

97. *See id.* at 1464 ("Finally, following a crowdfunding round, an issuer must annually file with the SEC, and make available to investors financial statements and a report on the results of operations.").

98. *See id.* at 1463 (stating that crowdfunding securities cannot be transferred within one year "unless being transferred to the issuer, an accredited investor, a family member of the purchaser, or as part of an offering registered with the SEC").

99. *See id.* at 1465 (noting a party will be liable if they "make[] an untrue statement of a material fact or omits to state a material fact required to be stated or necessary in order to make the statements . . . not misleading").

100. *See id.* at 1465 ("[T]he SEC is granted 'examination, enforcement and other rulemaking authority' over funding portals, and presumably retains authority to enforce the various statutory and regulatory mandates for both issuers and intermediaries.").

101. *See id.* at 1462 ("Crowdfunding transactions cannot be consummated directly between issuer and investor, but rather must be executed via a financial intermediary registered with the SEC.").

102. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 669 ("[D]ue to competing priorities, the SEC missed the deadline and issued only a preliminary

The SEC published 585 pages of proposed regulations in October 2013 and invited public comment thereon.[103] Two years later, in November 2015, the SEC promulgated the final version of Regulation Crowdfunding, which weighed in at nearly 700 pages.[104] Securities crowdfunding under the JOBS Act and Regulation Crowdfunding finally commenced in May 2016.[105]

C. Policy Goals: Efficiency and Inclusivity

Congress enacted securities crowdfunding in large part to benefit entrepreneurs.[106] The statute was even called the Jumpstart Our Business Startups Act! In that law, signed by President Obama, the government sought to create a public securities market that would be both efficient and inclusive.[107] "Efficient" in the sense of an effective and low-cost method of raising business capital for startup and other small companies.[108] 'Inclusive' in the sense of a system that is open to any entrepreneur who wants to participate—just like in reward crowdfunding.[109]

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proposal in late 2013.").

103. Crowdfunding, 78 Fed. Reg. 66,428 (proposed Nov. 5, 2013) (to be codified at 17 C.F.R. pt. 227).

104. 17 C.F.R. § 227 (2017).

105. *Id.* § 200.

106. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1466 ("[C]rowdfunding will emerge as an important, low-cost method of raising business capital from the public, thus expanding the opportunity for entrepreneurship.").

107. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 666, 671 (discussing the attention paid to efficiency and inclusivity).

108. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 457 ("[I]t will liberate startup companies to use peer networks and the Internet to obtain modest amounts of capital at low cost.").

109. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 671 ("An inclusive environment, broadly defined as one in which 'all people feel valued and respected and have access to the same opportunities,' can generate positive effects."). There are other policy goals behind crowdfunding, including a wish to empower retail investors to buy securities that have traditionally been offered to institutional or accredited investors, but the present work is focused on the interests of entrepreneurs.

1. Efficient Capital Raising

Startup companies, simply meaning companies that were only recently formed, are beneficial to the economy in that they enhance innovation, economic growth, and employment.[110] They are risky, and many eventually go out of business, but those that survive commonly "create satisfying employment opportunities and . . . products or services that improve our quality of life."[111] Hence it is in the public interest to encourage the formation and development of startup companies.

Nevertheless, startups commonly have trouble obtaining the capital financing they need to get off the ground.[112] The usual first source for startup financing is from personal savings, or from friends and family, but many people have limited savings and lack wealthy connections.[113] Furthermore, banks are broadly hesitant to extend credit to startup companies in their early years, simply because the risk is too high.[114] Professional early-stage investors, such as angel investors and venture capital funds, are potentially available, but there is tremendous competition for such funding, and they commonly focus on startups in certain geographic areas, like Silicon Valley.[115] Finally, a startup could solicit investments from the public through an IPO.[116] That process is heavily regulated by the securities laws, however, and compliance costs

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110. *See, e.g.*, Barack Obama, *Toward a 21st-Century Regulatory System*, WALL STREET J. (Jan. 18, 2011), https://www.wsj.com/articles/SB10001424052748703396604576088272112103698 (last visited Jan. 11, 2018) ("[V]ibrant entrepreneurialism is the key to our global leadership and the success of our people.") (on file with the Washington and Lee Law Review).

111. Schwartz, *Digital Shareholder*, *supra* note 9, at 620.

112. *See id.* at 621 ("This lack of access to financing disproportionately affects certain types of entrepreneurs, namely those that are 'out-of-the-loop' for one reason or another and do not have connections with angel investors or other wealthy financiers.").

113. *See id.* (stating that it is uncommon to have access to a large sum of money at the start of a company).

114. *See id.* (noting how startups often resort to the use of credit cards to finance their start).

115. *See id.* at 621–22 (commenting on how it can be difficult, and highly competitive, to secure financing from a venture capitalist).

116. *See id.* at 622 (noting that it is possible to take the business public through an IPO, but that comes with its own set of risks).

can easily run to several million dollars, "making an IPO economically infeasible for nearly all early-stage startups."[117]

Based on these difficulties, Congress saw a need to create a simple and low-cost method of capital-raising for startup companies, and decided to adapt the crowdfunding concept to serve this purpose.[118] Thus, the first policy goal of securities crowdfunding is to provide startup companies with an efficient way to raise capital from the public.[119] The exemption to the securities laws allows startups to sell stock or other securities to the public in a simple, low-cost manner, and without having to comply with the heavy legal, regulatory and practical costs of issuing registered securities.[120]

2. Inclusive Entrepreneurship

Securities crowdfunding was also designed to promote an inclusive vision of entrepreneurship.[121] The traditional way to obtain startup business capital has long been through asking friends and family, angel investors and venture capitalists.[122] But what about entrepreneurs of modest means, without a rich uncle, and who lack wealthy friends? What about entrepreneurs who live far from Silicon Valley?[123] Unfortunately, entrepreneurs who are

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117. *Id.*

118. *See* Andrew A. Schwartz, *Keep it Light, Chairman White: SEC Rulemaking Under the JOBS Act*, 66 VAND. L. REV. EN BANC 43, 46 (2013) ("The whole crowdfunding project depends on a very simple and inexpensive process for offering securities.").

119. *See id.* at 44 ("[T]he Act seeks to create an ultralow-cost method for startup companies, small business, farmers, and others. . . .").

120. *See id.* at 47 ("The Act provides a new means for companies to raise capital from investors by establishing an exemption to the Securities Act of 1933 for crowdfunded securities.").

121. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 673 ("One core pillar of securities crowdfunding is the idea of an inclusive system that invites all investors to participate.").

122. *See* Schwartz, *Digital Shareholder*, *supra* note 9, at 621 ("The traditional first source for entrepreneurial financing is from the entrepreneur's friends and family, as well as their own personal savings.").

123. *See* Andrew A. Schwartz, *Rural Crowdfunding*, 13 U.C. DAVIS BUS. L.J. 283, 283–84 (2013) [hereinafter Schwartz, *Rural Crowdfunding*] (noting that most investors live in major metropolitan cities); *accord* Calida Smylie, *Should Regulators Increase the Equity Crowdfunding Limit?*, NAT'L BUS. REV., July 1,

'out of the loop' for one reason or another appear to have a difficult time getting startup financing. This includes women and racial minorities,[124] as well as young entrepreneurs[125] and those from rural areas.[126]

Crowdfunding—being entirely Internet-based—is supposed to give everyone the opportunity to try to raise capital from the crowd, regardless of what they look like, how old they are, or where they are from.[127] As President Obama said when he signed the JOBS Act, "[f]or startups and small businesses, this bill is a potential game changer," Obama said at a White House signing ceremony flanked by lawmakers from both parties. "Startups and small business will now have access to a big new pool of potential investors, namely the American people."[128] The inclusive vision is that "anyone who can convince the public he has a good business idea can become an entrepreneur" through crowdfunding.[129]

In short, a second key policy goal of securities crowdfunding in the United States was to create an inclusive system that would give anyone with a business idea the opportunity to list her

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2016 [hereinafter Smylie, *Equity Crowdfunding Limit?*] ("[E]arly stage companies are basically left with the options of funds and high net worth individuals, which can be an obscure and fragmented market to navigate if you're not well connected.").

124. *See* Schwartz, *Digital Shareholder*, *supra* note 9, at 622 ("[T]his problem appears to be exacerbated for women and racial minorities.").

125. *See* Andrew A. Schwartz, *Teenage Crowdfunding*, 83 U. CIN. L. REV. 515, 516 (2014) [hereinafter Schwartz, *Teenage Crowdfunding*] (noting it is difficult for teenagers to secure start-up financing).

126. *See* Schwartz, *Digital Shareholder*, *supra* note 9, at 623 (noting that people in rural areas can often have a harder time receiving funding from venture capitalists or angel investors).

127. *See id.* at 624 ("Not just those in Silicon Valley; not just those with wealthy friends; not just those with connections. Crowdfunding will be open to anyone. . . ."); C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 104 ("Crowdfunding . . . gives poorer entrepreneurs whose friends and family lack the wealth to provide seed capital somewhere else to turn.").

128. Alexandra Alper, *Obama Signs Bill to Boost Business Startups*, REUTERS (Apr. 5, 2012, 3:58 PM), https://www.reuters.com/article/us-usa-jobsact/obama-signs-bill-to-boost-business-startups-idUSBRE83414F20120405 (last visited Jan. 11, 2018) (on file with the Washington and Lee Law Review).

129. *See* Bradford, *supra* note 127, at 10; *see also id.* at 101 ("Crowdfunding allows an entrepreneur to publish her request for funding to the entire world. . . .").

business on a crowdfunding website and solicit investments from the American people.[130] As illustrated below, however, this radically inclusive vision of crowdfunding was so threatening to efficiency that it was softened, and nearly overturned, by the SEC.[131]

D. Tension Between Inclusivity and Efficiency—Regulatory History

Securities crowdfunding has a fundamental tension at its core between inclusivity and efficiency, and the two goals must be balanced or traded off against one another. The goal of an inclusive marketplace, in the sense that there are no gatekeepers and any entrepreneur can pitch directly to the crowd, was part of the original vision of securities crowdfunding.[132] The SEC, in the draft regulations it released for public comment in 2013, operationalized this policy goal by denying platforms the power to curate or screen the issuers listing on their site.[133] This sweeping notion of a fully inclusive securities marketplace, where any and every entrepreneur was to be given a chance, was subsequently squelched by the SEC.[134] The SEC recognized it had to make a tradeoff between inclusivity and efficiency and ultimately decided to advance efficiency at the expense of inclusivity.[135] The final version of the regulations do empower platforms to curate and

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130. *See* Darian Ibrahim, *Crowdfunding Without the Crowd*, 95 N.C. L. REV. 1481, 1489 (2017) ("[F]unding portals were originally to play a passive role in the crowdfunding process. They were not designed to guide investors toward the best startups—that was left up to the 'crowd.'").

131. *See infra* notes 222–236 and accompanying text (discussing the limits the SEC placed on securities crowdfunding in the United States).

132. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 673 ("Inclusivity is essential to crowdfunding and drives the theory underlying the form.").

133. Crowdfunding, 78 Fed. Reg. 66,428, 66,485–87 (proposed Nov. 5, 2013) (to be codified at 17 C.F.R. pt. 227).

134. *See* Schwartz, *Inclusive Crowdfunding*, *supra* note 2, at 672 (noting the SEC, as well as scholars, believe "[t]he essence of the concept is the creation of an inclusive market where ordinary investors will be able to make investments that have traditionally been the exclusive purview of wealthy and connected investors").

135. *See infra* notes 136–140 and accompanying text (discussing how Congress limited inclusiveness in favor of efficiency).

select which entrepreneurs to include, and which to exclude.[136] This section recounts the regulatory process where this important change was made.

In 2013, the SEC published its initial version of Regulation Crowdfunding and solicited comments from the public.[137] Two years later, in 2015, the SEC promulgated the final version of Regulation Crowdfunding, incorporating changes suggested by public commenters.[138] Among the most significant changes between the proposed and the final regulations was the alteration of Rule 402(b)(1).[139]

Rule 402(b)(1) governs whether and to what extent a funding portal is permitted to decide which companies to allow to list on its site.[140] Under the original version of the Rule, funding portals were to play "an almost completely passive role."[141] If an entrepreneur wanted to post their business and solicit investments from the crowd, a funding portal had to allow her on its site, regardless of the portal's view of the company or its prospects.[142] Indeed, Rule 402(b)(1), as originally proposed, specifically stated that "a funding portal may not deny access to an issuer based on the advisability of investing in the issuer or its offering."[143] This was a radically inclusive rule: Every entrepreneur had to be included, and none could be excluded. [144]

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136. *See* 17 C.F.R. § 227.402(b)(1) (2017) (allowing discretion over who can use a platform and who cannot).

137. Crowdfunding, 78 Fed. Reg. at 66,428.

138. 17 C.F.R. § 227.

139. *Compare* Crowdfunding, 78 Fed. Reg. 66,428 (proposed Nov. 5, 2013) (to be codified at 17 C.F.R. pt. 227) (detailing the proposed rule), *with* 17 C.F.R. § 227.402(b)(1) (detailing the final rule).

140. *See* 17 C.F.R. § 227.402(b)(1) ("A funding portal may . . . [d]etermine whether and under what terms to allow an issuer to offer and sell securities in reliance on section 4(a)(6) of the Securities Act.").

141. Ibrahim, *supra* note 130, at 1496; *see also* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1462 n.25 (stating the portal's only purpose was to connect buyers and sellers, and nothing else).

142. *See* Crowdfunding, 78 Fed. Reg. at 66,560 ("A funding portal may . . . apply objective criteria to limit the securities offered in reliance on Section 4(a)(6) . . . .").

143. Crowdfunding, Release No. 33-9479, 107 S.E.C. Docket 2728 (proposed Oct. 23, 2013), https://www.sec.gov/rules/proposed/2013/33-9470.pdf.

144. *See* Ibrahim, *supra* note 130, at 1481 ("Funding portals were originally conceived of as almost completely passive entities who could not subjectively

The statutory basis for the SEC's proposed Rule 402(b)(1) was found in a portion of the JOBS Act that prohibited funding portals from "offer[ing] investment advice or recommendations."[145] The SEC took the view, at least at first, that to allow a portal to pick and choose who to permit on its site would be an implicit form of advice that the issuers it selected were worthy investments, and those that it rejected were not.[146]

The proposed Rule 402(b)(1) did have two exceptions to this basic prohibition on screening issuers: First, the portal was permitted to exclude an issuer that "present[ed] the potential for fraud or otherwise raise[d] investor protection concerns."[147] Second, the portal could have used "objective criteria" to select the issuers it allowed on its site.[148] So, a portal could have specialized in technology companies,[149] or those from a certain geographic area,[150] and exclude any issuers who did not fit the bill. But if an issuer did come within the objective criteria, the portal would be forced to include it, regardless of what it thought of the company and its prospects.[151] If a portal devoted itself to, say, women-owned businesses, then it would have had to allow any and every woman-owned business to list on its site.

When the SEC put out its proposed Regulation Crowdfunding for public comment, Rule 402(b)(1) received a wave of criticism.[152] Just like a regular stock exchange, funding portals

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'curate' (or screen) the startups that wished to list on the sites.").

