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SELLING CROWDFUNDED EQUITY:
A NEW FRONTIER

JOAN MACLEOD HEMINWAY*

“Shares of stock in a corporation are alienable, which is to say that they are freely transferrable and may be bought or sold at any time.” 1 The right to sell affords equity holders a number of advantages. Two of these benefits are particularly salient: the ability to protect the holder financially (allowing the holder to guard against loss or more productively redeploys the invested funds)2 and the power to discipline or signal poor firm management (including through the market for corporate control). 3 Both of these

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3. See Henry G. Manne, Mergers and the Market for Corporate Control, 73 J. POL. ECON. 110, 112 (1965) (positing the market for corporate control); see also, e.g., Kelli A. Alces, Strategic Governance, 50 ARIZ. L. REV. 1053, 1079-80 (2008) (“[A]ngry shareholders can exit the firm, thereby making equity compensation for managers significantly less valuable and making the firm more susceptible to takeover.”); Christine Sgarlata Chung, Government Budgets as the Hunger Games: The Brutal Competition for State and Local Government Resources Given Municipal Securities Debt, Pension and OBEP Obligations, and Taxpayer Needs, 33 REV. BANKING & FIN. L. 663, 691 (2014) (“Corporate security-holders may also use exit discipline—i.e., selling ones securities—to express disapproval.”); Carol Goforth, Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, but Not Too Late, 43 AM. U. L. REV. 379, 406 (1994) (“[S]hareholders who are dissatisfied with management decisions can ‘vote with their feet’ by selling their shares and finding a different enterprise in which to invest.”); Harry G. Hutchison, Choice, Progressive Values, and Corporate Law: A Reply to Greenfield, 35 DEL. J. CORP. L. 437, 449 (2010) (“Investors who are dissatisfied with corporate performance can exercise their exit option by selling their shares in the market. This move may depress the share price of the firm and provide incentives for managers to improve performance or face the prospect of a takeover.”); Troy A. Paredes, The Firm and the Nature of Control: Toward a Theory of Takeover Law, 29 IOWA J. CORP. L. 103, 121 (2003) (“Shareholders have the right to sell their shares when they disapprove of the way the board and the management team are running the company or for any other reason.”); Schwartz, supra note 1, at 772-73 (“[T]he ability of investors to buy a controlling stake in a corporation on the secondary market makes possible the ‘market for corporate control,’ which helps discipline managers...
elements of shareholder value, but especially the latter, typically are available only in the public-company context because of the more certain existence of a liquid secondary market. Regardless, restrictions on the right to sell necessarily limit these pecuniary and disciplinary capabilities, impacting not only the financial and governance aspects of equity ownership, but also the regulation of equity offerings and the healthy development of securities markets.

Transfer restrictions come in a number of forms but can be easily separated into two principal sources: (1) reasonable contractual, or contract-like, constraints authorized or contextually required under applicable law or regulation (e.g., for the attainment or maintenance of certain desired entity or transactional statuses—for instance, legal existence as a statutory close corporation or S corporation or standing as a private placement of securities) and (2) legal or regulatory restraints. The former are to put forth great effort on behalf of the corporation.”). At the extreme, unhappy selling equity holders may sell control of the firm. See Paredes, supra (”[A]t least as a default matter, shareholders have the right to sell their shares collectively so as to transfer control of the company . . . .”); Schwartz, supra note 1, at 772 (”[A] disaggregated group of small shareholders who collectively comprise a majority could jointly sell their shares (again at a premium) in response to a tender offer.”).

4. Professor Paula Dalley explains:

The lack of a market for stock in closely held corporations also means that stockholders in closely held corporations lack the protections provided by the market for corporate control. In public companies, mismanagement results in a decline in the stock price, which in turn provides opportunities for those who think they would do a better job managing the company to purchase control.

The threat of a change in control thus disciplines existing management.

Paula J. Dalley, The Misguided Doctrine of Stockholder Fiduciary Duties, 33 HOFSTRA L. REV. 175, 195 (2004) (footnote omitted); see also Donahue v. Rodd Electrotype Co., 328 N.E.2d 505, 514 (Mass. 1975) (“In a large public corporation, the oppressed or dissident minority stockholder could sell his stock in order to extricate some of his invested capital. By definition, this market is not available for shares in the close corporation.”); Luca Enriques, The Comparative Anatomy of Corporate Law, 52 AM. J. COMP. L. 1011, 1015-16 (2004) (reviewing Reinier Kraakman et al., The Anatomy of Corporate Law: A Comparative and Functional Approach (2004)) (highlighting liquidity and managerial discipline as features of the transferability of shares in public markets); Ian B. Lee, Citizenship and the Corporation, 34 LAW & SOC. INQUIRY 129, 153 (2009) (“There is no question but that public company shareholders' ability to exit the corporation lessens their vulnerability. Indeed, the prevailing understanding of the market for corporate control is that it is a potent, exit-based mechanism for the protection of the shareholders' interests.”).

5. See infra notes 6-7 and accompanying text (describing each type of transfer restriction); see also Velasco, Fundamental, supra note 2, at 415 (describing share transfer restrictions originating from shareholder fiduciary duties, federal securities law, contracts, and state corporate law); James F. Ritter, Comment, Unocal Corp. v. Mesa Petroleum Co.,
exemplified by charter, bylaw, or shareholder agreement restrictions permitted under state corporate law and characteristically are used in closely held or small firms. The latter include restrictions imposed under federal and state securities regulation that may apply more broadly.

This article briefly offers information and observations about federal securities law transfer restrictions imposed on holders of equity securities purchased in offerings that are exempt from federal registration under the Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act (the “CROWDFUND Act”), Title III of the Jumpstart Our Business Startups Act (commonly referred to as the “JOBS Act”). The article first generally describes crowdfunding and the federal securities regulation regime governing offerings conducted through equity crowdfunding—most typically, the offer and sale of shares of common or preferred stock in a corporation over the Internet—in a transaction exempt from federal registration under the CROWDFUND Act and the related rules adopted by the U.S. Securities and Exchange Commission (“SEC”).

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72 VA. L. REV. 851, 859 (1986) (noting the possibility of “valid contractual and legal restrictions on transfer”).

6. See, e.g., DEL. CODE ANN. tit. 8, § 202 (West 2010); MODEL BUS. CORP. ACT § 6.27 (AM. BAR. ASS’N 2010); Stephen J. Leacock, Share Transfer Restrictions in Close Corporations as Mechanisms for Intelligible Corporate Outcomes, 3 FAULKNER L. REV. 109, 128 (2011) (“[S]tock transfer restrictions may . . . prevent inadvertent violation of federal and state securities law that could lead to penalties and registration requirements. More particularly, these restrictions can substantially reduce or eliminate unintentional violations of the requirements for retention of subchapter S corporation tax status under the Internal Revenue Code.” (footnote omitted)); Jonathan Macey & Maureen O’Hara, Stock Transfer Restrictions and Issuer Choice in Trading Venues, 55 CASE W. RES. L. REV. 587, 607 (2005) (“Share transfer restrictions . . . are widely used by corporations and serve a number of valid purposes.”).

