SEC Opens the Door to Crowdfunding

By Erika Morphy

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Crowdfunding portals could be subject to significant liability, suggested T. Hale Boggs, a partner at Manatt. That, in turn, could have a chilling effect on the widespread adoption of crowdfunding. "I'm thinking about having to defend litigation -- likely class actions -- relating to acts or omissions in facilitating crowdfunded transactions," Boggs explained.

The Securities and Exchange Commission on Wednesday unanimously voted to propose new rules that would allow entrepreneurs to sell securities through crowdfunding portals such as Kickstarter.

The new rules, which are part of Title III of the Jumpstart Our Business Startups Act, are now up for comment over a 90-day period in the first step of a process many hope will culminate in permission for small businesses to raise up to US$1 million a year via unaccredited investors.

Several measures are included to protect retail investors from possible fraud. The question now is whether these regulations and disclosures will prove to be too onerous for small businesses.

'Thinking About Litigation'
Certainly businesses will not likely find crowdfunding a walk in the park. Among the disclosure requirements proposed by the SEC are that companies raising more than $500,000 must provide an audited financial statement, and that companies must use a registered broker-dealer.

Companies could use the new regulatory category of crowdfunding portfolio, but not a lot is known about these portals yet.

Too little information, as is often the case, leads to speculation.

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Protecting Investors
Indeed, even a cursory look at the proposal makes clear that the SEC came down heavily on the investor-protection side, Stradley Ronon attorney Lori Goldman told the E-Commerce Times.

"That is not a surprise," Goldman added. "The SEC was not particularly looking to go the other way on this issue."

Of course, what the SEC has put out is still a proposal and could easily go through one or more iterations before it goes into effect, she added.

In fact, usually the SEC issues one proposal, goes through one comment round and then writes the rule, she said. Then again, the crowdfunding regulation is a very high-profile one and complex as well.

"I would not be surprised to see the SEC go through another comment period round," Goldman said.

'Field of Dreams'
Even with the SEC's cautious approach, however, crowdfunding's appeal will likely translate into, at the very least, dashed hopes on the part of both investors and businesses, Bruce Bachenheimer, a professor of management at Pace University, told the E-Commerce Times.

"While there are many exciting possibilities that could come from the act, I'm afraid it will result in an amateur 'field of dreams,'" he said -- "early startups dreaming of easy funding and nascent individual investors dreaming of big returns."

On the other hand, "individuals will have the opportunity to invest into companies that were off-limits to them for decades," countered Philip Reicherz, cofounder and CEO of CrowdHut. "Entrepreneurs will have the potential to bring their concepts and lifelong dreams -- drawn out on napkins years ago -- to life, testing them while continuing to maintain their day jobs."

Reicherz also doesn't believe that investors are so naïve as to believe crowdfunding will immediately lead to riches. After all, all they have to do is visit sites like Kickstarter to see that such projects usually have a long runway in front of them, he told the E-Commerce Times.

In fact, he noted, "approximately 75 percent of successful reward-based campaigns do not deliver the product in the initial estimated time."