145. *See* 15 U.S.C. § 78c(a)(80)(A) (2012) (defining funding portal as "any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to Section 4(6) of the Securities Act of 1933 (15 U.S.C. 77d(6))").

146. *See* Crowdfunding, 78 Fed. Reg. 66,428, 66,486 (proposed Nov. 5, 2013) (to be codified at 17 C.F.R. pt. 227) ("[A] funding portal may not use criteria based on an assessment of the merits or the shortcomings of a particular issuer or offering. In particular, a funding portal may not deny access to an issuer based on the advisability of investing in the issuer or its offering.").

147. *Id.* at 66,463.

148. *Id.* at 66,486.

149. *See id.* (including "business segment" as a permissible objective criterion).

150. *See id.* (including "geographic location" as a permissible objective criterion).

151. *See id.* (explaining that the objective criteria were designed to prevent the appearance that the funding portal was providing investment advice).

152. *See* Crowdfunding, 80 Fed. Reg. 71,388, 71,462 (Nov. 16, 2015) (to be

have a fundamental business need to cultivate and protect a sound reputation among investors, otherwise people may not be willing to invest their money on the site.[153] Had Rule 402(b)(1) gone into effect as proposed, it would have been impossible for a funding portal to generate and protect its reputation for only listing companies with good prospects.[154] Thus by forcing a portal to include every entrepreneur who asked, the SEC's proposed rule would have undermined "the viability of the funding portal industry, and thus the crowdfunding market" as a whole.[155]

In essence, the commenters were concerned that the SEC's proposal privileged inclusivity over efficiency (although they did not put it in precisely these terms) and the SEC ultimately agreed.[156] The SEC concurred that the system would only work, or would at least work much better, if funding portals had the power to select which companies to include, and which to exclude, from its site.[157]

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codified at 17 C.F.R. pt. 227) ("We received a significant number of comments on the ability of a funding portal to limit the offerings on its platform . . . .").

153. *See* EDWARD PETER STRINGHAM, PRIVATE GOVERNANCE: CREATING ORDER IN ECONOMIC AND SOCIAL LIFE 29 (2015) ("A stock exchange that fails to provide assurances or attempts to stack the deck in favor of its members at the expense of investors will attract fewer investors in its market in the long run."); *id.* at 81 ("By providing extra assurances to investors, the New York Stock Exchange . . . increases the demand for its market. Here the exchange acts as a reputational intermediary, providing the equivalent of a Good Housekeeping Seal of Approval on listed firms." (citing JONATHAN MACEY, THE DEATH OF CORPORATE REPUTATION: HOW INTEGRITY HAS BEEN DESTROYED ON WALL STREET 199–210 (2013))).

154. *See* Crowdfunding, 80 Fed. Reg. at 71,462

> Commenters asserted that a funding portal's ability to limit the offerings on its platform is important for investor protection. They stated that funding portals should be permitted to screen out clearly unprepared or ill-conceived offerings, and should be permitted to limit offerings on their platforms to issuers that are "crowdfund-ready".

155. *Id.*

156. *See id.* ("We acknowledge the concerns raised by commenters that the proposed rules could otherwise have unduly restricted a funding portal's ability to limit offerings conducted on its platform, and we are modifying the safe harbor contained in Rule 402(b)(1) to address these concerns.").

157. *See id.* ("Specifically, we are revising Rule 402(b)(1) to read that a funding portal may '[d]etermine whether and under what terms to allow an issuer to offer and sell securities . . . through its platform, provided that the funding portal otherwise complies with Regulation Crowdfunding . . . .'").

The SEC was probably correct in concluding that a ban on platform curation would have led to significant inefficiencies for all market participants: Investors would have had to wade through tons of unsuitable investments in order to find the ones they like.[158] Investments would have been spread very thinly among many issuers, leading to many failed campaigns, as the combination of the investor cap and the all-or-nothing rule would make it difficult for any given issuer to reach its target amount. Platforms, who generally are compensated through a "success fee" paid by a company that meets its target, would have had to charge higher fees to account for the time and resources they waste on the many unsuccessful campaigns. And since the overall success rate would be relatively low in an un-curated marketplace, a large percentage of issuers would have wasted their time and effort trying to get funding. Without going any further, it is clear that the SEC was likely right in concluding that the proposed version of Rule 402(b)(1) would have led to massive inefficiency and perhaps a total breakdown in the system.[159]

The agency accordingly revised Rule 402(b)(1) to expressly allow a funding portal to "exercise its discretion . . . to limit the offerings and issuers that it allows on its platform."[160] Its revised version of Rule 402(b)(1) states, in no uncertain terms, "A funding portal may . . . [d]etermine whether and under what terms to allow an issuer to offer and sell securities . . . through its platform."[161] Thus the final Regulation Crowdfunding, which is presently in effect, authorizes and empowers funding portals to exclude what

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158. *See also* Crowdfunding, 78 Fed. Reg. 66,428, 66,487 (proposed Nov. 5, 2013) (providing search functions to help users to "search, sort, or categorize" offerings to more efficiently find desired offerings).

159. *See* Ibrahim, *supra* note 130, at 1498 (quoting other commentator's contention that failure to change the rule "could have spelled disaster for the nascent crowdfunding industry" (quoting Evan Engstrom, *The Good and the Bad in the SEC's New Crowdfunding Rules*, ENGINE (Nov. 5, 2015), http://www.engine.is/news/issues/the-good-and-the-bad-in-the-secs-new-crwdfunding-rules/6124 (last visited Mar. 8, 2018) (on file with the Washington and Lee Law Review))).

160. Crowdfunding, 80 Fed. Reg. 71,388, 71,463 (Nov. 16, 2015) (to be codified at 17 C.F.R. pt. 227).

161. 17 C.F.R. § 227.402(b)(1) (2017).

they perceived to be low-quality companies with poor prospects or too much risk.[162]

This important change between the SEC's proposed and final regulations is telling. The radically inclusive vision presented in the proposed Rule 402(b)(1) was that anyone with a business idea would be granted the legal right to present her idea to the crowd and ask for their financial backing.[163] You do not need to impress the VCs, the angels, the banks, the "guys in suits"—you get your shot. Regardless of whether you are a teenager,[164] a racial minority,[165] or live far from Silicon Valley,[166] everyone and every idea was welcome.

But this "revolutionary" idea of a totally inclusive marketplace for entrepreneurial finance was snuffed out without even being given a chance.[167] The SEC concluded, again, probably correctly, that some level of exclusivity is needed for crowdfunding to work; total inclusivity is simply too inefficient to function.[168] Congress may have had dual purposes when it authorized securities

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162. *See* Crowdfunding, 80 Fed. Reg. at 71,463 ("[W]e are providing funding portals with broad discretion to determine whether and under what circumstances to allow an issuer to offer and sell securities through its platform . . . .").

163. *See* Crowdfunding, 78 Fed. Reg. at 66,486 (requiring that limitations of funding portals use objective criteria "required to be reasonably designed to result in a broad selection of issuers").

164. *See* Schwartz, *Teenage Crowdfunding*, *supra* note 125, at 516 (describing how the CROWDFUND Act opened crowdfunding opportunities to those under age twenty-one).

165. *See* Schwartz, *Digital Shareholder*, *supra* note 9, at 623 (referencing recent literature showing that "most startups founded by African-Americans receive little or no outside financing from any source").

166. *See id.* (highlighting the geographical disadvantage of those who do not live in communities with large potential funding basis); Schwartz, *Rural Crowdfunding*, *supra* note 123, at 283 (discussing the localization of early stage investment and its impact on rural entrepreneurs).

167. *See* Ibrahim, *supra* note 130, at 1485 (observing that crowdfunding's move toward an expert-based system resembles a model closer to the existent angel and venture capital models).

168. *See id.* at 1496 (arguing that "expert curation is optimal in startup investing"). Indeed, one thoughtful commentator has repeatedly suggested that crowdfunding's efficiency would be greatly improved if the SEC went even further than the current Rule 402(b)(1) and allowed even more curation and exclusivity. *See id.* at 1496 (advocating that "funding portals should be allowed to do more screening of startups" (citing Darian M. Ibrahim, *Equity Crowdfunding: A Market for Lemons?*, 100 MINN. L. REV. 561, 603–06 (2015))).

crowdfunding—both efficiency and inclusivity—but the SEC privileged one over the other in its final Rule 402(b)(1).[169] And this makes sense, as an inclusive system isn't worth much if nobody actually uses it. In any event, the present system of American securities crowdfunding prioritizes efficiency over inclusivity.

Certain minor aspects designed to promote inclusivity for entrepreneurs do remain part of the SEC's final regulatory framework. For one thing, the SEC's final regulations still do require platforms to use objective criteria when highlighting offerings within the platform.[170] Thus they may not put a set of recommended investments on the home page and relegate the rest to sub-pages.[171] Similarly, platforms must also use objective criteria when providing search functions on its site.[172] However, these aspects of the rules are obviously of no use to a company who is excluded from the site altogether. Thus, the system is, at its core, not as inclusive of entrepreneurs as was originally framed.

In conclusion, the SEC's final rules prioritize efficiency over inclusivity in that they allow portals to screen and reject companies that they do not want to list.[173] The SEC changed Rule 402(b)(1) because it understood that it had to make a trade-off between efficiency and inclusivity. The agency's counterpart in

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169. *See* Crowdfunding, 80 Fed. Reg. 71,388, 71,462 (Nov. 16, 2015) (to be codified at 17 C.F.R. pt. 227) (explaining the SEC's response to the public comments with regards to granting funding portals discretion over limiting platform accessibility).

170. *See generally* 17 C.F.R. § 227.402(b)(2) (2017).

171. *See id* § 227.402(b)(2)(ii) ("[T]he funding portal may not highlight an issuer or offering based on the advisability of investing in the issuer or its offering . . . .").

172. *See id.* § 227.402(b)(3) ("A funding portal may . . . [p]rovide search functions or other tools that investors can use to search, sort, or categorize the offerings available through the funding portal's platform according to objective criteria . . . .").

173. *Cf.* STRINGHAM, *supra* note 153, at 30

> The terms "closing it to 'outsiders'" and "exclusion" have negative connotations to many, but a voluntary association would not be voluntary if everyone were forced together against their will. . . . Even though exclusion is an important part of a social system based on voluntary relations, the system would be much more inclusive overall. . . . [E]xclusion is nothing more than people deciding with whom they want to interact.

New Zealand, however, never had to make that trade-off, as the next Part will discuss.[174]

III. Equity Crowdfunding in New Zealand

While the idea of crowdfunding securities originated in the United States and the federal JOBS Act of 2012 provided the first template for this new form, other countries quickly took steps to emulate this American innovation.[175] New Zealand in particular took the idea and ran with it, to the point that it had its market up and running two years ahead of the Americans.[176] This Part discusses the distinctive New Zealand model of crowdfunding in advance of Part IV, which will compare the New Zealand and United States regimes in terms of efficiency and inclusivity.

A. New Zealand as Comparator

Much of the remainder of this Article will compare and contrast the crowdfunding laws and markets in New Zealand and the United States. This sort of analysis depends, of course, on the two countries being comparable. Despite obvious differences between them—New Zealand is a small island nation with less than five million people, including a large Polynesian population, located in the South Pacific[177]—they are actually quite similar in

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174. *See infra* Part III (discussing the evolution of crowdfunding in New Zealand).

175. *See* Ross S. Weinstein, Note, *Crowdfunding in the U.S. and Abroad: What to Expect When You're Expecting*, 46 CORNELL INT'L L. J. 427, 427–49, 437–438 (2013) (suggesting that crowdfunding through established portals emerged contemporaneously in Europe and tracing the crowdfunding phenomenon's growth around the world).

176. *See* Dehner & Kong, *supra* note 15, at 437 ("New Zealand equity and lending based crowdfunding laws became effective in April of 2014."); Ibrahim, *supra* note 130, at 1488 (noting that although the JOBS Act was passed in 2012, the market set-up was delayed until the SEC could implement the final rules in 2016).

177. *See World Factbook: New Zealand*, CENT. INTELLIGENCE AGENCY (2017), https://www.cia.gov/library/publications/the-world-factbook/geos/print_nz.html (last updated Dec. 12, 2017) (last visited Jan. 1, 2018) (providing general statistical information about New Zealand) (on file with the Washington and Lee Law Review).

their history and legal structure: Both began as British colonies, both speak English, both are developed countries with a democratic form of government and a legal system based on the common law, both even use dollars as their currency.[178]

While comparative analyses are never perfect, many legal scholars have concluded that the similarities between New Zealand and the United States are close enough to make at least rough and broad comparisons between them.[179] This is true in many areas of law. Scholars of tort law, in particular, have frequently compared the United States tort system with the rather different approach that New Zealand has followed since the 1970s.[180] In addition, many leading American tort law casebooks "contain extensive treatment of New Zealand's system,"[181] a further indication that New Zealand is an appropriate legal comparator for the United States with respect to tort law.[182]

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178. *See* DAVID HACKETT FISCHER, FAIRNESS AND FREEDOM: A HISTORY OF TWO OPEN SOCIETIES, NEW ZEALAND AND THE UNITED STATES 27, 476 (2012)

> The United States and New Zealand are both open societies and have been so for many generations. Each in its own way has a democratic polity, a mixed-enterprise economy, a pluralist culture, a strong commitment to human rights, and a firm belief in the rule of law. Both of these open systems encourage individual people to make their own choices. They also share many values in common, including liberty and freedom, fairness and justice.

179. *See infra* notes 180–188 (comparing New Zealand and the United States in various areas of the law).

180. *See, e.g.*, Peter H. Schuck, *Tort Reform, Kiwi-Style*, 27 YALE L. & POL'Y REV. 187, 198 (2008) (discussing "Tort Law in America: Lessons from New Zealand"); Sir Geoffrey Palmer, *The Design of Compensation Systems: Tort Principles Rule, O.K.?*, 29 VAL. U. L. REV. 1115, 1119 (1995) (discussing "lessons for American [tort-law] reformers from the New Zealand experience"); Richard S. Miller, *An Analysis and Critique of the 1992 Changes to New Zealand's Accident Compensation Scheme*, 52 MD. L. REV. 1070, 1070 (1993) (noting continued interest in New Zealand's no-fault accident compensation scheme as a possible alternative for how the United States handles personal injury torts); Craig Brown, *Deterrence in Tort and No-Fault: The New Zealand Experience*, 73 CAL. L. REV. 976, 976 (1985) (exploring the role of deterrence in discussions of replacing the U.S. tort law system with something akin to New Zealand's no fault insurance system); Marc A. Franklin, *Personal Injury Accidents in New Zealand and the United States: Some Striking Similarities*, 27 STAN. L. REV. 653, 654 (1975) (emphasizing that the similarities between the U.S. and New Zealand are a reason to consider New Zealand's experience with its new tort law system for changing the American system).

181. Palmer, *supra* note 180, at 1119.

182. *See id.* at 1119 n.6 (listing torts casebooks that discuss New Zealand law,

Beyond torts, American legal scholars have frequently claimed that New Zealand's experience holds lessons for various areas of United States law including antitrust,[183] family law,[184] criminal law,[185] labor law,[186] patent law,[187] and many more.[188]

including those authored by Richard Epstein, George Christie and James Meeks, and William Prosser).