7. See, e.g., 15 U.S.C. § 77e (2012) (making offers and sales of securities unlawful without registration or compliance with an exemption from registration); UNIF. P’SHIP ACT § 502 (1997) (UNIF. LAW COMM’N, amended 2013) (permitting transfer of a partner’s financial interest only, therefore prohibiting transfer of a partner’s governance interest); J. William Hicks, The Concept of Transaction as a Restraint on Resale Limitations, 49 OHIO ST. L.J. 417, 419 (1988) (“Judicial and administrative interpretations of the Securities Act of 1933 require parties to certain securities transactions to use transfer restraints, establish the scope and duration of the limitations, and make them enforceable irrespective of actual knowledge.” (footnote omitted)); Daniel S. Kleinberger, The Closely Held Business Through the Entity-Aggregate Prism, 40 WAKE FOREST L. REV. 827, 863 (2005) (describing the “pick your partner” attribute of partnerships and other unincorporated entities and noting that, as a result, transfer restrictions are statutory default rules in these entities).

regime includes restrictions on transferring securities acquired through equity crowdfunding. The article then offers selected comments on (1) ways in which the transfer restrictions imposed on stock acquired in equity crowdfunding transactions may affect or relate to shareholder financial and governance rights and (2) the regulatory and transactional environments in which those shareholder rights exist and may be important. A brief conclusion follows the description and commentary.

I. U.S. Federal Regulation of the Offer and Sale of Equity Through Crowdfunding

Crowdfunding (as that term is used in this article) is a form of Internet financing. This manner of funding activities online, labeled as such, began

to take the business finance world by storm at least ten years ago. A product of Web 2.0—the intersection of e-commerce applications with social media—crowdfunding represents populist, Internet-based business finance. Through crowdfunding, Main Street has the ability to get involved in an activity previously reserved to Wall Street actors: financing new and emerging business ventures.

A. Equity Crowdfunding as a Securities Offering

Crowdfunding may, but need not, include transactions in securities. When crowdfunding involves the solicitation of an investment in equity securities (financial instruments that typically have the capacity to comprise

Internet, though there is no requirement for this to be the medium of solicitation.”); Frye, supra, at 179 (“While the concept behind crowdfunding is old, Internet-based crowdfunding is quite new.”).


11. See Pekmezovic & Walker, supra note 9, at 366 (“The rise of websites such as Facebook, Twitter, and LinkedIn—websites generally associated with the emergence of Web 2.0—as well as the popular payment services site PayPal, enabled crowdfunding to gain greater visibility.”); John S. (Jack) Wroldsen, The Social Network and the Crowdfund Act: Zuckerberg, Saverin, and Venture Capitalists’ Dilution of the Crowd, 15 VAND. J. ENT. & TECH. L. 583, 592 (2013) (“Crowdfunding thus embodies “Web 2.0,” which capitalizes on the wisdom of the crowd and involves users in the creative process.”); Sherief Morsy, Note, The JOBS Act and Crowdfunding: How Narrowing the Secondary Market Handicaps Fraud Plaintiffs, 79 BROOK. L. REV. 1373, 1377 (2014) (“Crowdfunding is a combination of crowdsourcing and microfinance, enabled by social networking.”).

12. See Andrew A. Schwartz, The Digital Shareholder, 100 MINN. L. REV. 609, 627 (2015) (noting the likely diversity of crowdfunding investors and describing crowd-funded financing as “a nationwide (or statewide) market available to anyone with an Internet connection.”); Wroldsen, supra note 11, at 611 (“Crowdfunding brings the masses of everyday retail investors into what historically has been the nearly exclusive domain of venture capitalists and other wealthy investors.”); Morsy, supra note 11, at 1377 (“Crowdfunding websites solicit investments from ordinary people for projects.”).

13. See, e.g., Bradford, supra note 9, at 31 (“Crowdfunding offerings of the donation, reward, and pre-purchase type clearly do not involve securities for purposes of federal law. Crowdfunding sites organized on the lending model probably are offering securities if the lender is promised interest. Crowdfunding sites organized on the equity model are usually offering securities.”); Wroldsen, supra note 11, at 587-90 (describing five models of crowdfunding, noting that two of the five involve transactions in securities).
both financial and governance components), it often is referred to as “equity crowdfunding.”

“Equity crowdfunding offers investors a share of the profits or return of the business they are helping to fund.”

Having said that, not every crowdfunded offering of a profit-sharing instrument or interest is equity crowdfunding. Investment contracts that are not classifiable as equity instruments may include profit or revenue sharing. The crowdfunding of investment contracts was a catalyst for the enactment of, and has been occurring under, the CROWDFUND Act.

The most common type of equity crowdfunding involves the offer and sale of corporate stock, typically over the Internet. However, limited

14. See Michael B. Dorff, *The Siren Call of Equity Crowdfunding*, 39 J. CORP. L. 493, 495 (2014) (describing equity crowdfunding as “selling off equity stakes (such as stock in the company) through crowdfunding”); Garry A. Gabison, *Equity Crowdfunding: All Regulated but Not Equal*, 13 DePaul Bus. & Com. L.J. 359, 362 (2015) (defining equity crowdfunding as “a limited Initial Public Offering (‘IPO’) conducted via an internet intermediary, often called a funding portal, and during this internet-based IPO, companies seeking funds give campaign contributors stakes into their ventures—in the form of shares—in exchange for contributions”); Christine Hurt, *Pricing Disintermediation: Crowdfunding and Online Auction IPOs*, 2015 U. ILL. L. REV. 217, 238-39 (defining equity crowdfunding as “the sale of participatory interests to the general public over the Internet”). Admittedly, some commentators use equity crowdfunding in a broader sense, to refer to all investment crowdfunding. E.g., David Groshoff, *Equity Crowdfunding As Economic Development?*, 38 CAMPBELL L. REV. 317, 326 (2016) (“[T]his Article uses equity crowdfunding to describe investment crowdfunding that may also be debt or some other security.”); Anjanette H. Raymond & Abbey Stemler, *Trusting Strangers: Dispute Resolution in the Crowd*, 16 CARDOZO J. CONFLICT RESOL. 357, 361 (2015) (describing equity crowdfunding as “crowdfunding through profit sharing”); Schwartz, supra note 12, at 678 (“Although it is sometimes called ‘equity crowdfunding,’ startups will be allowed to sell any type of security they wish, not just equity or common stock.”). This article uses the term in its narrow, more literal, sense.


17. Heminway, supra note 9, at 877-78 (describing the offering of investment contracts before the enactment of the CROWDFUND Act); Heminway, supra note 16, at 360 (“The use of investment contracts . . . became more prominent in the crowdfunding environment that existed in the year or two before the U.S. federal government began to take an interest in crowdfunding—the time period leading up to Congress’s adoption of the JOBS Act.”); Jack Wroldsen, *Crowdfunding Investment Contracts*, 11 Va. L. & Bus. Rev. 543, 555, 569-70, 573-76 (2017) (describing inequity offered before the enactment of the CROWDFUND Act and the offering of revenue-sharing and SAFE instruments under the CROWDFUND Act).

18. See id. (noting that, before enactment and effectiveness of the CROWDFUND Act, “[o]ne study found that one-third of all crowdfunding sites that offered investor rewards offered stock”).
liability company ("LLC") membership interests and partnership interests also are equity instruments. Both LLC and limited partnership equity interests may be offered and sold through crowdfunding—in fact, LLC equity interests already are being sold in CROWDFUND Act offerings.\(^\text{19}\) This article focuses primary attention on the offer and sale of corporate stock, but much of the description and analysis also applies to the sale of equity in other entities—at least to the extent that those equity interests constitute securities. Corporate stock, LLC membership interests, and limited partnership interests typically are classified as securities under applicable federal and state law.