183. *See, e.g.*, Spencer Weber Waller, *Bringing Globalism Home: Lessons from Antitrust and Beyond*, 32 LOY. U. CHI. L.J. 113, 128–29 (2000) (discussing lessons for the United States to draw from New Zealand's "advanced" antitrust law); William J. Baumol & J. Gregory Sidak, *The Pricing of Inputs Sold to Competitors*, 11 YALE J. ON REG. 171, 189 (1994) (claiming that "the New Zealand experience will have considerable relevance to the American [antitrust law in the] telecommunications arena").

184. *See generally* MARK HARDIN ET AL., FAMILY GROUP CONFERENCES IN CHILD ABUSE AND NEGLECT CASES: LEARNING FROM THE EXPERIENCE OF NEW ZEALAND (1996) (advocating for the application of the New Zealand family group conferences model in U.S. family law).

185. *See generally* Carol A. Brook et. al., *A Comparative Look at Plea Bargaining in Australia, Canada, England, New Zealand, and the United States*, 57 WM. & MARY L. REV. 1147 (2016) (comparing the nature and effects of plea bargaining in the United States with other countries, including New Zealand).

186. *See, e.g.*, Ellen Dannin, *Solidarity Forever? Unions and Bargaining Representation Under New Zealand's Employment Contracts Act*, 18 LOY. L.A. INT'L & COMP. L.J. 1, 2–3 (1995) ("In 1991, New Zealand enacted the Employment Contracts Act (ECA), legislation that is premised on a completely different model than U.S. labor law. It affords a rich opportunity to study the impact of some key ideas advanced for labor law reform [in the U.S.].").

187. *See, e.g.*, Erin E. Block, *The End of the "Wild West" for Software Patents—Does the Patents Act 2013 Change New Zealand's Treatment of Software Patents from Permissive to Restrictive?*, 19 MARQ. INTELL. PROP. L. REV. 141, 154–56 (2015) (comparing the patentatibility of computer programs under United States and New Zealand law); Todd Martin, *Patentability of Methods of Medical Treatment: A Comparative Study*, 82 J. PAT. & TRADEMARK OFF. SOC'Y 381, 410 (2000) (same).

188. *See, e.g.*, Susanna Frederick Fischer, *Rethinking* Sullivan*: New Approaches in Australia, New Zealand, and England*, 34 GEO. WASH. INT'L L. REV. 101, 149–59 (2002) (comparing American defamation law with New Zealand's); Ruth W. Pritchard-Kelly, *A Comparison Between Spectrum Auctions in the United States and New Zealand*, 20 MD. J. INT'L L. & TRADE 155, 155 (1996) (explaining how the U.S. learned from New Zealand's experience in setting up an auction system for telecommunications licensing); Michael C. Blumm, *Native Fishing Rights and Environmental Protection in North America and New Zealand: A Comparative Analysis of Profits à Prendre and Habitat Servitudes*, 8 WIS. INT'L L.J. 1 (1989) (examining native fishing rights in America with British Columbia and New Zealand); *see also, e.g.*, Gregory S. Crespi, *Comparing United States and New Zealand Legal Education: Are U.S. Law Schools Too Good?*, 30 VAND. J. TRANSNAT'L L. 31, 32 (1997) (comparing the two nations' legal educational systems).

The comparison between the two countries is especially appropriate when it comes to securities regulation in general, and crowdfunding in particular.[189] New Zealand's securities law is, on the whole, a close cousin to the United States. They both rely on a central national regulator (the SEC and the FMA) to keep close tabs on the public securities markets (the New York Stock Exchange, NASDAQ, et cetera, and the New Zealand Exchange (NZX)).[190] Like the United States,[191] New Zealand has an extensive history of precisely the sort of fraud and wrongdoing that securities law is designed to combat.[192] In New Zealand during the 2000s, for instance, there was a rash of so-called "finance companies" that sold unregistered securities to huge numbers of "mum and dad" investors and then went bust.[193] Hence both countries have an elaborate set of mandatory disclosure rules for publicly traded companies,[194] as well as analogous exemptions from those rules,

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189. *See infra* notes 190–200 (drawing similarities in the regulatory construction and rules in New Zealand and the United States).

190. *See generally* VICTORIA STACE, ET AL., FINANCIAL MARKETS CONDUCT REGULATION: A PRACTITIONER'S GUIDE (2014) (describing securities regulation in New Zealand).

191. *See generally* EDWARD J. BALLEISEN, FRAUD: AN AMERICAN HISTORY FROM BARNUM TO MADOFF (2017) (tracing the prevalent history of fraud in American businesses).

192. *See* STACE, ET AL., *supra* note 190, at 3 ("In New Zealand, a rich jurisprudence on securities law has emerged in the wake of the GFC [(Global Financial Crisis)] and finance company collapses, with many prominent cases that have attracted media attention—more often for the villains than the heroes.").

193. *See* Nicola Won, *Regulation of Finance Companies: Coming Out of the Shadows*, 21 N.Z. BUS. L.Q. 110, 110 (2015)

> The finance company collapses from 2006 onwards had a major financial impact on New Zealand investors (and taxpayers). The Reserve Bank of New Zealand (Reserve Bank) has calculated that 45 finance companies involving over 170,000 investors (4% of the national population; the equivalent of about 12 million Americans) failed between 2006 and 2011, with an estimated $6 billion in outstanding deposit liabilities.

See also Mark A. Fox et. al., *Corporate Governance Research on New Zealand Listed Companies*, 29 ARIZ. J. INT'L & COMP. L. 1, 1 (2012) ("[T]here has been a rolling set of corporate failures in [New Zealand's] finance company sector since the global financial crisis . . . ."); *id.* at 4 (mentioning the "raft of finance company failures in New Zealand").

194. *See* Fox et. al., *supra* note 193, at 5 (suggesting that one reason for the collapse of so many finance companies was that they were "not subject to the discipline of the New Zealand Exchange Listing Rules" especially "the continuous

including the commonly used accredited (“wholesale” in New Zealand) investor exemption.[195]

Finally, and most relevant to the present discussion, New Zealand expressly modeled its legal regime for crowdfunding on the American JOBS Act.[196] The New Zealand Parliament, guided by the Ministry of Business, Innovation and Employment (MBIE), carefully studied the JOBS Act upon its enactment in 2012,[197] and adopted a similar scheme in the Financial Markets Conduct Act of 2013.[198] But as the next section will show, New Zealand’s crowdfunding law did not follow the American model in every respect.[199] To the contrary, New Zealand’s Parliament, upon the recommendations of MBIE, made significant changes to the JOBS Act,[200] thereby setting up a useful comparison of the two crowdfunding laws.

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disclosure regime that applies to listed companies”).

195. *Compare* STACE, ET AL., *supra* note 190, at 131 (“An offer of financial products to a wholesale investor does not require . . . disclosure. This reflects the generally accepted policy rationale that wholesale investors are capable of looking after themselves, by reason of their expertise or experience in relation to financial matters.” (citing the New Zealand Financial Markets Conduct Act 2013, pts 1–9 (N.Z.))), *and id.* at 134 (explaining that the definition of wholesale investor includes individuals with a net worth that exceeds NZ$5 million), *with* 15 U.S.C. § 77d(a)(5) (2012) (exempting offerings of securities “solely to one or more accredited investors”), *and* 17 C.F.R. § 230.215(e) (2017) (defining “accredited investor” as including individuals with a net worth that exceeds $1 million).

196. *See* MINISTRY OF BUSINESS, INNOVATION AND EMPLOYMENT, FINANCIAL MARKETS CONDUCT REGULATIONS 237 (2012), http://www.mbie.govt.nz/info-services/business/business-law/financial-markets-conduct-act/regulations/financial-market-conduct-regulations-discussion-paper-december-2012/documentsimages-library/Financial%20Markets%20Conduct%20Regulations%202013%20Discussion%20Paper.pdf (“The United States has recently introduced a crowd-funding exemption from its Securities Act, as part of the Jumpstart Our Business Startups Act (‘JOBS Act’) . . . . We propose [in the FMCA] to provide an [analogous] exception for crowd-funding . . . .”); *id.* at 240–41 (taking note of specific portions of the JOBS Act and discussing whether, and to what extent, New Zealand should copy the American legal scheme for crowdfunding).

197. *See id.* at 240–41 (referencing the JOBS Act requirements and proposing questions for comment based upon enacting similar requirements).

198. *See* Interview with James Hartley, Manager, Fin. Mkts. Policy, N.Z. Ministry of Bus., Innovation & Emp’t, in Auckland, N.Z. (Apr. 4, 2017) (recounting legislative history).

199. *See infra* Part III.B (describing how the American system imposes more restrictions on the practice of crowdfunding).

200. *See infra* Part III.B (explaining that New Zealand consciously omitted mandatory disclosure and investment cap provisions found in the JOBS Act).

In sum, while New Zealand and the United States are not precisely the same in every way, they appear to be close enough for the present purpose, which is to provide a broad and rough comparison of their crowdfunding laws and markets.

B. Crowdfunding Under the FMC

Once the United States enacted the JOBS Act in 2012, other countries sought to emulate the crowdfunding provisions of Title III.[201] One of the first movers was New Zealand.[202] The Parliament there took Title III as a model for its own equity crowdfunding law, which it passed in 2013 as part of a massive overhaul of securities law called the Financial Markets Conduct Act (FMCA).[203] Regulations were promptly issued the next year[204] and the New Zealand equity crowdfunding[205] market opened for business in 2014, two years ahead of the United States.[206]

New Zealand's model of crowdfunding is broadly similar to the JOBS Act, although the New Zealand version is simpler and more

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201. *See* Weinstein, *supra* note 175, at 427–49 (looking at the expansion of crowdfunding outside the United States).

202. *See* Dehner & Kong, *supra* note 15, at 437 (observing that despite starting their legislation after the JOBS Act, New Zealand's laws became effective in 2014).

203. *See supra* note 201 and accompanying text (documenting that New Zealand modeled its crowdfunding law on Title III of the JOBS Act).

204. *See Financial Markets Conduct Regulations*, MINISTRY BUS., INNOVATION, & EMP'T, http://www.mbie.govt.nz/info-services/business/business-law/financial-markets-conduct-act/regulations (last visited Mar. 8, 2018) ("The full Financial Markets Conduct Regulations (FMC Regulations) were made on 3 November 2014 and came into force on 1 December 2014.") (on file with the Washington and Lee Law Review).

205. United States law "permits any 'security' to be crowdfunded" while New Zealand allows equity securities to be crowdfunded through a "crowd funding service" and allows debt securities to be crowdfunded through a "peer-to-peer lending service." *Compare* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1482 (observing that in the U.S. system, most expect issuers to sell stock in their companies, but other securities, such as bonds, notes, or other debt instruments, could also be issued), *with* Financial Markets Conduct Regulations 2014, reg. 185(1) (N.Z.) (placing the focus on equity crowdfunding, because peer-to-peer lending is predominantly used by individuals, rather than companies).

206. *See supra* note 176 and accompanying text (comparing the relative start dates for the crowdfunding regulatory schemes in each nation).

liberal ("light-handed," as they would say)[207] in that it imposes very few restrictions on the practice.[208] In the United States, Congress included mandatory disclosure and an investment cap in the JOBS Act to prevent investors both from fraud and from losing more than they could afford.[209] The New Zealand Parliament consciously deleted these features from its version of equity crowdfunding.[210]

There are only a few hard and fast rules in New Zealand crowdfunding. For one, all listings must be hosted by an online "platform" licensed by the Financial Markets Authority (FMA), the New Zealand equivalent of the SEC.[211] For another, issuers may only sell up to NZ$2 million (~$1.4 million) in equity per year through crowdfunding.[212]

Beyond those few rules, New Zealand's law is spare and light-handed. There is no rule mandating any certain disclosures, and the FMA does not review or approve of individual offerings.[213] Rather, it is up to each private platform to decide which companies to list on its site and what, if any, disclosure to demand from them, without direct input or oversight from the FMA.[214]

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207. *See, e.g.*, Calida Smylie, *Are Equity Crowdfunding Regulations too Light-Handed?*, NAT'L BUS. REV., June 12, 2017 [hereinafter Smylie, *Crowdfunding Regulations too Light-Handed?*]; *see also, e.g.*, Clear Comm's, Ltd. v. Telecomm. Corp. of N.Z., CP590/91, 22 Dec. 1992 (using the term in the antitrust context).

208. *See* Smylie, *Equity Crowdfunding Limit?*, *supra* note 123 (describing New Zealand's crowdfunding regime as "relatively liberal" (quoting New Zealand government official)); Interview with Colin Magee, Head of Conduct, N.Z. Fin. Markets Auth., in Auckland, N.Z. (Feb. 24, 2017).

209. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1461–62, 1464 (explaining these two provisions of the CROWDFUND Act).

210. Interview with James Hartley, *supra* note 198.

211. *See* Financial Markets Conduct Regulations 2014, reg. 186(1) (N.Z.) (providing the eligibility requirements for licensing from the FMA for crowd funding service providers).

212. *See id.* reg. 186(1)(g) (requiring service providers must have procedures to ensure issuers do not raise more than $2 million (New Zealand dollars) per year).

213. *See* Taylor Burgess & Caitlin Hollings, Legislation Note, *Financial Markets Conduct Act 2013*, 20 AUCKLAND U. L. REV. 290, 295 (2014) (explaining the FMA's exclusion of peer-to-peer lending platforms from disclosure requirements and use of a licensing process to provide protections for the general public).

214. *See id.* (noting that the FMA utilizes a licensing process for the platforms as its main form of supervision).

Another key difference between the crowdfunding laws in the United States and New Zealand is that the JOBS Act imposes an annual cap on the amount that any individual may invest through crowdfunding.[215] The precise amount depends on one's income and net worth, but for the average person it would work out to be about $3,000-$5,000 in all crowdfunding companies each year, and only slightly more for even very wealthy investors.[216] An investor cap is a standard practice in crowdfunding laws around the world—Australia's statute includes a cap of AU$10,000 per company,[217] for instance—and it is there to protect investors from losing more than they can afford. New Zealand, in its light-handed way, has no investor cap at all![218] People are free to invest as much as they wish in as many companies as they wish.

C. Policy Goal: Efficiency (and Not Inclusivity)

New Zealand's crowdfunding law is directed at the singular policy goal of efficiency, and is not directly concerned with advancing an inclusive model of entrepreneurship.[219] New Zealand's crowdfunding law, unlike the JOBS Act, was not intended to advance the cause of inclusive entrepreneurship.[220]

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215. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1461 (stating the U.S. law set limitation upon both issuers and investors).

216. The JOBS Act defines the annual investor cap for those whose annual income or net worth is below $100,000 as the greater of $2,000 or 5% of their annual income or net worth (10% for people with an annual income and net worth over $100,000, up to an absolute cap of $100,000 per year). 15 U.S.C. § 77d(a)(6)(B) (2012). To offer an example, someone with an annual income of $500,000 and a net worth of $5 million may legally invest up to $50,000 per year (10% of the lesser) in all crowdfunding issuers.

217. *See Corporation Amendment (Crowd-sourced Funding) Act 2017* ss 738ZC (Austl.) (setting the Australian investment cap).

218. This was a conscious departure from the model of the JOBS Act. Interview with James Hartley, *supra* note 198; Interview with Hayley Buckley, Partner, Wynn Williams, in Auckland, N.Z. (May 18, 2017).