B. Federal Regulation of CROWDFUND Act Securities Offerings

Equity crowdfunding, as a financing method involving the offer and sale of securities,\(^\text{20}\) engages securities regulation. Specifically, in the United States, under the Securities Act of 1933, as amended (the "1933 Act"),\(^\text{21}\) absent an exemption, an issuer must register the offer and sale of investment instruments categorized as securities.\(^\text{22}\) Registration, which provides standardized public information to potential investors and others, requires the preparation of a comprehensive disclosure document—a registration statement—that includes specifics about the issuing firm, the subject securities, and the offering. That registration statement must then be filed with the SEC.\(^\text{23}\) The registration process requires the issuer to commit

\(\text{\underline{19.} See Marc A. Leaf et al., Leading the Crowd: An Analysis of the First 50 Crowdfunding Offerings, DRINKER BIDDLE (July 14, 2016), http://www.drinkerbiddle.com/insights/publications/2016/07/leading-the-crowd-first-50-crowdfunding-offerings?noredirect=true (noting that five of the first fifty offerings under the CROWDFUND Act involved the offer and sale of LLC units).}\)

\(\text{\underline{20.} See Hurt, supra note 14, at 238 ("The offer and sale of stock or shares in a corporation clearly involves the offer and sale of securities under the plain language of Section 2(a)(1). Likewise, the offer or sale of an investment interest in a limited partnership, limited liability company, or even unincorporated project may be a security . . . .").}\)

\(\text{\underline{21. 15 U.S.C. §§ 77a to 77aa (2012).}}\)

\(\text{\underline{22. Id. § 77e; see also Bradford, supra note 9, at 42 ("Offerings of securities must be registered with the SEC unless an exemption is available.").}}\)

\(\text{\underline{23. See 15 U.S.C. §§ 77f, 77g (describing the process for the registration of offers and sales of securities and the contents of a registration statement); see also Heminway & Hoffman, supra note 10, at 908 ("As for the federal registration requirements, an issuer must file a registration statement that includes operating and financial disclosures about the issuer, information about the securities being offered and sold, and details about the plan of distribution of those securities."); Donald C. Langevoort & Robert B. Thompson, IPOs and the Slow Death of Section 5, 102 KY. L.J. 891, 894 (2014) ("An issuer seeking to raise capital in a public offering must first prepare and file a detailed disclosure document with}}\)
personnel and financial resources to the process, which ordinarily takes several months to complete. 24 State securities regulatory bodies, commonly known as “blue sky” commissions, engage in parallel regulation of securities offerings, and that state regulation applies in tandem with the federal regulation, unless preempted. 25 Under the CROWDFUND Act, state law registration of compliant offerings is expressly preempted. 26

Before enactment of the CROWDFUND Act, no clear exemption existed for crowdfunded offerings of securities. 27 The broad solicitation of investment dollars from the masses that crowdfunding employs typically is synonymous with a public offering—an offering to those who may not be sophisticated or otherwise able to adequately fend for themselves; an offering that compels application of the protective regime that registration the SEC, called the registration statement, and then await the SEC staff's approval before actually selling the securities.

24. See generally Heminway & Hoffman, supra note 10, at 908-10 (commenting, in sum, that “[r]egistration of the offer and sale of securities under the Securities Act is an expensive and time-consuming proposition”).


27. See Bradford, supra note 9, at 44 (“Companies selling securities on crowdfunding sites could avoid registration if an exemption were available. . . . Unfortunately, none of those exemptions is conducive to crowdfunding.” (footnotes omitted)); Edward A. Fallone, Crowdfunding and Sport: How Soon Until the Fans Own the Franchise?, 25 MARQ. SPORTS L. REV. 7, 20 (2014) (“Prior to 2012, offerings of securities sold under the equity crowdfunding model were not a good fit with the available exemptions from registration.”); Heminway & Hoffman, supra note 10, at 912 (noting before enactment of the CROWDFUND Act, that, among “[t]he few possible transactional registration exemptions under the Securities Act that one would consider in connection with a primary offering of interests in a crowdfunded business . . . none . . . provides a feasible path for a crowdfunding website or crowdfunded venture to avoid registering the offer or sale of profit-sharing interests” (footnotes omitted)).
provides. The CROWDFUND Act, signed into law in April 2012 and first operative under enabling SEC regulations in May 2016, introduces a new section 4(a)(6) to the 1933 Act (also sometimes denominated section 4(6), as a hold-over reference from prior iterations of section 4 of the 1933 Act) that provides an exemption from registration for crowdfunded offerings of securities that comply with specified requirements (the “Crowdfunding Exemption”).

1. Offering Registration Exemption

Overall, the Crowdfunding Exemption allows issuers to raise limited amounts of funding (initially, up to $1,000,000 in a twelve-month period) through open, public solicitations of investments in securities as long as those solicitations are conducted over the Internet through one of two mandated types of registered securities intermediary under required procedures and subject to required disclosures about the securities issuer, the securities, and the offering. The securities intermediary must be either a broker or a funding portal (the latter being a new type of registered intermediary created under the CROWDFUND Act). Investors are limited in the aggregate amount they can invest (based on the investor’s annual income or net worth) through offerings qualifying under the Crowdfunding Exemption.

Although the Crowdfunding Exemption became law in 2012, it was not automatically effective or self-actuating. The CROWDFUND Act expressly

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28. See Sec. & Exch. Comm'n v. Ralston Purina Co., 346 U.S. 119, 125 (1953) (“Since exempt transactions are those as to which ‘there is no practical need for [the bill's] application,’ the适用ability of § 4(1) should turn on whether the particular class of persons affected needs the protection of the Act. An offering to those who are shown to be able to fend for themselves is a transaction ‘not involving any public offering.’” (alteration in original)); see also Bradford, supra note 9, at 45 (“Crowdfunding offerings are not limited to sophisticated investors. Most crowdfunding sites are open to the general public—the whole point of crowdfunding is to appeal to this ‘crowd.’”); Nicholas Herdrich, Just Say No to Crowdfunding, 6 U.P.R. BUS. L.J. 157, 175-76 (2015) (“Crowdfunding opens investment opportunities to non-accredited investors, who are historically viewed as investors that are vulnerable to fraud and unable to easily absorb financial loss.”); Wroldsen, supra note 11, at 603 (“[H]istorical precedent demonstrates the need for investor protections when small businesses sell unregistered stock to unsophisticated investors over the Internet . . . .”).

29. See infra note 34 and accompanying text.

30. 15 U.S.C. § 77d(a)(6); see also Cohn, supra note 9, 1438 (“The crowdfunding registration exemption has been embedded as new § 4(6) of 1933 Securities Act.”).

31. 15 U.S.C. § 77d(a)(6)(A), (C), (D); id. § 77d-1(b).