219. Interview with Colin Magee, *supra* note 208; Interview with James Hartley, *supra* note 198; Interview with Simeon Burnett, CEO, Snowball Effect, in Auckland, N.Z. (Feb. 27, 2017).

220. *See supra* notes 129–130 and accompanying text (explaining the original intention that the JOBs Act would open up potential investment for "anyone who can convince the public he has a good business idea").

This is not because New Zealand is opposed to an inclusive economy—if anything, the contrary is true.[221]

Rather, the focus on efficiency stems from the fact that the country has long suffered from a dearth of venture capital and angel investment,[222] to the point that even highly promising startup companies had trouble getting the capital they need to survive and grow.[223] New Zealand looked to equity crowdfunding to serve as an efficient and significant source of early-stage finance for promising startup companies.[224] It could not afford to potentially reduce the efficiency of the system by trying to make it inclusive as well.

Unlike in the United States, where talented entrepreneurs can obtain several million dollars from any of a number of well-established VC funds and so-called angel investors,[225] New Zealand has long had a much shallower pool for early-stage capital financing.[226] Angel investors, for their part, have traditionally been almost non-existent: The New Zealand Angel Association was not established until 2008,[227] and at the time of the FMCA, angels were investing just NZ$30 million per year in all New Zealand

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221. *See, e.g.*, Treasury Inclusive Economy Working Group, *Towards an Inclusive Economy*, (New Zealand Treasury, Working Paper 01/15, July 2001), http://www.treasury.govt.nz/publications/research-policy/wp/2001/01-15 ("[S]et[ting] out the Treasury's thinking on how the Government can achieve its goal of an inclusive economy."); *cf.* FISCHER, *supra* note 178, at 476 ("New Zealanders are more mindful of fairness, justice, and equity [than are Americans] . . . .").

222. *See supra* notes 226–233 and accompanying text (discussing the slow growth of angel investors and venture capitalism in New Zealand).

223. Interview with Simon Papa, Principal, Cygnus Law, in Auckland, N.Z. (Feb. 7, 2017); Interview with Hayley Buckley, *supra* note 218.

224. Interview with Simon Papa, *supra* note 223; Interview with Hayley Buckley, *supra* note 218.

225. *See* Darian M. Ibrahim, *The (Not So) Puzzling Behavior of Angel Investors*, 61 VAND. L. REV. 1405, 1419 n.57 (2008) ("In 2006, angels and venture capitalists each invested approximately $25 billion.").

226. *See* New Zealand Government, *Building Capital Markets*, 23 (Feb. 2013) ("[I]t is often difficult for New Zealand businesses to raise sufficient risk capital in our relatively thin markets."); Smylie, *Equity Crowdfunding Limit?*, *supra* note 123 ("[T]here is a hole in the capital markets.").

227. *See Our Role*, ANGEL ASS'N N.Z., https://www.angelassociation.co.nz/our-role/ (last visited Jan. 12, 2018) (providing the start date of the organization) (on file with the Washington and Lee Law Review).

companies.[228] By way of comparison, American angels were investing over $9 billion per year at that time.[229]

As for venture capital, New Zealand had "no venture capital market" at all, as recently as the late 1990s.[230] In 2002, the New Zealand government attempted to jump-start the domestic VC industry by establishing a state-run VC fund-of-funds in 2002, called the New Zealand Venture Investment Fund (NZVIF).[231] Despite the addition of the NZVIF, New Zealand VC funds continued to "struggl[e] to get the cash they needed to maintain the rapid growth of the small, precocious and risky companies in their portfolios."[232] "Then the international finance crisis hit," and VC "funding came to a grinding halt."[233]

In 2012, the year that crowdfunding was authorized as part of the FMCA, the lack of VC financing remained a major problem.[234] As a NZVIF report from that year explained, "A major issue for New Zealand's capital markets is the lack of sufficient capital to meet the needs of young high growth companies. . . . $200 million of investment capital is needed each year to meet the existing demand, over double what is currently available."[235] Even recently,

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228. *See Consolidating Angels Hold Their Own*, NZ YOUNG CO. FIN., Issue 14, Apr. 2013, at 1, http://www.angelassociation.co.nz/media/2014/04/Young_Company_Finance_Issue_14_April_2013.pdf (providing investment information for angel investors in New Zealand).

229. *Id.* at 5.

230. N.Z. VENTURE INV. FUND LTD., STATEMENT OF INTENT: 2014–2019, at 2, https://www.nzvif.co.nz/assets/publications/Statement-of-Intent-2014.pdf; *see also* JOSH LERNER ET AL., LECG, A STUDY OF NEW ZEALAND'S VENTURE CAPITAL MARKET AND IMPLICATIONS FOR PUBLIC POLICY: TO THE MINISTRY OF RESEARCH, SCIENCE AND TECHNOLOGY 4, 63 (2005), https://pdfs.semanticscholar.org/5ed8/580c2f1e003da67f9c400354a51cd8b01fcb.pdf (stating that prior to 2002, "there was a virtual absence of dedicated venture capital funds operating in New Zealand").

231. N.Z. VENTURE INV. FUND LTD., *supra* note 230, at 2.

232. Mike Booker, *The State of Venture Capital in New Zealand*, IDEALOG (Jan. 30, 2009), https://idealog.co.nz/venture/2009/01/show-us-the-money (last visited Feb. 17, 2018) (on file with the Washington and Lee Law Review).

233. *Id.*

234. *See* NZVIF, DISCUSSION PAPER: INSTITUTIONAL INVESTMENT IN VENTURE CAPITAL AND PRIVATE EQUITY IN NEW ZEALAND 1 (2012), https://www.nzvif.co.nz/assets/publications/Institutional-Inv-Discussion-Paper-Sept12.pdf (remarking on the continued lack of institutional participation in the venture capital and private equity markets).

235. *Id.*

New Zealand's volume of VC investment—scaled as a percentage of GDP—is just 8% that of the United States.[236]

Thus, a key policy goal of the New Zealand government when it passed the FMCA was to address the lack of early-stage entrepreneurial finance in the country, and it decided to use equity crowdfunding to ameliorate this problem. In its "Business Growth Agenda Progress Report" from 2013, the government recognized that "it is often difficult for New Zealand businesses to raise sufficient risk-capital in our relatively thin markets,"[237] and pointed to the crowdfunding authorization in the FMCA as a way to increase access to startup financing in an efficient manner.[238] In other statements, the government repeatedly reiterated that its policy goal for authorizing equity crowdfunding was to encourage efficient and effective capital raising for startups and small businesses.[239] Notably absent from these discussions was any talk

236. *See* OECD ENTREPRENEURSHIP AT A GLANCE 2016, at 137, http://dx.doi.org/10.1787/entrepreneur_aag-2016-graph119-en (graphing venture capital investments as a percentage of GDP); *see also* Smylie, *Equity Crowdfunding Limit?*, *supra* note 123 ("Without a doubt, the capital markets infrastructure for companies raising less than $10 million is sparse. Until the large brokers kick in for deals of more than $10 million, there just isn't an efficient distribution channel to tap into the capital markets.").

237. New Zealand Government, *supra* note 227, at 23.

238. *See id.* ("The Government's updated securities legislation provides explicit mechanisms for regulating new forms of intermediated capital raising, such as . . . 'crowd funding'. These enable funds for small businesses . . . to be raised in internet-based market places, potentially more efficiently than through traditional public or private offerings."); CABINET BUS. COMM., FINANCIAL MARKETS CONDUCT REGULATIONS PAPER 4—LICENSING REGIMES, ¶ 124, at 16, http://www.mbie.govt.nz/info-services/business/business-law/financial-markets-conduct-act/regulations/financial-market-conduct-regulations-decisions-june-2013/documents-images-library/Paper%204%20-%20licensing.pdf ("Enabling crowd-funding was highlighted in the Government's Business Growth Agenda as an initiative to support early-stage and growth companies to access the risk-capital they need to grow."); Hayley Buckley, *Exploding the Crowdfunding Myths*, NAT'L BUS. REV., Apr. 12, 2014 (observing that the crowdfunding provision in the FMCA responds to the "significant gap in the market for companies looking to raise funds").

239. *See* Press Release, Craig Foss, N.Z. Commerce Minister, Foss Welcomes First Crowd-funding License (July 31, 2014) ("New Zealand needs more innovative businesses to increase economic growth—[equity crowdfunding] is one way for early-stage and growth companies to source the risk capital they need to flourish. . . . [Equity crowdfunding is] part of the Government's Business Growth Agenda to build New Zealand's capital markets and drive business growth, exports and jobs . . . .") (on file with the Washington and Lee Law Review); *see*

of how crowdfunding could be an inclusive form of startup finance. Rather, the focus was entirely on efficiency and addressing the insufficient funding from VCs and angel investors.

Finally, New Zealand's focus on efficiency rather than inclusivity is directly expressed in the FMCA's statement of purpose, found in Sections 3 and 4 of that statute.[240] The word and concept of inclusivity is nowhere to be found in those Sections; rather, the emphasis is on efficient capital raising in order to promote economic growth.[241] In sum, the policy goal behind New Zealand's authorization of equity crowdfunding in the FMCA was efficiency: The government sought to generate a helpful new source of venture finance for promising startup companies.[242]

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also Press Release, Craig Foss, N.Z. Commerce Minister, *NZ Financial Markets Enter New Era*, (Apr. 1, 2014) ("Today's changes [including equity crowdfunding] will support confident and informed participation by businesses, investors and consumers in New Zealand's financial markets. It is important that we have clear rules for companies wishing to raise capital . . . .") (on file with the Washington and Lee Law Review); CABINET BUS. COMM., FINANCIAL MARKETS CONDUCT REGULATIONS PAPER 1: OVERVIEW, at 2, ¶ 11, http://www.mbie.govt.nz/info-services/business/business-law/financial-markets-conduct-act/regulations/financial-market-conduct-regulations-decisions-june-2013/documents-images-library/Paper%201%20-%20overview.pdf (explaining that the FMCA seeks to "promot[e] innovation and new sources of capital . . . by providing for . . . crowd-funding platforms").

240. *See* New Zealand Financial Markets Conduct Act 2013, pt 1, s 3 (N.Z.) ("The main purposes of this Act are to—(a) promote the confident and informed participation of businesses, investors, and consumers in the financial markets; and (b) promote and facilitate the development of fair, efficient, and transparent financial markets."); *id.* s 4.

> This Act has the following additional purposes: (a) to provide for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products or the provision of financial services: (b) to ensure that appropriate governance arrangements apply to financial products and certain financial services that allow for effective monitoring and reduce governance risks: (c) to avoid unnecessary compliance costs: (d) to promote innovation and flexibility in the financial markets.

241. *See* Thomas Gibbons, *Purpose and Principles of Securities Regulation* 11–12, 16 (interpreting the FMCA statement of purpose as "emphasi[zing] capital raising and economic growth" because "[s]ound financial markets—productive, successful financial markets—have the potential to be of significant benefit to the New Zealand economy"), *in* FINANCIAL MARKETS CONDUCT REGULATION: A PRACTITIONER'S GUIDE, *supra* note 190.

242. *But cf.* FISCHER, *supra* note 178, at 476 ("Americans think of an open society as a free society, centered primarily on the values of liberty and freedom that are deeply rooted in American history. New Zealanders are more mindful of fairness, justice, and equity, which have long been an important part of their

IV. Efficient Versus Inclusive Crowdfunding: A Comparative Analysis of New Zealand and the United States

From the outset, New Zealand sought to establish an efficient market for crowdfunding, while the United States tried to create a crowdfunding market that was both efficient and inclusive. New Zealand deputized crowdfunding platforms to act as gatekeepers in order to protect investors from investing in companies that were either fraudulent or unlikely to succeed. But the United States, at least initially, envisioned a system where platforms would be passive entities required by law to allow any and every entrepreneur onto their site. Without an active gatekeeper on duty, Congress reasonably concluded that it had better demand significant mandatory disclosure and other regulations in order to protect investors. Of course, the SEC did ultimately empower platforms to act as gatekeepers, but that was years later and during the regulatory process.[243] The unhappy result is that although the SEC tried to downgrade inclusivity in an attempt to enhance efficiency, the inefficiencies were already baked into the statute.

A. Crowdfunding in New Zealand is More Efficient but Less Inclusive

With its laser-like focus on efficiency, New Zealand has created a crowdfunding market that is much more financially successful than its counterpart in the United States. This Section reports on the results of the New Zealand crowdfunding market, and compares those results with both the American crowdfunding experience as well as New Zealand venture capital and angel investment.[244] As will appear, the New Zealand model has turned out to be rather efficient, generating a relatively large amount of startup capital and avoiding fraud, and is handily outpacing the United States in economic terms.[245]

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experience.").

243. *Supra* Part I.D.

244. *See infra* Sections III.A.1–4 (providing statistical comparisons of the New Zealand and U.S. crowdsourcing platforms).

245. *See* John Anthony, *New Zealand crowdfunding platforms gearing up for*

The data in this Section is based on the first year of equity crowdfunding in New Zealand, which ran from mid-2014 through mid-2015.[246] Although New Zealand has been conducting crowdfunding for over three years, the focus here is on the first year so as to allow a comparison with the United States, which has only one year of experience.[247] In addition, the second year of New Zealand equity crowdfunding had similar results as the first.[248]

In the first year of equity crowdfunding in New Zealand, there were 27 crowdfunding campaigns in total, 21 of which were successful, representing a 78% success rate.[249] Those 21 successful campaigns raised a cumulative total of NZ$12 million (US$10 million).[250] The average successful raise was NZ$590,000 (US$470,000), and two campaigns reached the legal limit of NZ$2

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big 2016, STUFF, http://www.stuff.co.nz/business/industries/75424341/new-zealand-crowdfunding-platforms-gearing-up-for-big-2016 (last updated Jan. 24, 2016) (last visited Dec. 28, 2017) (quoting Simeon Burnett, CEO of Snowball Effect, describing equity crowdfunding as "really efficient") (on file with the Washington and Lee Law Review).

246. *See New Zealand Equity Crowdfunding 1st Year in Review*, CROWDREADY (Aug. 18, 2015), http://www.crowdready.com.au/news-1/2015/8/new-zealand-equity-crowdfunding-1st-year-in-review (last visited Jan. 2, 2017) [hereinafter *1st Year in Review*] (reporting on the first year of equity crowdfunding in New Zealand, which commenced when the first licenses were issued on July 30, 2014) (on file with the Washington and Lee Law Review).

247. *See generally* U.S. SEC. & EXCH. COMM'N, REGULATION CROWDFUNDING: A SMALL ENTITY COMPLIANCE GUIDE FOR ISSUERS (2016) (noting that American crowdfunding commenced on May 16, 2016).

248. *See* Calida Smylie, *Equity Crowdfunding Numbers Slump After First Year*, NAT'L BUS. REV. (Nov. 7, 2014), https://www.nbr.co.nz/article/equity-crowdfunding-numbers-slump-after-first-year-cs-p-196346 [hereinafter Smylie, *Crowdfunding Numbers Slump*] ("New Zealand's equity crowdfunding market has just completed its second full year and, on the face of it, the numbers look a little flat."); *New Zealand Equity Crowdfunding 2nd Year in Review*, CROWDREADY (Oct. 16, 2016), http://www.crowdready.com.au/news-1/2016/10/nz-equity-crowdfunding-2nd-year-in-review (last visited Jan. 2, 2018) [hereinafter *2nd Year in Review*] (reporting on New Zealand's second year of crowdfunding) (on file with the Washington and Lee Law Review).