32. Id. § 77d(a)(6)(C); id. § 77d-1(a).

33. Id. § 77d(a)(6)(B).
required SEC rulemaking before the Crowdfunding Exemption could become operative. 34 The applicable SEC rules were finalized in October 2015 (the "Crowdfunding Rules").35

2. Resale Restrictions

Under the Crowdfunding Rules, the availability of the Crowdfunding Exemption appears to be conditioned on compliance with resale restrictions.36 Both the Crowdfunding Exemption and the Crowdfunding Rules address an investor’s ability to transfer securities acquired in a crowdfunded offering exempt from registration under the CROWDFUND Act. In each case, resales of securities acquired in an offering conducted using the Crowdfunding Exemption are prohibited for a one-year period following the date on which the securities are purchased, with certain exceptions.37 Those exceptions expressly include transfers

- to the issuer of the securities,
- to an accredited investor,
- in a registered offering,
- to a family member of the purchaser (or the equivalent), or

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34. Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 302(c), 126 Stat. 306, 320 (2012) (“Not later than 270 days after the date of enactment of this Act, the Securities and Exchange Commission . . . shall issue such rules as the Commission determines may be necessary or appropriate for the protection of investors to carry out sections 4(6) and section 4A of the Securities Act of 1933, as added by this title.”).


36. See 17 C.F.R. § 227.100(a)(4) (2016) (“An issuer may offer or sell securities in reliance on section 4(a)(6) . . . provided that . . . [t]he issuer complies with the requirements in section 4A(b) . . . and the related requirements in this part; provided, however, that the failure to comply with §§ 227.202, 227.203(a)(3) and 227.203(b) shall not prevent an issuer from relying on the exemption provided by section 4(a)(6) . . . .” (first emphasis added)); see also Bradford, supra note 9, at 144-45 (“[I]f resale restrictions are given any teeth, such resales could cause issuers to lose their exemptions.”). Interestingly, the CROWDFUND Act does not expressly condition the availability of the Crowdfunding Exemption on compliance with the resale restrictions. See 15 U.S.C. § 77d(a)(6) (setting forth express conditions to the availability of the Crowdfunding Exemption); id. § 77d-1(c)(1) (noting that the transfer of securities is restricted, but not that compliance is a condition to availability of the Crowdfunding Exemption).

• in connection with the death or divorce of the purchaser or other similar circumstance.  

Under the Crowdfunding Exemption, the SEC is afforded express discretion over the “similar circumstance” to death or divorce. Moreover, resales under the Crowdfunding Exemption are “subject to such other limitations as the Commission shall, by rule, establish.” The SEC also has general exemptive power and interpretive influence under the 1933 Act that would encompass these matters.

Rule 501 of Regulation Crowdfunding incorporates and expands upon the CROWDFUND Act’s resale restrictions. Rule 501 clarifies that the Crowdfunding Exemption’s resale restrictions apply to any purchaser during the one-year period beginning when the securities were first issued. In other words, the resale restrictions apply to those who purchase securities from an initial purchaser (one who buys from the issuer) and that initial purchaser’s direct and indirect transferees during the one-year period following the initial purchase. Under Rule 501, Crowdfunding Exemption purchasers reselling to an accredited investor (which the rule defines using the existing definition in Regulation D under the 1933 Act) must have a reasonable belief that the purchaser qualifies as an accredited investor. The SEC also provides in Rule 501 that transfers are permitted during the one-year restricted period in several enumerated (and similar) circumstances: to certain trusts, to family members and others in equivalent

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39. Id. § 77d-1(e)(1)(D).
40. Id. § 77d-1(e)(2).
41. See id. § 77z-3; Sec. & Exch. Comm’n v. Timetrust, Inc., 28 F. Supp. 34, 39 (N.D. Cal. 1939) (“The administrative construction placed upon the Act by the Commission is entitled to great weight.”).
42. 17 C.F.R. § 227.501. Regulation Crowdfunding includes the rules set forth id. § 227.100 through id. § 227.503.
43. See id. § 227.501(a) (providing that securities issued in an offering conducted under the Crowdfunding Exemption “may not be transferred by any purchaser of such securities during the one-year period beginning when the securities were issued in a transaction exempt from registration”).
44. See id. § 227.501(b) (“[T]he term accredited investor shall mean any person who comes within any of the categories set forth in § 230.501(a) of this chapter, or who the seller reasonably believes comes within any of such categories, at the time of the sale of the securities to that person.”).
relationships, and in connection with death or divorce. The rule defines the family and equivalent relationships necessary to an understanding of the scope of the rule. Finally, the Crowdfunding Rules mandate that investor education materials provided to potential investors explain the resale restrictions.

II. Observations About U.S. Equity Crowdfunding Resale Restrictions

From the very start, the idea of restricting resales of securities acquired in CROWDFUND Act offerings was controversial. Before, at, and after the enactment of the Act, many were or have been critical of the resale restrictions as unnecessary or undesirable from the standpoint of investor protection or investor relations or as harmful to a potentially desirable securities offering market. Others have been more sanguine about the inclusion of resale restrictions in a system of securities crowdfunding regulation geared to minimize fraud and support the development of a fledgling trading market (depending on the other elements of regulation that may be employed).

45. See id. § 227.501(a)(4) (permitting transfers during the one-year restricted period to (among others) “a trust controlled by the purchaser” or, “to a trust created for the benefit of a member of the family of the purchaser or the equivalent”).

46. See id. § 227.501(c) (defining family members to include “a child, stepchild, grandchild, parent, stepparent, grandparent, spouse or spousal equivalent, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of the purchaser, and . . . adoptive relationships” and defining spousal equivalents as “a cohabitant occupying a relationship generally equivalent to that of a spouse”).

47. See id. § 227.302(b)(1)(iii) (“In connection with establishing an account for an investor, an intermediary must deliver educational materials to such investor that explain in plain language and are otherwise designed to communicate effectively and accurately: . . . [t]he restrictions on the resale of a security offered and sold in reliance on section 4(a)(6) of the Securities Act.”).

48. See, e.g., Bradford, supra note 9, at 144 (“Restrictions on resale are neither necessary nor desirable, although their presence will not unduly chill use of the exemption.”); Morsy, supra note 11, at 1393 (“While the one-year resale restriction tenuously serves an anti-fraud purpose, it ultimately harms investors more than it helps them.”).

49. See, e.g., Heminway & Hoffman, supra note 10, at 948-49, 954 (noting resale restrictions in a list of possible “general substantive attributes” of a securities crowdfunding registration exemption and offering that “restricting . . . resale . . . may help constrain fraud, which may be more likely to occur in resale markets”); Darian M. Ibrahim, Crowdfunding Without the Crowd, 95 N.C. L. Rev. 1481, 1501–02 (2017) (positing that “resale restrictions and other liquidity issues” may help constrain overoptimistic or untrue promotional statements on crowdfunding platform message boards); Jason W. Parsont, Crowdfunding: The Real and the Illusory Exemption, 4 HARV. BUS. L. REV. 281, 332 (2014) (“Since this
This diversity of opinion is noted in the SEC’s final rulemaking release. Yet, the SEC determined to preserve the congressionally imposed one-year holding period and to clarify its application to all transactions occurring during the year after the initial sale of securities under the CROWDFUND Act. Experience with resales of equity securities acquired in offerings conducted under the Crowdfunding Exemption, just a bit more that a full year in operation at the time work on this article was completed, will reveal whether any (and, if so, which) of the points made by commentators may be borne out in reality. In the interim, however, certain general observations can be made about the resale limitations imposed in the Crowdfunding Exemption and under the Crowdfunding Rules on crowdfunded stock in relation to a shareholder’s right to sell.

A. Effects on Shareholder Financial and Governance Rights

The restrictions on resale in the CROWDFUND Act, like other transfer restrictions, may hamper the development of a liquid trading market for the affected securities. This effect, in turn, makes it harder for investors to

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50. Crowdfunding, 80 Fed. Reg. 71,387, 71,475 (Nov. 16, 2015) (“Two commenters supported the proposed restrictions on resales, while several other commenters opposed any resale restrictions.”) (footnote omitted).

51. See supra note 43 and accompanying text.

52. Cf. Thomas Lee Hazen, Crowdfunding or Fraudfunding? Social Networks and the Securities Laws—Why the Specially Tailored Exemption Must Be Conditioned on Meaningful Disclosure, 90 N.C. L. REV. 1735, 1765 (2012) (“Only time will tell whether the express disclosure requirements in new section 4(6) of the 1933 Act will be sufficient to provide meaningful investor protection.”).

53. See, e.g., Richard A. Epstein, The Political Economy of Crowdsourcing: Markets for Labor, Rewards, and Securities, 82 U. CHI. L. REV. DIALOGUE 35, 50 (2015) (“The amounts invested are too small and the likelihood of major economic gains are too slight to justify the investments that would be required to create a secondary market.”); Ibrahim, supra note 49, at 1506 n.57 (2017) (“[I]t remains to be seen what secondary markets might develop for crowdfunding securities.”); Parsont, supra note 49, at 323 (noting that the resale restrictions, together with other features of the Crowdfunding Exemption, “will likely prevent a liquid secondary market comprised of knowledgeable professional investors from developing”); Schwartz, supra note 12, at 652 (“[T]here will likely be only a very limited and illiquid secondary market for crowdfunded securities.”); id. at 655 (“[T]here is unlikely to be much of a secondary market for crowdfunded securities, and definitely not one as deep and liquid as for traditional public companies.”); Andrew A. Schwartz. Keep It Light, Chairman White: SEC Rulemaking Under the Crowdfund Act, 66 VAND. L. REV. EN BANC 43, 49 (2013) [hereinafter Schwartz, Keep It Light] (“The secondary market for crowdfunded securities is
realize value from their investments, since they may or may not find a ready and willing buyer for their securities when they want to exit their investments. Moreover, the lack of a public market is likely to result in a marketability discount in the pricing of any investments sold. Of course, security holders still have the possibility of earning a current return on their investments through distributions. For equity holders, this means that they likely will be required to rely more heavily on dividends (or the equivalent in non-corporate entities) and repurchases—both of which are dependent on board action and subject to statutory constraints—in assessing the financial value of their investments.

Share transfer restrictions also affect the shareholders’ individual and collective abilities to discipline or signal to management through sales of their securities. Without a liquid public market for securities, the message sent to management may be nonexistent, weak, or unclear, and the effects sharply limited by the Act . . . .”)

See Hicks, supra note 7, at 421 (noting that an investor whose shares are subject to resale restrictions “loses the full range of opportunities that market liquidity provides to a security owner whose circumstances or investment needs have changed”); Schwartz, supra note 12, at 668 (“[T]he JOBS Act expressly prohibits a secondary market for a year after issuance. Even after that, the number of shares available will generally be too small to make practical a secondary market.” (footnote omitted)); Andrew A. Schwartz, Crowdfunding Securities, 88 NOTRE DAME L. REV. 1457, 1463 (2013) (“Crowdfunded companies, by contrast, are likely to have only thousands of securities outstanding, making it difficult and expensive to transact in them.”).

See, e.g., Hicks, supra note 7, at 421 (“Where an owner is foreclosed from the retail market and shunted into private transactions, he is likely to encounter a smaller number of potential purchasers and a lower sale price.”).

See, e.g., DEL. CODE ANN. tit. 8, § 170 (West 2010); MODEL BUS. CORP. ACT § 6.40 (AM. BAR ASS’N 2010). Professor Julian Velasco commented on the nature of shareholders’ dividend rights a decade ago.

The right to receive dividends is a limited one, both in law and in fact. Legally, shareholders only have the right to receive such dividends as are declared by the corporation’s board of directors. Directors have no obligation to declare dividends and may reinvest the corporation’s profits rather than distribute them to shareholders. Shareholders only have a legal right to the payment of dividends after, and to the extent that, the board of directors declares any.

Velasco, Fundamental, supra note 2, at 414 (footnote omitted). Nothing has changed in the intervening ten years.

See, e.g., Hicks, supra note 7, at 421 (“He cannot as easily dissociate himself from an issuer if for any reason he becomes dissatisfied with its management.”); Schwartz, supra note 12, at 652 (“The discipline of takeovers cannot be translated from traditional public companies to crowdfunded ones. As in the case of proxy contests, most crowdfunded companies will likely sell only a minority interest to the crowd, rendering a takeover impossible.” (footnote omitted)).
on the market for corporate control may be correspondingly uncertain. Moreover, at least one commentator has identified the possibility that the resale restrictions under the Crowdfunding Exemption create the opportunity for shareholder oppression akin to that in closely held firms.\textsuperscript{58} These governance-oriented aspects of a shareholder’s right to sell may contribute to discounted trading prices.

Yet, it is important to recognize that under the Crowdfunding Exemption, transfers to accredited investors are not subject to the one-year transfer restriction period. As a result, a market can develop among accredited investors even within the first year after primary sales are made under the CROWDFUND Act. If a secondary trading market is cultivated and sustained, the negative financial and governance effects of the resale restrictions under the Act may be less significant than they otherwise would be.

Also, the overall transfer restriction period under the Crowdfunding Exemption is only one year from the date of the initial purchase in the primary offering, which allows for a trading market to develop after that one-year period. Under Rule 144 (which initially included holding periods of two and three years for the unregistered resale of securities acquired in a transaction or chain of transactions not involving a public offering), a significant resale market eventually was generated.\textsuperscript{59} The SEC has decreased holding periods under Rule 144 over the past twenty years,

\textsuperscript{58} Schwartz, \textit{Keep It Light}, supra note 53, at 54 (“[T]he lack of a liquid secondary market creates the same potential for oppression in the crowdfunding context that is found in the close corporation.”).

ostensibly without a significant change in investor protection or market integrity, which facilitated the development of these markets.\textsuperscript{60} In like manner, a strong primary market for unregistered offerings under the CROWDFUND Act may also generate a robust—even if not fully liquid—resale market. If offerings under the Crowdfunding Exemption foster a healthy, ongoing secondary market for crowdfunded equity, shareholders may be able to realize some financial (and maybe even governance) rights akin to those of their public-company brethren.\textsuperscript{61}

\textbf{B. Effects on Public Offerings of Securities}

“U.S. federal securities law does not hold out a unitary concept of publicness, nor does it necessarily mandate a single path to becoming public.”\textsuperscript{62} Yet, the registered public offering has traditionally been the lodestar for analysis and the key entry point for firms that want to initiate and develop a public market for their equity securities in the United States.\textsuperscript{63} Public-company status is important in no small part because of the positive effects on issuers and investors created by a strong, liquid secondary market associated with public-company status.

\textsuperscript{60}. See William K. Sjostrom, Jr., Rebalancing Private Placement Regulation, 36 Seattle U. L. Rev. 1143, 1149-51 (2013) (tracing the history of decreased holding periods under Rule 144 and noting the SEC’s view that investor protection was not diminished through these changes); see also Langevoort & Thompson, Publicness, supra note 59, at 351 (“The 1933 Act's restriction on resales of restricted securities that began at three years in the early years of the Act has now shrunk to one year because of the changes to Rule 144 . . . .”); Thompson & Langevoort, Capital Raising, supra note 59, at 1595-96, 1613-14 (summarizing and commenting on the shortening of holding periods under Rule 144 over time); Parsont, supra note 49, at 325 (“[N]ew secondary markets have emerged to facilitate private security resales.”).