249. *See 1st Year in Review*, *supra* note 246 (discussing that the results were very positive given the historic difficulty in raising capital).

250. *See id.* (noting the amount raised in over twenty-one New Zealand companies). The currency conversions in this Section are based on a 0.8 conversion rate between US and NZ dollars, which was the approximate rate at the time in question (2014–2015), and are rounded for the sake of simplicity.

million.[251] Technology, consumer products and food and beverages were the most popular industries.[252]

These numbers, while seemingly modest, are significant when compared to the traditional forms of startup finance in New Zealand, namely VC and angel investors. In 2014, which was the year crowdfunding commenced, New Zealand angels invested NZ$56 million in 118 deals—a record high.[253] New Zealand venture capital funds contributed almost precisely the same amount that year, NZ$56 million in total, spread across 62 investments.[254] Equity crowdfunding's total of NZ$12 million over 21 investments represent a significant contribution of entrepreneurial capital for New Zealand startup companies.[255]

New Zealand's equity crowdfunding market is even more impressive when compared to its counterpart in the United States. In its first year of operation, from mid-2016 to mid-2017, there were 211 crowdfunding campaigns in the United States, 112 of which were successful, representing a 53% success rate.[256] Those 112 successful campaigns raised a cumulative total of about $35 million.[257] The average successful raise was about $300,000, and nine campaigns reached the legal limit of $1 million.[258] Similar to

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251. *See id.* (stating that six other companies reached their own lower, self-imposed maximum targets).

252. *See id.* ("Industry wise, the technology companies represented the most number of campaigns with 43% whilst the food/beverage raised the most money in New Zealand with $3.8 million despite only 17% of campaigns being companies in this industry.").

253. *See* N.Z. MINISTRY OF BUS. INNOVATION & EMP'T, BUSINESS GROWTH AGENDA: BUILDING INVESTMENT 2 (2015) (noting strong activity in early-stage capital markets).

254. *See* N.Z. PRIVATE EQUITY & VENTURE CAPITAL ASS'N, NEW ZEALAND PRIVATE EQUITY AND VENTURE CAPITAL MONITOR: 2014 FULL YEAR REVIEW 7 (2014) (detailing venture and early stage investment).

255. *See id.* at 8 (charting early stage investments by sector).

256. *CCA Regulation Crowdfunding Indices*, CROWDFUND CAP. ADVISORS, http://crowdfundcapitaladvisors.com/cca-reg-cf-index/ (focusing on Charts 1 and 3 as of May 15, 2017, one year after crowdfunding commenced in the United States) (on file with the Washington and Lee Law Review).

257. *See CCLEAR Dashboard*, CROWDFUND CAP. ADVISORS (July 28, 2016), http://crowdfundcapitaladvisors.com/cclear_public (last visited Jan. 10, 2018) (reporting a total of about $35 million) (on file with the Washington and Lee Law Review).

258. *See id.* (noting the average campaign success).

New Zealand, technology and food and beverages were among the most popular industries.[259]

When comparing New Zealand and American crowdfunding, one must account for the fact that the American economy is about 100 times as large as that of New Zealand.[260] If we scale the New Zealand crowdfunding numbers up by a factor of 100, then the number of campaigns would have been 2,700 (2,100 of which were successful), and the successful campaigns would have raised a total of US$1 billion.[261] Recall that the United States had only 211 campaigns (112 successful ones), raising a total of $35 million.[262] In other words, scaled for the size of its economy, New Zealand had about *thirteen times as many campaigns* as the United States; New Zealand companies had a *success rate of nearly 80%*, compared to the American rate of about 50%; and New Zealand issuers raised about *thirty times as much money* as did their American counterparts.[263] These numbers are remarkable.

Furthermore, in the brief history of New Zealand crowdfunding, not a single funded company was revealed to be a fraud, and there has been just one liquidation.[264] Now, this time period is relatively brief, and the overall New Zealand economy has been strong over those three years, so these aspects of the results must be taken with a grain of salt. Fraud and poor business performance could be occurring at crowdfunded companies and we

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259. *See 1st Year in Review*, *supra* note 246 (outlining New Zealand's most successful crowdfunding industries).

260. *See* WORLD BANK, GROSS DOMESTIC PRODUCT RANKING 1 (2016) (reporting that the United States has the largest GDP while New Zealand has the fifty-first largest GDP). In U.S. dollars, the GDP of the United States is about $18 trillion and the GDP of New Zealand is about $184 billion.

261. *See id.* (noting the significant difference between the size of the two economies).

262. *See supra* note 256 and accompanying text (discussing the first year U.S. crowdfunding campaigns).

263. *See supra* notes 248–262 (outlining New Zealand's crowdfunding statistics).

264. *See* Interview with Colin Magee, *supra* note 209; Paul McBeth, *Balex Marine, Snowball Crowdfunder Participant, Sunk by High Costs, Slow Sales*, NAT'L BUS. REV. (May 17, 2017), https://www.nbr.co.nz/article/balex-marine-snowball-crowdfunder-participant-sunk-high-costs-slow-sales-b-203033 (last visited Feb. 17, 2018) (reporting on the first crowdfunding company to liquidate) (on file with the Washington and Lee Law Review).

would not necessarily know about it.[265] It also bears noting that dividends are practically nonexistent among New Zealand crowdfunded companies, and that we have yet to see any IPOs or other sort of remunerative "exit" for the investors.[266]

At the same time, zero instances of fraud after three years is a record that New Zealand should be proud of. In other countries with active equity crowdfunding markets, fraud has revealed itself fairly promptly,[267] but this has not happened in New Zealand. Thus, it remains impressive for New Zealand crowdfunding to have generated a perfect record regarding fraud, and a near-perfect record regarding business failures, to date.

In sum, New Zealand set out to create a highly efficient system of equity crowdfunding that would funnel capital to promising startups that need it.[268] It was not distracted by any other policy goals, most notably inclusivity.[269] And the data presented in this Section show that New Zealand has largely succeeded in achieving its singular goal of creating an efficient market for equity crowdfunding.[270]

How did New Zealand generate such an efficient equity crowdfunding market? First, New Zealand's law and regulations are liberal and simple, thus imposing much lower compliance costs than the JOBS Act and related regulations.[271] Second, and more

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265. *See* Nathaniel Popper, *Doubts Arise as Investors Flock to Crowdfunded Start-Ups*, N.Y TIMES (Jan. 24, 2017), https://www.nytimes.com/2017/01/24/business/dealbook/crowdfunding-fraud-investing-startups.html (last visited Mar. 8, 2018) (noting that fraud found in crowdfunding may be easily overlooked by investors) (on file with the Washington and Lee Law Review).

266. *See Equity Crowdfunding in New Zealand*, CROWDSPHERE, https://crowdsphere.co.nz/ (last visited Jan. 10, 2018) (detailing risks of investment including illiquidity, lack of dividends, loss of investment and dilution) (on file with the Washington and Lee Law Review).

267. *See, e.g.,* James T. Areddy, *Chinese Pile On Risk, One Swipe at a Time*, WALL ST. J., Mar. 29, 2017, at A1 (describing investigations into fraud and sharp dealing in the China crowdfunding industry).

268. *See supra* Part II.A (comparing New Zealand's crowdsourcing strategy to United States crowdfunding).

269. *See supra* Part II.C (outlining New Zealand's policy goal of efficiency over inclusivity).

270. *See infra* Part III.A.1–4 (providing statistics on the efficiency of New Zealand's system).

271. *See supra* Part I.B (discussing compliance costs under the U.S. crowdfunding policies).

importantly for present purposes, New Zealand's crowdfunding system depends on private actors to organize the market, keep it honest, and make it work well, all without direct participation on the part of the government.[272] As expected, market participants have indeed established numerous effective modes of private ordering or private governance, including "gatekeepers," "syndication," "pre-existing crowds," and "reputation."[273] As will be seen, these techniques have the side effect of diminishing entrepreneurial inclusivity, which is not a problem in New Zealand, but it may be in the United States.

1. Gatekeepers

New Zealand's law envisions that the licensed crowdfunding platforms would act as strict "gatekeepers" and only allow legitimate and promising companies to access the crowd. The model is one of market-based incentives, rather than regulatory commands.[274] Platforms have a self-interest in establishing and maintaining an online reputation as a reliable place for investors to put their money.[275] If they allow fraudulent or low-quality companies onto their site, and investors lose their money, the investors will not come back and the platform will go out of business.[276] Knowing all this, platforms can be expected to only invite legitimate and sound companies to participate on their

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272. *See generally* Schwartz, *Crowdfunding in New Zealand*, *supra* note 18.

273. *See infra* Part III.A.1–4 (outlining critical elements of New Zealand's crowdfunding program).

274. *See* Mackenzie McCarty, *Cabinet Gives Green Light to Equity Crowdfunding*, N.Z. LAW (Feb. 28, 2014), https://www.nzlawyermagazine.co.nz/news/cabinet-gives-green-light-to-equity-crowdfunding-184672.aspx (last visited Feb. 17, 2018) (noting that the system incentivizes crowdfunding platforms to have reputable companies to avoid failures) (on file with the Washington and Lee Law Review).

275. *See* Interview with Simeon Burnett, *supra* note 219 (describing reputation as a driver).

276. *See* McCarty, *supra* note 274 (quoting Hayley Buckley as saying, "[i]t's . . . really going to be quite self-fulfilling, because the platform will be incentivised to have the best companies—they really don't want any failures on their platforms. And that's aligning them absolutely with the interests of investors").

site.[277] The platform's gatekeeping role thus protects investors and gives them the confidence to participate in the market.[278]

This gatekeeper model may well be an efficient system, and the results discussed above suggest it is, but it is plainly not inclusive. The effect is that entrepreneurs are not allowed to go directly to the crowd and solicit funds; rather, they do have to impress the platform's management to get their chance to crowdfund.[279] This is the polar opposite of the inclusive vision found in reward crowdfunding and the original version of SEC Rule 402(b)(1), where entrepreneurs would go straight to the crowd and it would decide whom to support.[280]

In practice, New Zealand platforms take their gatekeeper role seriously and are very selective in deciding which companies to allow to list on their site.[281] They understand perfectly well how vital it is to protect their reputation and accordingly exclude companies that are unlikely to succeed, or that have any chance of being fraudulent. Snowball Effect, for instance, lists only 2% of the hundreds of companies that want to crowdfund on their site, "mostly because they're not investment ready."[282] The platform is selective because, according to the company, "we've got our own reputation [to protect and because] we want investors to get what

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277. *See id.* (discussing the strict licensing process).

278. *See id.* ("It's [also] really going to be quite self-fulfilling, because the platform will be incentivised to have the best companies—they really don't want any failures on their platforms. And that's aligning them absolutely with the interests of investors." (quoting Hayley Buckley)); Interview with Hayley Buckley, *supra* note 218.

279. *See* Josh Daniell, *Do We Still Call it Equity Crowdfunding?*, SNOWBALL EFFECT (Oct. 6, 2016), https://nzbusiness.co.nz/article/do-we-still-call-it-equity-crowdfunding (last visited Feb. 17, 2018) (discussing the process for connecting investors and companies) (on file with Washington and Lee Law Review).

280. *See supra* notes 234–235 and accompanying text (detailing that funding portals were originally almost completely passive entities and could not subjectively screen crowdfunding offers).

281. *See* Interview with Simeon Burnett, *supra* note 219 (discussing the rigorous listing requirements).

282. *See* Smylie, *Crowdfunding Regulations too Light-Handed?*, *supra* note 207 ("98% of companies we point in another direction.") (quoting Snowball Effect co-founder, Josh Daniell); Anthony, *supra* note 245 ("Snowball Effect had been approached by hundreds of companies wanting to crowdfund but it was selective about which were chosen for the platform.").

we think are interesting opportunities that are ready for public investment."[283]

This focus on selectivity, rather than inclusivity, is not unique to Snowball Effect, but is rather standard practice in the industry.[284] A founder of another equity crowdfunding platform was quoted as saying, "I think everyone's being really selective about what offers they're putting in the market to make sure there is a higher probability of success."[285] This line of thinking has been criticized by some, including the founder of yet another platform, who wished that New Zealand would have embraced a more inclusive model: "The only way to maintain a high success rate is for the platform to cherry-pick offers they think will succeed. If that's the case, then really you are just mirroring the current finance models—entrepreneurs end up convincing an individual gatekeeper, not testing their idea on the crowd."[286]

A seeming exception to the general practice is found in PledgeMe, an equity crowdfunding platform that tries to be inclusive and "welcomes all businesses to use its platform": "We don't tell people that they can't crowdfund but we definitely give them feedback on areas they might want to look at before they go live."[287] However, even PledgeMe screens companies that ask to list on the site by putting each one through a multi-week one-on-one course called "Crowdfunding U[niversity]" before allowing them to use the site.[288] Given that nearly half of the

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283. *See* Anthony, *supra* note 245 ("We need to make sure that companies are suitable for our offering and a lot of companies aren't." (quoting Snowball Effect co-founder Josh Daniell)).

284. *See* Nathan Rose & Josh Daniell, *Angel Investors Join the Crowd*, ASSEMBLE ADVISORY ("Each equity crowdfunding marketplace [in New Zealand] is 'curated' or 'vetted' to some extent.").

285. *See* Brendan Manning, *Riding the New Wave of Equity Raising*, N.Z. HERALD, July 23, 2015 (quoting David Wallace, founder of the Crowdcube equity crowdfunding platform).

286. *See* Calida Smylie, *Younger Crowdfunding Platforms Fail to Gain Traction*, NAT'L BUS. REV. (Oct. 5, 2015), https://www.nbr.co.nz/article/younger-crowdfunding-platforms-fail-gain-traction-cs-p-179663 (quoting Adam Hunt, founder of the Liftoff equity crowdfunding platform); Interview with Adam Hunt, Founder, Liftoff, in Auckland, N.Z. (Apr. 7, 2017).

287. Anthony, *supra* note 245; *see generally also* Interview of Anna Guenther, CEO, PledgeMe, in Wellington, N.Z. (June 19, 2017); Interview of Barry Grehan, Chief Lending Officer, PledgeMe, in Auckland, N.Z. (Feb. 24, 2017).

288. *See Crowdfunding University*, PLEDGEME, http://guide.pledgeme.co.nz/

companies drop out before completing the course,[289] this acts as an effective way to separate the wheat from the chaff.

In sum, rather than allowing every entrepreneur to "have a go," the platforms act as strict gatekeepers that only allow a select few to access the crowd.[290] This is efficient, but not inclusive, from the perspective of an entrepreneur.

2. Syndication

Syndication is where the crowd invests alongside a large and sophisticated "lead" investor, and is a method borrowed directly from angel investors.[291] Under this model, one "active" or "lead" angel, presumably an expert in the relevant industry, researches a company and the proposed terms of investment, and then reports back to the rest of the angels in the group.[292] The other angels in the group play a "passive" role; they trust in the expertise and diligence of the lead angel.[293]

The distinctive legal regime in New Zealand has allowed for syndication to develop as a key method for privately regulating its equity crowdfunding market. Unlike the United States (as well as practically every other country), New Zealand's crowdfunding law imposes no cap on the amount an investor may contribute.[294] This was a conscious decision on the part of the government and specifically designed, at least in part, to facilitate large

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crowdfundingu (last visited Jan. 11, 2018) (detailing the site's training program for new companies) (on file with the Washington and Lee Law Review).