\textsuperscript{61}. But see Schwartz, supra note 12, at 652 (“The discipline of takeovers cannot be translated from traditional public companies to crowdfunded ones. As in the case of proxy contests, most crowdfunded companies will likely sell only a minority interest to the crowd, rendering a takeover impossible.” (footnote omitted)).

\textsuperscript{62}. Dombalagian, supra note 59, at 668.

\textsuperscript{63}. See id. at 655 (“The most basic gradation of publicness might encompass companies that have offered for sale to the general public debt or equity interests that are freely alienable without further negotiation of exit rights. The canonical example is a company that has made a ‘registered public offering’ under section 5 of the Securities Act.” (footnote omitted)); Langevoort & Thompson, supra note 23, at 894 (“Contemporaneous with the public offering the issuer will typically list its securities on a securities exchange, so that secondary trading of the newly issued securities begins immediately.”); A. C. Pritchard, Revisiting "Truth in Securities" Revisited: Abolishing IPOs and Harnessing Private Markets in the Public Good, 36 Seattle U. L. Rev. 999, 1000 (2013) (describing initial public offerings as “the customary path for attaining public-company status”).
In addition to providing money, shareholders create the secondary market for shares. A well-functioning market for shares allows existing shareholders to exit at a price that is a reasonable estimate of the value of the investment in the firm and likewise allows new shareholders to enter at a reasonable price. Moreover, a secondary trading market with reasonably accurate prices means that shares can be used to make acquisitions without dilution of the buying firm's shareholders (in the case of undervalued shares) or dilution of the selling firm's shareholders (in the case of overvalued shares). Similarly, a reasonably accurate stock price makes stock- or option-based compensation a more useful tool for aligning manager and shareholder interests. 64

These benefits are available to public companies, but not all public companies have the active, efficient trading markets that afford the full range of these benefits.

Although public offerings long have been the primary means of creating public securities trading markets in the United States, “[t]here is nothing about public offerings . . . that makes them inherently antecedent to public-company status.”65 The CROWDFUND Act introduces a new, unregistered, wide-reaching brand of securities offering into the mix of capital-raising alternatives that, together with other changes in U.S. securities regulation, may become a new gateway to public securities markets. The resale provisions of the CROWDFUND Act constitute a significant piece of the regulatory puzzle that engages shareholder liquidity, public offerings, and public markets.

Equity crowdfunding qualifies as a public offering under the accepted standard definition adopted in decisional law more than sixty years ago.66

64. Edward B. Rock, Shareholder Eugenics in the Public Corporation, 97 CORNELL L. REV. 849, 854-55 (2012) (footnote omitted); see also Schwartz, supra note 1, at 772 (“An important aspect of the corporation is its facilitation of passive investments by individual investors, which the corporation can then aggregate to permit large-scale investments and operations.”).

65. Pritchard, supra note 63, at 1001.

Specifically, because crowdfunded offerings are made through general solicitations over the Internet, there is no guarantee that investors can fend for themselves or that they otherwise are adequately protected absent registration of the offering under the 1933 Act.67 As a result, the Crowdfunding Exemption provides an alternative disclosure scheme, scaled to and otherwise customized for use in a CROWDFUND Act offering.68 That scheme, along with other aspects of offerings using the Crowdfunding Exemption, places equity crowdfunding somewhere in the nether land between public offerings and private placements in the spectrum of offering regulation.69

The Crowdfunding Exemption’s resale restrictions distinguish equity offerings under the CROWDFUND Act from public offerings of equity as they existed prior to the adoption of the Act. In particular, registered public offerings of securities allow for free resales of those securities by non-affiliates of the issuer, facilitating trading markets.70 Typically, holding period restrictions are imposed in connection with private placements of securities and other unregistered securities offerings to control the market for securities by preventing an indirect unregistered distribution of the 

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67. See sources cited supra note 28 and accompanying text; see also Bradford, supra note 9, at 109 (“[C]rowdfunding is open to the general public, and many members of ‘the crowd’ are not that financially well-informed.”); Cox, supra note 25, at 854 (“[T]he participants in crowdfunding cannot be expected to be sophisticated, or to have sufficient investment at stake to merit professional representation, and are so dispersed as to encounter non-trivial costs to engage in coordinated response.”).

68. See 17 C.F.R. §§ 227.201-202 (2016) (comprising the disclosure and reporting requirements under the Crowdfunding Exemption); Hazen, supra note 52, at 1765 (“The JOBS Act conditions the crowdfunding exemption on disclosure to investors which quite properly preserves the proper balance by encouraging small business financings while also giving appropriate consideration to investor protection.” (footnote omitted)).

69. See Joan MacLeod Heminway, Crowdfunding and the Public/Private Divide in U.S. Securities Regulation, 83 U. Cin. L. Rev. 477, 489 (2014) (“[T]he CROWDFUND Act . . . appears to create an integrated offering and issuer status somewhere between public and private by combining concepts from each regime.”); Parsont, supra note 49, at 323 (“Retail crowdfunding is a hybrid between a public and a private offering.”).

70. See Hicks, supra note 7, at 432 (“A person who purchases securities in a registered public offering will not discover resale restrictions imprinted on his stock certificate or other evidence of ownership interest.”); J. William Hicks, Protection of Individual Investors Under U.S. Securities Laws: The Impact of International Regulatory Competition, 1 Ind. J. Global Legal Stud. 431, 448 (1994) (“Securities that are sold in registered public offerings may be resold immediately in any manner and in any amount by any person who is not deemed to be an affiliate of the issuer.”).
securities.\textsuperscript{71} They are designed to serve as instruments of both investor and market protection.\textsuperscript{72} Yet, restrictive holding periods are getting ever shorter in length (as exemplified by the sequential changes to Rule 144) and may have narrower application.\textsuperscript{73}

In the wake of resale restrictions with short holding periods and significant exceptions (like those under the CROWDFUND Act), the protections of the 1933 Act become less significant. The principal protection provided to investors under the 1933 Act is the requirement that public offerings be registered.\textsuperscript{74} Given the human and financial capital investment involved in the 1933 Act registration process,\textsuperscript{75} registered public offerings will become a less favored option for raising capital.

\textsuperscript{71} See, e.g., C. Steven Bradford, Expanding The Non-Transactional Revolution: A New Approach to Securities Registration Exemptions, 49 EMORY L.J. 437, 478-79 (2000) (noting that holding period requirements help to establish the investment intent that helps securities resellers avoid being classified as underwriters involved in a distribution of securities); Dombalagian, supra note 59, at 673 (“The SEC has traditionally justified restrictions on the offer and resale of securities as anti-evasion rules to discourage issuers from effecting unregistered public offerings.”); Hicks, supra note 7, at 432 (“Holding period requirements attach to securities that are sold pursuant to private placements under section 4(2) or 4(6) or in limited offerings under rules 504 or 505 of Regulation D.” (footnotes omitted)); Parsont, supra note 49, at 323 (describing the resale restrictions under the CROWDFUND Act as “privatelike”).

\textsuperscript{72} See Hicks, supra note 7, at 471 (expressing concern that relaxing resale limitations on privately placed securities may “jeopardize public confidence in our securities markets and reduce investor protection in unregistered offerings”).