289. Interview with Barry Grehan, *supra* note 287.

290. *See supra* notes 282–289 and accompanying text (noting that the selectivity is a defining feature of the system).

291. *See* Dale A. Oesterle, *Intermediaries in Internet Offerings: The Future is Here*, 50 WAKE FOREST L. REV. 533, 542 (2015) ("The syndicates shadow trade, as coinvestors, on the trades of 'lead angels' or 'angel advisers.'").

292. *See id.* at 542–43 ("[T]he angel takes the lead in identifying the investment opportunity and negotiating the terms on behalf of their syndicate.").

293. *See id.* at 543 (noting that passive investors are able to observe and follow in the angels' lead).

294. *See supra* note 217 and accompanying text (stating that the U.S. puts a cap on the investment to prevent investors from risking more than they can afford).

investments by lead investors and syndication by the rest of the crowd—just like in traditional angel investing.[295]

Hence under New Zealand law an angel investor is legally permitted to invest hundreds of thousands through a crowdfunding campaign, making it cost-effective to undertake the burden of acting as a lead investor.[296] The lead investor often makes a very sizable investment herself, sometimes as much as $500,000 at a time.[297] Such an amount would be unlawful under American law, but it is perfectly legal in New Zealand. In practice, lead investors have become a very important component of the equity crowdfunding marketplace.[298] Like in an angel group, the lead investor conducts research on the company and the rest of the crowd comes along for the ride. Professional investors, including angels and VCs, sometimes play the role of cornerstone investor.[299] They serve to lend credibility to an offer; others take the fact that someone has bought a large block of shares as a signal that the company is sound and the valuation is fair.[300] Commonly, a lead investor will arrange in advance to contribute a large sum to a crowdfunding campaign, thus providing it with momentum from the first day.

The experience in New Zealand shows that lead or cornerstone investors have become an important component of the crowdfunding marketplace.[301] As the market has matured, and the

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295. *See* Interview with James Hartley, *supra* note 198 (noting the similarities to angel investing).

296. *See* Oesterle, *supra* note 291, at 543 ("The lead angels' or angel advisers' economic incentive to participate is a form of carried interest, a slice of the profits of the syndicate returns.").

297. Interview with Simeon Burnett, *supra* note 219.

298. *Id.*

299. *See* Smylie, *Crowdfunding Numbers Slump*, *supra* note 248 (describing "at least four campaigns [as] being partially led by a professional investor"); Manning, *supra* note 285 ("We're seeing some angels and VCs integrating equity crowdfunding as a step in their investment strategy.").

300. *See* Shaun Edlin, *Pre-arranged Capital and Momentum: Is Real Money Being Raised Through Online Marketplaces?*, SNOWBALL EFFECT (Aug. 24, 2016), https://www.snowballeffect.co.nz/blog/lessons-weve-learnt-about-momentum (last visited Jan. 11, 2018) (noting that a lead investor helps validate the offer price) (on file with the Washington and Lee Law Review). *See generally* Interview with Simeon Burnett, *supra* note 219.

301. *See* Edlin, *supra* note 300

We encourage companies raising through Snowball to seek a credible importance of cornerstone investors has become clearer, the average number of investors in successful campaigns dropped from 152 in the first year to 82 in the second year, and the average investment amount increased 65%.[302] A knowledgeable observer explained this change as a direct consequence of the participation of cornerstone investors contributing NZ$100,000 to NZ$400,000 to a single campaign.[303]

In the United States, syndication is not a viable model for crowdfunding due to the structure of the securities crowdfunding law in place there. The JOBS Act places a low legal limit on the total amount that a person may invest in all crowdfunding companies each year.[304] The upshot is that most Americans are limited to about $3,000–$5,000 per year or less—and this amount is not per investment, but rather per year—making it economically infeasible for any one person to take on the role of lead investor.[305] The investor cap is simply too low to make it worthwhile for a lead angel to spend the time and effort it takes to find an appropriate investment and conduct adequate due diligence.

On the whole, cornerstone investors are an important component of the New Zealand equity crowdfunding market. Their presence is a significant factor in whether an offer will succeed in

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> investor to lead their offer. . . . To date, only three offers through our marketplace have failed to reach their minimum investment target. [T]he one thing all three offers had in common was that they lacked a credible lead investor for the round.

See also Interview with Hayley Buckley, *supra* note 218.

302. *See* Smylie, *Crowdfunding Numbers Slump*, *supra* note 248 (noting that the average investment amount increased 65%).

303. *See id.* (emphasizing the impact of the presence of a professional investor).

304. *See supra* note 217 and accompanying text (stating that the average limit does not exceed $5,000).

305. *See* 15 U.S.C. § 77d (2012) (placing limits on amounts sold to investors per year). The JOBS Act defines the annual investor cap as 5% of the lesser of one's annual income or net worth (10% for people with an annual income and net worth over $100,000, up to an absolute cap of $100,000). *Id.* Thus, even a wealthy person of the sort who might act as an angel investor would be legally barred from making large investments via crowdfunding. Someone with an annual income of $400,000 and a net worth of $25 million may only legally invest $40,000 per year (10% of the lesser) in all crowdfunding companies. Even someone with an annual income of $5 million and a net worth of $1 billion may only invest $100,000 (the cap) each year. The effect is that wealthy investors effectively cannot participate in crowdfunding in the manner that they would in a traditional angel group.

reaching its financing goal, both because they contribute a large sum and because they encourage other investors to participate.[306] In this way, they have greatly enhanced the New Zealand equity crowdfunding market's efficiency and ability of companies to get funded.

The importance of finding a cornerstone investor, however, makes New Zealand crowdfunding more exclusive than it would otherwise be. All else being equal, platforms are more likely to list a company if it already has a cornerstone investor lined up and ready to contribute, and less likely if the company lacks such an investor.[307] New Zealand's market has thus evolved in a manner that makes it more difficult for those who have trouble finding traditional investors to get their chance to impress the crowd. In other words, while syndication does seem to enhance efficiency, it does so at the cost of inclusivity.

3. Pre-Existing Crowds

The crowdfunding law enacted in the United States expressly prohibits a company from directly advertising their crowdfund offering to potential investors.[308] The apparent rationale for the bar on advertising was that Congress wanted people to make their investing decisions based on the full disclosures mandated under the law, and feared that advertisements might not include all of the required information.[309] Thus the law does allow issuers to direct investors to the online funding platform, where they would find the full set of mandated disclosures.[310] The SEC's regulations implemented this portion of the JOBS Act by providing that issuers may publish simple, textual "tombstone ads" that include

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306. *See supra* notes 282–59 (outlining the benefits of having lead investors).

307. *See supra* notes 301–306 and accompanying text (discussing how New Zealand platforms are more selective when choosing companies to offer to investors).

308. *See* 15 U.S.C. § 77d-1(b)(2) ("[A]n issuer who offers or sells securities [via crowdfunding] shall . . . not advertise the terms of the offering, except for notices which direct investors to the funding portal or broker.").

309. *See* Schwartz, *Crowdfunding Securities*, *supra* note 15, at 1464 (listing the information that issuers are required to provide).

310. *See* 15 U.S.C. § 77d-1(b)(2) (prohibiting any advertising other than notices directing investors to the funding portal).

only the terms of the offering and "direct an investor to the intermediary's platform through which the offering is being conducted, such as through a link."[311]

New Zealand's equity crowdfunding law, in contrast, has no prohibition or limitation on advertising.[312] Rather, the law allows an issuer to advertise, promote and market its offering as it sees fit.[313] This is an important feature of the FMCA, since it enables crowdfunding companies to "activate" their pre-existing crowd of supporters, such as customers or previous investors, to participate in the offering. This is an effective way to jumpstart a crowdfunding campaign and generate momentum off the bat, which as discussed above is vital to successfully reaching the all-or-nothing target.[314] In other words—and this is hardly surprising—by advertising its offering to its supporters, a crowdfunding issuer increases its likelihood of success.

But all of this depends on a company actually having a pre-existing crowd of supporters ready to invest. What about a brand-new startup company with no product, no customers and no ready-made crowd? Those sorts of issuers are much less likely to generate the early momentum needed to reach the all-or-nothing target.[315] And because they are unlikely to succeed, the gatekeeper platforms are unlikely to want them on their site. Thus the effect of the FMCA's permission to advertise is to help established companies succeed in their crowdfunding campaigns, and to marginalize those that lack a pre-existing group of supporters.[316]

By allowing flashy and exciting advertising and other forms of marketing, the New Zealand system enhances efficiency by increasing the success rate of crowdfunding campaigns.[317] At the

311. *See* 17 C.F.R. § 227.204 (2016) (regulating advertising that offerors may issue).

312. *See supra* Part II.B (emphasizing that the FMCA is simpler than the JOBS Act).

313. *See* Financial Markets Conduct Act 2013 st 89–94 (N.Z.) (providing advertising regulations for offers).

314. *See supra* notes 317–92 (noting strategies to initiate campaign momentum to create successful crowdfunding).

315. *See infra* notes 325–93 and accompanying text (discussing the importance of a strong initial campaign launch).

316. *See supra* Part II.B (discussing that the FMCA gives crowdfunding companies great autonomy in conducting offers and advertising).

317. *See* James Murray, *Equity Crowdfunding and Peer-to-Peer Lending in*

same time, it also has the effect of excluding entrepreneurs who are out-of-the-loop and who lack connections—the precise group that crowdfunding was originally intended to include.[318]

Consistent with the FMCA's authorization of advertising, New Zealand equity crowdfunding platforms prefer to list companies that already have a strong network or following, such as customers or prior investors.[319] This enhances efficiency, but is not inclusive in the sense originally advanced in reward crowdfunding and in the SEC's preliminary version of Rule 402(b)(1).[320] To the contrary, it excludes those sorts of entrepreneurs who lack connections and access, those who have not yet tasted success—precisely the group that was crowdfunding originally intended to help.

Experience in New Zealand and elsewhere shows that momentum is key to a successful crowdfunding campaign.[321] Thus to generate that momentum, market participants all agree that it is vital for a campaign to have a pre-arranged set of investors "ready to pledge in the first few hours the campaign is live."[322] In the colorful words of one commenter, "Launching an online equity offer is like making a movie: everything depends on pre-production. If your offer doesn't explode as soon as it goes live, it's probably going to limp to the finish line, or die trying. This means you need to build the buzz before your offer is even live."[323] Thus at Snowball Effect, for instance, "an average of 15.8% of all

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New Zealand: The First Year, 2 JASSA FINSIA J. APPLIED FIN. 1, 7 (2015) (detailing numerous campaigns experiencing high success rates).

318. *See supra* Part I.C.2 (emphasizing that crowdfunding is supposed to give everyone the opportunity to try to raise capital).

319. Interview of Anna Guenther, *supra* note 288.

320. *See supra* notes 226–39 (describing the initial proposal as radically inclusive).

321. *See supra* note 300 and accompanying text (discussing how investors lend credibility to an offer).

322. *See Promoting 101*, PLEDGEME, http://guide.pledgeme.co.nz/promo-1/ (last visited Jan. 8, 2017) (noting how to organize a "cornerstone crowd" on social media) (on file with the Washington and Lee Law Review).

323. Steven Male, *Ultimate Guide to Marketing Your Equity Crowdfunding Offer*, SNOWBALL EFFECT (May 21, 2015), https://www.snowballeffect.co.nz/blog/ultimate-guide-to-marketing-your-equity-crowdfunding-offer (last visited Jan. 8, 2017) (on file with the Washington and Lee Law Review).

investment . . . has been pre-arranged before each offer has gone live."[324]

The only way to generate this sort of ready-to-go interest (apart from cornerstone investors) is if the issuer already has a pre-existing crowd of supporters that are willing to invest and spread the word.[325] The platforms count on the issuers to "activate" their crowd.[326] For example, Invivo Wines, the first company to hit the NZ$2 million crowdfunding limit, had pledges of over NZ $770,000 already in place at the start of the crowdfunding campaign.[327] The model relied heavily on the company as opposed to the platform to raise funds.[328] "If you look at . . . Invivo . . . they're going to the market with 20,000 plus followers on Facebook and they're who they're activating for the funding. . . . Those sorts of networks are really important for the process to work."[329] Another similar example can be found in Yeastie Boys, a craft brewer, which raised NZ$500,000 "in half an hour following an active social media campaign and investor information sessions to promote the offer."[330] More generally, an executive at PledgeMe estimates that about 75% of investors in a given offering have some sort of pre-existing connection to the company.[331]

The effect of the need for a pre-existing network is that a

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324. Edlin, *supra* note 300.

325. *See Promoting 101*, *supra* note 322 (providing guidance for advertising crowdfunding campaigns on social media) (on file with the Washington and Lee Law Review); *see also id.*

> Your First 50 are your champions! Get them ready to pledge in the first few hours the campaign is live. Ask them to share the fact they've pledged with their networks. Get them to write a blog post for you about why they pledged and what they hope for your company. Get them working for you.

326. *See id.* (advising how to engage individuals on social media to advertise for a campaign).

327. *See* Murray, *supra* note 317, at 7 (demonstrating the largest equity campaign in New Zealand).

328. *See* Manning, *supra* note 285 (noting the strategies of highly successful crowdfunding companies).

329. *See id.* (quoting David Wallace, founder of a New Zealand equity crowdfunding platform).

330. Murray, *supra* note 317, at 7.

331. *See* Interview with Barry Grehan, *supra* note 287 (discussing the composition of investors in a typical offering).

company without one is unlikely to reach its financial target and thus unlikely to be accepted onto a platform in the first place. Unless you have "an established business," "customers," and "a large network of people who are ready and waiting to spread your message," you are probably going to be screened out by the gatekeeper platforms.[332] This is great for efficiency, as it is most efficient to list only companies that are likely to succeed, but it fosters an exclusive, not an inclusive, crowdfunding market.[333]

4. Reputation

Individual entrepreneurs have their own reputations to consider when they launch a crowdfunding campaign. Because New Zealand is a small country (about the size and population of a single state), personal connections are never too tenuous—and the Internet never forgets. If an entrepreneur were to be caught deceiving the public in her crowdfund listing, her reputation would be forever marred, with evidence of the wrongdoing etched in permanent digital form on Facebook and elsewhere. A similar fate would befall someone who squandered the money she collected through crowdfunding, whether through shirking or malfeasance.

Knowing all this, crowdfunding entrepreneurs in New Zealand can be expected to behave themselves both during their campaign and once they have received the money. This seems to happen in practice, as there has never been a single funded company that turned out to be a fraud, and only one company has gone out of business, since New Zealand began crowdfunding in 2014.[334]

At the same time, the importance of reputation is contrary to a desire for inclusivity. In the United States, at least, crowdfunding was envisioned as a way for unknown entrepreneurs, meaning those without a reputation in the funding community, to pitch their idea directly to the public.[335] But the

332. *See* Male, *supra* note 323 (discussing marketing strategies for crowdfunding offers).

333. *See id.* (outlining marketing methods to make crowdfunding offers feels exclusive).

334. *See supra* notes 267–33 (noting the remarkable absence of fraud in New Zealand's crowdfunding campaigns).

335. *See supra* notes 226–39 (discussing that the U.S. system creates very

New Zealand system benefits entrepreneurs with strong reputations and punishes those with weak reputations, which is contrary to the inclusive ideal.

B. Crowdfunding in the United States is Less Efficient but More Inclusive

Crowdfunding in the United States is less efficient and much smaller than in New Zealand, as detailed in the last Section.[336] One probable cause of this relative paucity of interest on the part of entrepreneurs is the high cost of conducting a crowdfunding offering in the United States.[337] When an issuer is limited to raising only $1 million, it is vital to keep costs very low. In New Zealand, the law and regulations are liberal and simple, thus imposing much lower compliance costs than the JOBS Act and related regulations.[338] In the United States, compliance costs are so high that they prevent many issuers from conducting a crowdfund offering that makes economic sense.[339] If it costs $40,000 to raise $100,000 through crowdfunding, many companies

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few, if any, obstacles for entrepreneurs).

336. *See supra* Part III.A (providing an overview of the differences in efficiency between crowdfunding in New Zealand and the U.S.).

337. *See* Jason W. Parsont, *Crowdfunding: The Real and the Illusory Exemption*, 4 HARV. BUS. L. REV. 281, 284–85 (2014)

> [The regulatory burden of complying with Title III of the JOBS Act] will translate into higher legal and accounting fees, higher premiums on directors and officers liability insurance ("D&O insurance"), and higher intermediation fees. For a capital raise of $1 million (which is the maximum in retail crowdfunding), the SEC roughly estimates a cost of up to $152,260, which may be an underestimation. This could be prohibitively expensive for many small issuers.

See also Thompson & Langevoort, *supra* note 83, at 1605 (commenting on the "costly set of responsibilities" imposed by Title III of the JOBS Act).

338. *See* Henry William Hillind, *Exploiting the Crowd: The New Zealand Response to Equity Crowd Funding*, 21 N.Z. BUS. L.Q. 46, 52 (2015) (noting New Zealand's decision to not impose an investor cap as compared to other countries).

339. *See* Brian Korn, *SEC Proposes Crowdfunding Rules*, FORBES (Oct. 23, 2013, 2:41 PM), https://www.forbes.com/sites/deborahljacobs/2013/10/23/sec-proposes-crowdfunding-rules/#637b9f77f6bd (last visited Jan. 24, 2018) ("The high expenses compared to the low maximum amounts that can be raised by a company and invested by an individual make public equity crowdfunding one of the costliest forms of (legal) capital raising.") (on file with the Washington and Lee Law Review).

will not participate, even if they have good use for $100,000 and cannot obtain the money elsewhere.

Because New Zealand was focused entirely on efficiency, it comes as no surprise that New Zealand's crowdfunding market is much more successful in economic terms than the one in the United States.[340] But what about inclusivity? The American system was supposed to achieve that policy goal as well,[341] while New Zealand had no intention of doing so.[342] The SEC's final version of its crowdfunding regulations, although they allow platforms to act as gatekeepers,[343] still retain other legal rules designed to create an inclusive market. The final regulations sharply limit advertising[344] and maintain the per-investor cap that prevents cornerstone investors from playing a role.[345] The remainder of this Section examines the empirical evidence from the first year of American crowdfunding to determine whether it has met its policy goal of inclusivity for entrepreneurs.[346] As will be discussed, the evidence on this score is somewhat mixed.

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340. *See* Lloyd Kavanagh, *New Zealand: The Equity Crowdfunding Revolution*, MINTERELLISONRUDDWATTS (Oct. 11, 2017), https://minterellison.co.nz/our-view/new-zealand-the-equity-crowdfunding-revolution (last visited Jan. 24, 2018) (providing data on the first three years of crowdfunding in New Zealand compared to the first year in the United States and citing an earlier draft of the present article) (on file with the Washington and Lee Law Review).

341. *See supra* Part II.C.2 (discussing the use of securities crowdfunding as a means of promoting inclusive entrepreneurship).

342. *See supra* Part III.C (identifying efficiency as the singular goal of New Zealand's crowdfunding law).

343. *See supra* Part III.D (discussing the ways in which the SEC attempted to balance the goals of inclusivity and efficiency in the finalized regulations).

344. *See* Max E. Isaacson, *The So-Called Democratization of Capital Markets: Why Title III of the JOBS Act Fails to Fulfill the Promise of Crowdfunding*, 20 N.C. BANKING INST. 439, 459–61 (2016) (discussing the key advertising limitations of the JOBS Act).

345. *See id.* at 454–55 (discussing the potential negative impacts of the funding cap).

346. Some of the data in this Part is based on statistics from the first 7.5 months of crowdfunding in the United States, namely from May 16, 2016, through the end of that calendar year. *See* VLADIMIR IVANOV & ANZHELA KNYAZEVA, U.S. SECURITIES-BASED CROWDFUNDING UNDER TITLE III OF THE JOBS ACT 1 (2017), https://www.sec.gov/dera/staff-papers/white-papers/RegCF_WhitePaper.pdf (setting forth evidence on initial crowdfunding activity in the period immediately after the new regulations became effective); Sherwood Neiss, *Here's How Regulation Crowdfunding Performed in 2016*, VENTURE BEAT (Jan. 11, 2017, 5:05 PM), https://venturebeat.com/2017/01/11/heres-how-regulation-crowdfunding-

Like in New Zealand, crowdfunding platforms in the United States may screen, curate and otherwise exclude companies based on the platform's subjective view of the merits of the investment.[347] To get listed on a crowdfunding site in the United States, entrepreneurs must first prove their worth to the gatekeeper (the platform) who has a financial incentive to only open the gate for the most promising companies.[348] Even so, American crowdfunding has become a fairly inclusive market from the standpoint of entrepreneurs. Despite the ability of American crowdfunding platforms to act as gatekeepers, there is substantial evidence to indicate that platforms are relatively liberal in deciding whom to present to the crowd.

In particular, very young startup companies without a track record, without a crowd of pre-existing investors or customers, and even without any assets, are in fact given a chance to pitch to the crowd.[349] The typical crowdfunding company in the United States is so young as to be brand new. About 40% are less than one year old,[350] and 20% are less than three months old. The median age of a crowdfunding company in the United States is just eighteen months, and the average age is two years.[351] In New Zealand, by contrast, the average crowdfunding issuer is eight years old.[352] Consistent with the goal of inclusivity, American crowdfunding platforms are much more welcoming to brand-new, untested startups, whereas New Zealand gatekeepers are more likely to list established companies.

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performed-in-2016/ (last visited Jan. 11, 2018) (providing data concerning the immediate impact of the JOBS Act crowdfunding regulations) (on file with the Washington and Lee Law Review) .

347. *See* Ibrahim, *supra* note 130, at 1496–99 (discussing the importance of allowing crowdfunding platforms to regulate fundraising activities).

348. *See* 17 C.F.R. § 227.402(b)(1) (2017) (granting discretion to funding portals to determine which issuers to include on their platforms).

349. *See* IVANOV & KNYAZEVA, *supra* note 346, at 13 ("[T]he typical [crowdfunding] issuer is a small, young startup.").

350. *CCA Regulation Crowdfunding Indices*, *supra* note 256 (focusing on Chart 11, which provides the total amount of committed capital to all campaigns raising funds under Regulation Crowdfunding since May 16, 2016).

351. *See* IVANOV & KNYAZEVA, *supra* note 346, at 13–14 (noting that these ages are based "on the initial filing relative to the date of incorporation").

352. *Id.*

In the same vein, the median crowdfunding company in the United States had just three employees and $43,000 in assets, and one-quarter of issuers had no assets at all.[353] The majority (60%) of American companies had no revenue, and almost all (91%) were not profitable, when they undertook a crowdfunding campaign.[354] Most successful crowdfunding campaigns in the United States raised less than $200,000, with dozens raising under $100,000.[355] The median amount raised was about $170,000.[356] These numbers indicate that American crowdfunding has attracted tiny startups of the sort that are not generally listed on New Zealand crowdfunding platforms, but which are given their chance in the inclusive American system.

In addition, only about 10% of American crowdfunding companies have previous investors, such as VCs or angel investors.[357] For the other 90% of issuers, "crowdfunding [is] their initial foray into capital raising through a securities offering."[358] Recall that in New Zealand, platforms tend to prefer companies that already have a pre-existing investor base.[359] This is another indicator that crowdfunding in the United States is achieving its goal of including all entrepreneurs, even those "out of the loop."

One final indicator of the inclusive nature of American crowdfunding is the fact that crowdfunding campaigns in the United States have a much lower success rate than in New Zealand. Recall that New Zealand platforms generally try to only

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353. *See id.* (noting that the average issuer had five employees and held approximately $327,000 in assets).

354. *See id.* at 14 ("The median offering involved an issuer with 3 employees and approximately $43,000 in assets . . . .").

355. *See 183 Reg CF Companies Have Hit Their Funding Target*, WEFUNDER, https://wefunder.com/stats/all (last visited Jan. 12, 2018) (providing data on company funding targets as of May 16, 2017) (on file with the Washington and Lee Law Review); *see also* IVANOV & KNYAZEVA, *supra* note 346, at 19 (describing the characteristics of issuers that reported success and those that did not report success).

356. *See* IVANOV & KNYAZEVA, *supra* note 346, at 1 ("[T]he median (average) amount raised was approximately $171,000 ($303,000).").

357. *Id.* at 15.

358. *See id.* at 15 (highlighting evidence that "some issuers had previously or subsequently conducted an offering under Regulation D or Regulation A").

359. *See supra* Part IV.A.3 (discussing the ways in which New Zealand's crowdfunding laws promote efficiency by favoring established companies, while marginalizing those without a pre-existing base of supporters).

list companies that they expect to succeed in reaching their financial target, leading to a success rate of about 80%.[360] American crowdfunding campaigns, by contrast, succeed about 50% of the time.[361] This statistical disparity was previously used to show that New Zealand has a more efficient crowdfunding market than does the United States (which it does).[362] But it also shows that American crowdfunding platforms are relatively liberal and inclusive when deciding which companies to list on their sites.

Based on all of these statistics, the SEC has concluded that American crowdfunding is fulfilling its inclusive goal of "providing a new source of capital for entrepreneurial and small businesses that may not otherwise have had access to capital."[363] Even so, other evidence from the first year of American crowdfunding indicate that the system may not be quite as inclusive as was originally hoped.[364]

In terms of geography, there are certain, well-known hubs of venture capital and angel investment, led by Silicon Valley in California, as well as New York City, Boston, and Austin, Texas.[365] The traditional way for an entrepreneur to access those pools of capital was to physically travel or relocate to one of those places.[366]

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360. *See supra* Part IV.A.1 (discussing the gatekeeping role that New Zealand crowdfunding platforms play in excluding companies that are unlikely to succeed).

361. *See supra* notes 246–259 and accompanying text (discussing the differences in the first-year success rates of equity crowdfunding between New Zealand and the United States).

362. *See supra* Part IV.A.1 (explaining the methods used by New Zealand crowdfunding platforms in their gatekeeping role to promote selectivity and efficiency).

363. IVANOV & KNYAZEVA, *supra* note 346, at 16.

364. *See supra* notes 121–131 and accompanying text (discussing the policy rationales behind the United States' goal of inclusivity in crowdfunding regulations).

365. *See* Schwartz, *Rural Crowdfunding*, *supra* note 123, at 286 (noting that most venture capital firms tend to be concentrated in metropolitan locales, and angel investors are generally found in "urban oases among rural regions).

366. *See id.* at 284

> The upshot is that an entrepreneur with big dreams is still given the same advice today that Horace Greely is said to have offered in the late 1800s: "Go west, young man, go west!" The conventional thinking is that the ambitious among us must physically relocate from one part of the country to another in order to find early-stage business financing. Even for rural entrepreneurs that would prefer to remain in, say, Iowa,

American crowdfunding under the JOBS Act was a way "to bring venture capital to rural areas. By allowing rural entrepreneurs to connect with and obtain financing from angel investors on the Internet, crowdfunding frees them from the geographic constraint that has long hindered entrepreneurship in rural areas."[367]

In practice, as crowdfunding has developed, this transcendence of geography occurred, but only to a modest extent. As might have been expected, the geographic distribution of crowdfunding issuers is dominated by California, with about one-third of all crowdfunding offerings coming from issuers based in that state.[368] New York, Texas, and Florida all have significant numbers of crowdfunding offerings, but they each account for only about one-fifth the number of issuers as California.[369] This comes as no surprise, as those four boast the largest populations of all the states.[370] When it comes to successful fundraising totals, California also leads the pack, with more than triple its closest competitor, Texas, and more than five times the state in third place, Massachusetts.[371]

At first blush, crowdfunding appears to have replicated the existing geographic centers of venture finance in Silicon Valley, Austin and Boston. Furthermore, at least fourteen states have not had a single local company even attempt to raise money in this way.[372] And this group of states—Iowa, the Dakotas, West Virginia

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> rather than move to California, the siren song of wealthy and experienced angel investors is near impossible to resist. You can't keep the kid on the farm, as they say.

367. *Id.* at 292–93.

368. *See* IVANOV & KNYAZEVA, *supra* note 346, at 18 (noting that California also led in the target amount sought, the number of offerings reported complete, and the amount reported raised).

369. *See id.* at 18 (noting that New York had the second most offerings, with 9% of the total).

370. *See Idaho is Nation's Fastest-Growing State, Census Bureau Reports*, U.S. CENSUS BUREAU (Dec. 20, 2017), https://www.census.gov/newsroom/press-releases/2017/estimates-idaho.html (last visited Jan. 12, 2018) (finding that California is the largest state by population with an estimated 39,536,653 residents, followed by Texas (28,304,596), Florida (20,984,400), and New York (19,849,399)) (on file with the Washington and Lee Law Review).

371. *See CCA Regulation Crowdfunding Indices*, *supra* note 256 (focusing on Chart 9).

372. *See id.* (focusing on Chart 8, which shows zero offerings from Washington, Montana, Wyoming, North Dakota, South Dakota, Kansas,

and others—is closely correlated with the rural areas who were supposed to benefit from crowdfunding's ability to overcome geography.[373]

On the other hand, a solid majority of the states have seen their companies launch crowdfunding campaigns, and this includes many states that are largely off the radar of traditional VCs and angel investors, such as Idaho, New Mexico and South Carolina.[374] To cherry-pick one example, Alabama-based companies raised nearly as much as Colorado-based companies in the first year of crowdfunding.[375] In the end, although it obviously has not transformed Bismarck into Boston, or Pine Bluff into Palo Alto, crowdfunding has in fact achieved some real amount of geographic inclusivity.

Beyond geography, crowdfunding also shows modest success when it comes to demographic inclusivity. It has been well documented that women and minorities have very little success in attracting traditional methods of startup finance, namely venture capital and angel investment.[376] To offer just one statistic, only 8% of companies that receive venture capital investment have female founders.[377] Crowdfunding was supposed to help ameliorate this disparity by allowing all entrepreneurs, of every demographic stripe, to pitch their idea to the crowd for funding.[378]

Nebraska, Oklahoma, Iowa, Arkansas, Wisconsin, Kentucky, West Virginia, and Virginia).