\textsuperscript{73} See supra note 60 and accompanying text. Professor Onnig Dombalagian notes the following in this context:

Mechanistic limitations on the resale of securities have arguably lost some of their luster as a strategy to check the emergence of secondary markets in privately placed securities. Time and size restrictions—such as holding periods or limitations on the amount of securities that can be freely resold in the wake of an unregistered offering—are crude tools to slow the penetration of securities into a secondary market because they force initial purchasers to assume economic risk for a longer period of time.

Dombalagian, supra note 59, at 673 (footnote omitted).

\textsuperscript{74} See Stuart R. Cohn, The Impact of Securities Laws on Developing Companies: Would the Wright Brothers Have Gotten Off the Ground?, 3 J. SMALL & EMERGING BUS. L. 315, 361 (1999) (describing the investor protection provided by 1933 act registration); Lucas S. Osborn, The Leaky Common Law: An “Offer to Sell” as a Policy Tool in Patent Law and Beyond, 53 SANTA CLARA L. REV. 143, 159 (2013) (“To provide full and fair disclosure and thus help protect investors, the act generally requires offering companies to file registration statements with the Securities & Exchange Commission . . . ”).

\textsuperscript{75} See supra note 24 and accompanying text.
One has to ask if we are not close to, if not at, a point at which it will be seriously tempting for intermediaries to take on that limited holding period (perhaps with some hedging of the risk) if there are no limits or restrictions—other than antifraud rules—on the dump that takes place thereafter. If so, that could be one more nail in the coffin of the registered public offering and the demise of the protections supposedly afforded by the '33 Act.\footnote{Thompson & Langevoort, Capital Raising, supra note 59, at 1596.}

Certainly, the human and money capital costs of registration and the availability of viable primary offering alternatives that afford investors appealing (even if not perfect) resale options decrease the importance of registered public offerings as a means of accessing capital from the public.\footnote{See Chris Brummer, Disruptive Technology and Securities Regulation, 84 FORDHAM L. REV. 977, 1024 (2015). Specifically, Professor Brummer observes that public offerings in the twenty-first century are even less legally and practically necessary. . . . [T]echnology has worked alongside regulatory reforms to make staying private easier and private placements more efficient and attractive. These developments contrast considerably with the public offering process, which is not only more costly than in the 1930s, but also presents fewer obvious comparative advantages. As a result, the public offering process, and indeed public company status, are faced with the uncomfortable prospect of becoming increasingly marginalized as private markets and private market infrastructure continue to develop in ways that maximize the flexibility of recent regulatory reforms. Id.}

C. Effects on Offering and Trading Markets

Given that the U.S. Congress enacted legislation supporting equity crowdfunding and that equity crowdfunding undertaken in compliance with the Crowdfunding Exemption has the potential to be a new gateway to public securities trading markets that facilitate resales of equity securities, the effects of the CROWDFUND Act’s resale restrictions on public securities markets bear some scrutiny. Among other things, to be successful as a market for business finance, equity crowdfunding must present a cost-effective alternative to other available financing options for all participants. I have previously been critical of the costs of securities crowdfunding under the CROWDFUND Act, speculating that the financial costs of the proposition exceed its potential benefits for many firms.\footnote{Heminway, supra note 9, at 880-85. Although the views expressed in that article predate the adoption of final rules under the CROWDFUND Act, those final rules change}
In an April 2003 article, Professor Ron Gilson examined the U.S. venture capital market to offer direction to other countries in establishing similar markets. A number of the observations he makes in that article provide interesting insights into the emergent crowdfunding market. Specifically, he perceives that three factors—uncertainty, information asymmetry, and agency costs—"inevitably bedevil early-stage, high-technology financing." Although not all businesses financed through equity crowdfunding are high-technology firms, crowdfunding involves the use of technology and crowdfunded offerings typically provide early-stage financing.

Perhaps because of these commonalities, Professor Gilson’s factors are attributes of the prototypical firm seeking to use equity crowdfunding as a financing method. The faceless nature of the Internet as a transactional medium adds uncertainty to the start-up and small-business environment in which equity crowdfunding most often occurs. Moreover, although the Internet opens up avenues for direct and tailored communication, the relative inexperience of issuers and investors, without intervention by expert intermediaries, may prevent or delay the optimization balanced

80. Id. at 1069. Professor Gilson characterizes uncertainty, information asymmetry, and agency costs as “three central problems” that “[a]ll financial contracts respond to.” Id. at 1076.
81. Professor Gilson observes that early-stage, high-technology firms manifest extreme uncertainty, information asymmetry, and agency costs. Id. at 1076. He notes in this connection that “the technology base of the portfolio company's business exacerbates the general uncertainty by adding scientific uncertainty,” “the fact that the portfolio company's technology involves cutting-edge science assures that there will be a substantial information asymmetry in favor of the entrepreneur even if the venture capital fund employs individuals with advanced scientific training,” and “the significant variance associated with an early stage, high technology company's expected returns” amplify agency costs. Id. at 1077.
82. Schwartz, supra note 12, at 612-13 (referencing Gilson’s work and asserting that “[t]his well-known ‘trio of problems’ applies directly to crowdfunding, where they will present themselves in “extreme form” due to the very early stage of the startups involved.”).
83. Id. at 630-31 (concluding that “uncertainty is at a height for the type of startups that will use crowdfunding”); id. at 659 (“Investing in startups with no track record through online crowdfunding presents tremendous uncertainty . . . for investors.”); Gmeleen Faye B. Tomboc, The Lemons Problem in Crowdfunding, 30 J. MARSHALL J. INFO. TECH. & PRIVACY L. 253, 267 (2013) (“[O]nline investors face greater uncertainty than investors in offline brick and mortar businesses.”).
information access.\textsuperscript{84} Founders and promoters, among others, still may benefit from information asymmetries. In addition, the impersonal nature of Internet finance offerings creates opportunities for agency costs to surface and escalate.\textsuperscript{85} Agency costs may be exacerbated by the same volatility in expected returns that characterizes early-stage high-technology ventures, expected returns that are impacted by resale restrictions under the CROWDFUND Act.\textsuperscript{86}

The CROWDFUND Act is designed to address these three aspects of issuers in the equity crowdfunding market principally through governmental prescriptions and proscriptions that include mandatory disclosure, the required use of a registered intermediary, expert financial statement review, and other provisions. The resale restrictions in and under the CROWDFUND Act, however, contribute little—if at all—to resolving investor unease or market integrity questions in any of the three problem areas. In fact, they may reinforce or magnify questions regarding uncertainty, information asymmetry, and agency costs. On the one hand, the resale restrictions prevent the early generation of a realistic exit market for non-accredited investors. Equity crowdfunding investors—at least some of them—may be effectively locked into their investments, at least for a year. On the other hand, the resale restrictions under the CROWDFUND Act allow for the creation of an immediate realistic exit market for accredited

\textsuperscript{84} Schwartz, \textit{supra} note 12, at 631-33 (concluding that “crowdfunded startups present a great deal of information asymmetry.”); \textit{id}. at 659 (“Investing in startups with no track record through online crowdfunding presents . . . information asymmetries for investors.”); Tomboc, \textit{supra} note 83, at 279 (noting the high level of information asymmetry in crowdfunding, quoting from and citing TOSHI O YAMAGISHI ET AL., SOLVING THE LEMONS PROBLEM WITH REPUTATION, E- TRUST: FORMING RELATIONSHIPS IN THE ONLINE WORLD 73 (Karen S. Cook et al. eds. 2009).