373. *See* Schwartz, *Rural Crowdfunding*, *supra* note 123, at 292–93 (discussing the increased access to investors that securities crowdfunding has brought to rural entrepreneurs).

374. *See CCA Regulation Crowdfunding Indices*, *supra* note 256 (focusing on Chart 8).

375. *See id.* (finding that Colorado-based companies raised $933,000 and Alabama-based companies raised $825,000).

376. *See* Schwartz, *Digital Shareholder*, *supra* note 9, at 622–23 (noting the "severe lack of access to startup financing" for women and racial minorities).

377. *See* Habib Jamal, *Crowdfunding's Potential for Minority and Women Owned Enterprises*, CROWDFUND CAP. ADVISORS (July 28, 2014), https://www.scribd.com/document/235308665/Crowdfunding-s-Potential-for-Minority-and-Women-Owned-Enterprises (last visited Jan. 11, 2018) (noting that "41% of businesses are women owned, but only 8% of ventures that are backed by professional investors are founded by women") (on file with the Washington and Lee Law Review).

378. *See* Schwartz, *Digital Shareholder*, *supra* note 9, at 623 ("Crowdfunding offers a new and inclusive way to bring needed financing to startups all across America, from coast to coast, in rural areas and urban, to entrepreneurs rich and

To some extent, this has happened. Companies with at least one female founder represented about 20% of American crowdfunding campaigns, and nearly 90% of companies founded by women-only teams were successfully funded.[379] Although the absolute numbers for this latter statistic were quite small (seven of eight), these statistics are encouraging.[380] At the same time, further statistical analysis would be needed to fully answer whether crowdfunding is succeeding in its goal of providing a demographically inclusive form of entrepreneurial finance.[381] For now, it appears that crowdfunding has been at least somewhat successful in giving entrepreneurs of every demographic group a fair chance to obtain financing.[382]

Overall, American crowdfunding has achieved substantial success in creating an inclusive environment for entrepreneurs, especially as compared to New Zealand. Brand-new companies with nothing but an idea are given a chance to try to convince the crowd to fund their business, and the market is also fairly inclusive in terms of geography and demography.

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poor, young and old, men and women of every race, ethnicity, and religion."); Jamal, *supra* note 377 (providing evidence on the reality of crowdfund investing for women and minorities).

379. *See Women and Minorities in Regulation Crowdfunding*, CROWDFUND CAP. ADVISORS (May 4, 2017), http://crowdfundcapitaladvisors.com/women-minorities-regulation-crowdfunding/ (last visited Jan. 11, 2018) (noting that companies with only male founders had a 41% success rate) (on file with the Washington and Lee Law Review).

380. *See id*. (providing data showing that 68 out of 165 companies founded by white men were successful).

381. *Cf*. John R. Becker-Blease & Jeffrey E. Sohl, *Do Women-Owned Businesses Have Equal Access to Angel Capital?*, 22 J. BUS. VENTURING 503, 504 (2007) (reporting on survey finding that only 9% of proposals presented to angel investors came from women entrepreneurs).

382. One demographic group that should, in theory, benefit by an inclusive system of crowdfunding is youthful entrepreneurs. *See* Schwartz, *Teenage Crowdfunding*, *supra* note 125, at 516 ("Teenagers, being experts at Facebook, Snapchat, Twitter, Instagram and such, are very well positioned to take advantage of the online securities exemption that the [JOBS] Act creates. . . . [S]ecurities crowdfunding may well develop into an important funding source for financing teenage startup companies . . . ."). This aspect of demographic inclusivity is not addressed because the author is unaware of any statistics or data showing the extent to which young entrepreneurs have sought to finance their companies via crowdfunding.

V. Inclusive Crowdfunding is a Luxury

The divergent laws, regulations, policy goals and practical results of crowdfunding in the United States and New Zealand teach that there is a trade-off between inclusivity and efficiency.[383] The American system is more inclusive, but less efficient; the New Zealand system is more efficient, but less inclusive. This is an important lesson, especially for the many countries around the world presently in the process of drafting and implementing their own crowdfunding laws, such as Australia, which enacted its law in March 2017, which is scheduled to go into effect in September 2017.[384] It is also highly relevant to those countries, including the United States, that are considering whether and how to reform the crowdfunding laws they currently have in place.[385]

The evidence and analysis discussed in this Article indicate that the original concept for securities crowdfunding, where every entrepreneur would get the chance to pitch her idea to the crowd, is probably too inefficient to function.[386] The gatekeeper model, which was adopted from the outset in New Zealand and belatedly in the United States, seems clearly to be more efficient for all participants in the market, both in theory and in practice.[387] But it is also exclusive by its nature because it relies on intermediaries to curate their listings and exclude many companies who request access to the crowd.

The upshot is that policymakers around the world need to think carefully about which policy goal they are trying to achieve—inclusivity or efficiency—and design their crowdfunding market accordingly. It may be possible to achieve both goals, but the

383. *See supra* notes 337–364 and accompanying text (comparing New Zealand's focus on efficiency with the United States' concern for inclusivity in crowdfunding policies).

384. *See, e.g.*, *Corporations Amendment (Crowd-Sourced Funding) Act 2017* (Cth) (Austl.) (codifying Australian crowdfunding law, enacted on March 28, 2017).

385. *See, e.g.*, Financial Choice Act of 2017, H.R. 10, 115th Cong. §§ 476–479 (2017) (proposing legislation altering current crowdfunding laws).

386. *See* Ibrahim, *supra* note 130, at 1506 ("True crowd-based investing was always a fantasy.").

387. *See supra* Part IV.A (discussing the steps New Zealand has taken to ensure efficiency in their crowdfunding market); *see also* Ibrahim, *supra* note 130, at 1499 (calling for even "*more* curation" in crowdfunding (emphasis in original)).

experience in the United States is not encouraging on that front.[388] In going for both at the same time, the American system ended up being only weakly inclusive, and not very efficient.[389] It is possible that a different set of laws could have worked better to promote both inclusivity and efficiency at the same time, but the most immediate lesson seems to be that a crowdfunding market will work best if a clear choice between one and the other is made.

So which to choose? It seems that the most important consideration for policymakers deciding whether to enact an efficient crowdfunding regime, or an inclusive one, is whether their jurisdiction already has an effective source of early stage venture capital.[390] If a country has a deep and well-functioning set of VC funds and angel investors that are available to finance promising startup companies, then it can afford to design a relatively inefficient crowdfunding market as an inclusive complement to that source of capital. On the other hand, if a country lacks VC funds and angel investors, and therefore needs a new and significant source of early stage capital, it should try to create an efficient system for crowdfunding; inclusivity is a luxury it cannot afford.

This suggested decision-making process is consistent with what we have seen happening over the past few years around the world. Countries with shallow pools of VC and angel investment have tried to enact efficient crowdfunding regimes that would serve as a substitute source of capital for its startup companies. And countries with deep pools of VC and angel investment have adopted inclusive and inefficient crowdfunding laws—or have not even adopted a crowdfunding law at all.[391]

388. *See supra* notes 349–352 and accompanying text (discussing the crowdfunding considerations that allow for an inclusive market).

389. *See supra* Part II.D (reviewing the regulatory history of crowdfunding in the United States and the tension between efficiency and inclusivity).

390. *See supra* notes 225–234 and accompanying text (noting the difference in the levels of pre-existing early stage venture capital between the United States and New Zealand).

391. *See generally* AYAL SHENHAV & GAL HOFFMAN, EUROPEAN CROWDFUNDING NETWORK, REVIEW OF CROWDFUNDING REGULATION: INTERPRETATIONS OF EXISTING REGULATION CONCERNING CROWDFUNDING IN EUROPE, NORTH AMERICA AND ISRAEL (2014), http://eurocrowd.winball2.de/wp-content/blogs.dir/sites/85/2014/12/ECN-Review-of-Crowdfunding-Regulation-2014.pdf (providing an overview of the crowdfunding market and regulations in twenty-nine countries across Europe

Two countries stand out as having far and away the deepest pools of entrepreneurial capital (measured by percentage of venture capital as a percentage of GDP): Israel and the United States.[392] These countries do not 'need' crowdfunding to fund their promising startup companies.[393] They can afford to enact a crowdfunding law that is designed to be inclusive, even at the expense of efficiency, or even decline to pass a crowdfunding law in the first place. Thus the United States, as discussed above, adopted an inclusive crowdfunding regime that suffers from inefficiency, and Israel has yet to enact any sort of crowdfunding law at all.[394] Going forward, the United States should consider amending the JOBS Act to achieve greater inclusivity among crowdfunding entrepreneurs, even at the cost of efficiency. We can afford it.

Other countries have few VCs and angels and thus really need some new and efficient means of channeling capital to promising early stage startup companies. Examples of these sorts of countries are Italy and New Zealand. Scaled for the size of its economy, Italy's venture capital activity amounts to less than 1% of the United States, the lowest in Western Europe; the relevant percentage for New Zealand is 8%.[395] It should come as no surprise that these countries would be quick to enact securities crowdfunding laws. The New Zealand experience was discussed in

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and North America, as well as Israel).

392. *See Entrepenuership at a Glance 2016: Venture Capital Investments as a Percentage of GDP: Percentage, 2015, or Latest Available Year*, OECDILIBRARY (2016), http://www.oecd-ilibrary.org/industry-and-services/entrepreneurship-at-a-glance-2016/venture-capital-investments-as-a-percentage-of-gdp_entrepreneur_aag-2016-graph119-en (last updated Sept. 28, 2016) (last visited Jan. 12, 2018) [hereinafter *Venture Capital*] (providing data on venture capital investments as a percentage of gross domestic product for thirty-two countries) (on file with the Washington and Lee Law Review).

393. *See id.* (noting the significant drop off in late stage venture funding between the United States and Israel and the rest of the surveyed countries).

394. *See* SHENHAV & HOFFMAN, *supra* note 391, at 130 (discussing proposed crowdfunding legislation in Israel). Reports indicate that the Israeli government is in the process of enacting regulations to cover equity crowdfunding. *See Is Equity Crowdfunding right for you*, VCFORU, https://www.vcforu.com/equity-crowdfunding (last visited Jan. 11, 2018) (reporting that on "March 20, 2017 the Israeli Government passed a new regulation on equity crowdfunding") (on file with the Washington and Lee Law Review).

395. *Venture Capital*, *supra* note 392.

detail above, and a similar story unfolded in Italy.[396]

Italy was the first in the world to enact a securities crowdfunding law, outpacing even New Zealand.[397] Italy's legislation was passed in 2012 and went into effect in 2013, and it had several features consistent with a policy goal of creating an efficient source of entrepreneurial capital, including a legal requirement that issuers be "innovative start-up" companies, and that every issuance be led by a professional cornerstone investor.[398] Furthermore, when Italy's crowdfunding law did not lead to as much investment as the government had hoped, it went back to the drawing board and issued a revised law in 2016.[399] Italy is understandably trying to make its crowdfunding system more efficient, because the country desperately needs it to fill in for the absence of VC and angel investors.

In sum, the key question for policymakers around the world deciding on a new or revised crowdfunding law is whether their country needs equity crowdfunding as a *substitute* for VC and angel investment, or if it can afford to have crowdfunding serve as a *complement* to existing VC and angel financing. Countries that already possess sufficient pools of entrepreneurial capital can afford to undermine the efficiency of their crowdfunding regime by trying to make it inclusive. But countries that lack satisfactory levels of startup finance cannot afford that luxury; they need to follow New Zealand's lead and focus exclusively on efficiency, at the cost of inclusivity.

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396. *See supra* Part III.B (discussing New Zealand's reaction to the United States JOBS Act through crowdfunding regulations).

397. *See* Blair Bowman, *A Comparative Analysis of Crowdfunding Regulation in the United States and Italy*, 33 WIS. INT'L L. J. 318, 332 (2015) (reporting that Italy enacted the "world's first equity crowdfunding law, the Decreto Crescita Bis," in 2012).

398. *See id.* at 339–41 (discussing the bars to participation in equity crowdfunding in Italy).

399. *See Italy Opens Up Equity Crowdfunding to All Kinds of SMEs*, EUROPEAN CROWDFUNDING NETWORK (Dec. 13, 2016), http://eurocrowd.org/2016/12/13/italy-opens-equity-crowdfunding-kind-smes/ (last visited Jan. 25, 2018) (noting that the new Italian law allows "any SME to raise funds via equity crowdfunding") (on file with the Washington and Lee Law Review).

VI. Conclusion

This Article provided a theoretical and empirical study of securities crowdfunding in the United States and New Zealand. It analyzed the origins, the legislation, and the regulation of crowdfunding in the two jurisdictions,[400] and provided data on the first year of practical experience in each country.[401] To a significant degree, the policy goals in each country have been achieved.[402]

The law in the United States was designed to create a market that is both inclusive and efficient, and in practice it has achieved a little of each.[403] American crowdfunding welcomes all types of investors and has created a space for a broad swath of entrepreneurs to pitch their ideas to the crowd.[404] At the same time, the market has not been a huge financial impact, having raised just $35 million across all companies in its first year.[405]

The law in New Zealand was designed for efficiency only and it has achieved its goal in practice.[406] Crowdfunding companies in New Zealand have conducted thirteen times as many campaigns and raised thirty times as much capital than their counterparts in the United States, with a much higher success rate.[407] Unlike in the United States, the New Zealand market is not particularly

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400. *See supra* Part II.A–B (describing the foundations and regulations of crowdfunding regulation in the United States); *supra* Part III.A–B (describing New Zealand's crowdfunding regulations and comparing them to those in the United States).

401. *See supra* Part IV (comparing the results of the first year of crowdfunding regulations in the United States and New Zealand).

402. *See supra* Part II.C (discussing the United States' policy goals in crowdfunding regulation); *supra* Part III.C (describing New Zealand's policy goals and the results of crowdfunding regulation).

403. *See supra* Part II.C (describing the steps taken by the United States to ensure a crowdfunding market that is both efficient and inclusive).

404. *See supra* notes 376–382 (discussing the impact of equity crowdfunding regulations on female and minority entrepreneurs).

405. *See The Current Status of Regulation Crowdfunding*, WEFUNDER, https://wefunder.com/stats (last visited Jan. 25, 2018) (noting that as of January 25, 2018 investors had funded $56,106,031) (on file with the Washington and Lee Law Review).

406. *See supra* Part III.C (discussing New Zealand's policy goals of efficiency in crowdfunding regulations).

407. *See supra* notes 246–259 (comparing the first-year success rates of crowdfunding in New Zealand and the United States).

inclusive, especially of entrepreneurs, but then it was never designed to be.[408]

The broader lesson for countries around the world in the process of designing or reforming their own crowdfunding laws is that they should decide whether they are trying to create an inclusive system, an efficient system, or if they are trying to balance the two. Once they settle upon their policy goals, they can craft their laws accordingly, using New Zealand or the United States as a model. Countries that lack a deep pool of entrepreneurial finance (like New Zealand) should probably focus on efficiency, while countries that already have a mature market for VC and angel investment (like the United States) can afford to try for both goals at once.

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408. *See generally* Schwartz, *Crowdfunding Social Enterprise*, *supra* note 59 (reporting that approximately one-third of the companies that attempt to (and succeed in) raise money via equity crowdfunding in New Zealand can be classified as "social enterprises").