\textsuperscript{86} Cf. J.W. Verret, \textit{Uber-Ized Corporate Law: Toward A 21st Century Corporate Governance for Crowdfunding and App-Based Investor Communications}, 41 J. CORP. L. 927, 944 (2016) (“Crowdfunding for many smaller startups will be characterized by a relatively higher level of firm-specific executive talent and by a relatively illiquid secondary market for the firm's securities relative to larger firms on public markets.”); Shekhar Darke, \textit{Note, To Be or Not to Be a Funding Portal: Why Crowdfunding Platforms Will Become Broker-Dealers}, 10 HASTINGS BUS. L.J. 183, 188–89 (2014) (“One downside to crowdfunding is small business and startup volatility. Investments in start-ups and small businesses are not liquid . . . . Moreover, start-ups and small businesses are inherently risky . . . .”).
investors who may have networks of fellow accredited investors to whom they can sell. Even these sales do not necessarily decrease uncertainty, information asymmetries, and agency costs, however. Accredited investors have the financial capacity to bear risk but may not have the capacity to acquire, understand, and efficaciously process the information necessary to optimal investment decision making. Accordingly, even after taking into account the potential detriments associated with the resale restrictions (including related observations about uncertainty, information asymmetry, and agency costs), the costs of using the Crowdfunding Exemption may outweigh its benefits.87

Both the lack of existence of a resale market and support for an unsustainable resale market may have adverse effects on the markets involved in equity crowdfunding. To the extent that equity crowdfunding investors are (or believe themselves to be) locked into their ownership of the firm without governance power or influence over the firm, concerns about uncertainty, information asymmetry, and agency costs may dissuade investors from buying stock in a crowdfunded offering. The governmental creation and maintenance of a vigorous trading market for crowdfunded equity when uncertainty, information asymmetry, and agency costs continue to exist at high levels may also impair the success of the equity crowdfunding market. At the extreme, the equity crowdfunding market could collapse and damage the overall investment market for start-ups and early-stage ventures.88 That would, indeed, be an undesirable and, for many, unfortunate result.

87. Cf. Heminway, supra note 9, at 884-85 (noting that market participants may continue to choose private placement transactions instead of securities crowdfunding for early-stage financings). As I noted in earlier work, the creation of a crowdfunding market that invites participation principally from accredited investors would be an unfortunate by-product of the CROWDFUND Act, inconsistent with its original ostensible purpose.

A two-tiered system in which the general public—which includes non-accredited investors—is left with unattractive investment options is inconsistent with the spirit underlying the CROWDFUND Act. If, as I contend, the costs of complying with the crowdfunding exemption shut promising small businesses (both potential issuers and intermediaries) out of the capital market or shift their preferences to private placement transactions involving a limited, elite group of investors, then the CROWDFUND Act will have failed in its mission and constitutes a waste of congressional and SEC resources.

Id. at 885.

88. See Gilson, supra note 79, at 1077 (concluding, with respect to the venture capital market, that “[a]bsent a workable response, the extremity of uncertainty, information asymmetry, and agency problems likely would raise the cost of external capital to a point of
III. Conclusion

The right to sell is an important part of the shareholder rights package and the regulatory and market structures in which equity investments are made. Specifically, “[t]his right of alienation is of the utmost importance to shareholders both because it is a means of obtaining economic benefit from their investment in the corporation and because it is their means of exit should they become dissatisfied with management.” Although a shareholder’s right to sell in the public-company setting is (absent contractual restrictions) relatively unfettered in the United States, privately placed securities and securities in privately (and especially closely) held firms are, by their legal nature under federal and state securities laws, more limited. Ideally, stock transfer restrictions imposed under the U.S. securities laws strike “a proper balance between public protection and securityholder freedom.”

Equity crowdfunding under the CROWDFUND Act occupies a regulatory space somewhere between traditional, pre-JOBS Act public offerings of securities and private placements of equity. Resales of equity securities acquired in an offering that complies with the Crowdfunding Exemption are restricted for a one-year period. This one-year holding period is subject to certain exceptions, however, including an exception for transfers to accredited investors. Given the relatively short holding period and the potential to transfer shares to accredited investors, the extent to

market failure, leading to a similar collapse in the formation of early stage, high technology companies”).

89. Velasco, Fundamental, supra note 2, at 425 (footnote omitted); see also Philip M. Nichols, Creating a Market Along the Silk Road: A Comparison of Privatization Techniques in Central Asia, 29 N.Y.U. J. INT’L L. & POL. 299, 306 n.28 (1997) (“A functioning secondary market in shares, of course, is vital both for allowing shareholders to appreciate the value of their investment and for the purposes of applying market discipline to management.”).

90. See supra note 4 and accompanying text; see also Robert C. Illig, Minority Investor Protections as Default Norms: Using Price to Illuminate the Deal in Close Corporations, 56 AM. U.L. REV. 275, 288 n.43 (2006) (“This ability of public company shareholders to exit at minimal cost is known informally as the ‘Wall Street Rule’ and is distinguished from the close corporation context where no such exit is typically available.”).

91. Hicks, supra note 7, at 472.

92. See supra note 69 and accompanying text; see also Hurt, supra note 14, at 239 (“Crowdfunding via an Internet website walks a strange path between regulated public offerings and exempt private placements . . . .”).

93. See supra note 37 and accompanying text.

94. See supra note 38 and accompanying text.
which shareholder rights, securities offering regulation, and securities trading markets are or may be affected by the CROWDFUND Act’s resale restrictions remains unclear.

The uncertain long-term effects of the resale restrictions imposed in and under the CROWDFUND Act have the capacity to impact equity investing in all three of these areas. Shareholders with the limited monitoring rights associated with public-company ownership but without the freedom to resell in a liquid public market supported by standardized disclosures likely would determine that their rights are undesirably limited. While shareholders who purchase crowdfunded equity in an offering conducted under the Crowdfunding Exemption do have limited monitoring rights, standardized disclosures are required\(^{95}\) and there is a capacity for market development that may enable exit and the enjoyment of related shareholder-rights benefits.\(^{96}\) Moreover, although resale restrictions may be deemed to prevent the development of public markets that would have benefits to issuers and shareholders alike, the limited nature of resale restrictions under the CROWDFUND Act may help to make equity crowdfunding an attractive and superior alternative to registered public offerings for the primary sale of equity securities. Relatedly, the limited resale restrictions imposed on equity offerings under the CROWDFUND Act may enable a more cost-effective development of public trading markets for stock in privately held firms than is possible through traditional registered public offerings. Even if trading markets are generated, however, they may or may not be healthy or sustainable in the long term.

I am not a soothsayer; I make no predictions. But I sense from the observations made in this article that the long-term potential for suitable resale markets for crowdfunded equity—whether under the CROWDFUND Act or otherwise—are important to the generation of capital for small business firms (and especially start-ups and early-stage ventures). In that context, three important areas of reference will be shareholder exit rights, public offering regulation, and responsiveness to the uncertainty, information asymmetry, and agency costs inherent in this important capital-raising context. Only after a period of experience with resales under the CROWDFUND Act will we be able to judge whether the resale restrictions under that legislation are appropriate and optimally crafted.\(^{97}\)

\(^{95}\) See supra note 68 and accompanying text.

\(^{96}\) See supra Part II.A.

\(^{97}\) Hicks, supra note 7, at 471 (“[T]he validity and scope of any resale limitation must be judged by the function it serves in furthering statutorily based regulation of that transaction.”).