The JOBS Act and Crowdfunding: How Narrowing the Secondary Market Handicaps Fraud Plaintiffs

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The JOBS Act and Crowdfunding

HOW NARROWING THE SECONDARY MARKET HANDICAPS FRAUD PLAINTIFFS

INTRODUCTION

Social networking has dominated the beginning of the twenty-first century. Its utility has extended beyond contacting friends to becoming a powerful marketing tool. Most recently, startup companies have begun to recognize its capability as a tool for acquiring funds by soliciting small donations from other internet users. This mechanism, by which funds for projects are procured by appealing to the internet community, is aptly called crowdfunding.

In recognition of its potential, crowdfunding has received further legitimation as a means for raising necessary capital from the federal government. Federal securities law has been amended to specifically legalize issuing equity-based securities through crowdfunding. In 2012, Congress passed the Jumpstart Our Business Startups Act (JOBS Act). The JOBS Act contains “game chang[ing]” provisions intended to allow small businesses, especially tech startups, to solicit investors. Among the provisions that have generated excitement from

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7 Id.
investors and small businesses are those that create the new crowdfunding exemption. After certain disclosure requirements are met, small businesses may solicit investors through approved brokers or funding portals. The JOBS Act exempts crowdfunding issuers and investors from SEC reporting requirements so long as the transactions fall within statutory boundaries.

Nevertheless, while the JOBS Act creates new investment opportunities, it also creates the potential for investment fraud, posing unique challenges to investor fraud claims. Statutes such as the Private Securities Litigation Reform Act pose additional hurdles to those pursuing a fraud securities action. Furthermore, crowdfunding securities will occupy a novel space in common law jurisprudence on federal securities fraud litigation. Although the securities are generally available to the public, they cannot be resold within the first year of ownership. This restriction reduces liquidity of those securities, which diminishes the viability of a vibrant secondary market. Secondary markets have played an important role in the viability of currently established securities markets. A robust secondary market is a key factor in determining whether a market is efficient, that is, whether the information is reflected by the stock price. In turn, this makes it harder to establish that the stock price reflects information, in essence, making it hard to prove loss causation. If investors cannot show loss causation, then their fraud lawsuits will ultimately fail. Thus, without proper guidance by the Securities and Exchange Commission (SEC), plaintiff crowdfunding investors may be left with nothing but worthless stock.

This note addresses challenges to fraud litigation created by the JOBS Act. Part I provides background on the

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10 Id. For a securities transaction to be exempted under § 77d, the “aggregate amount sold to all investors by the issuer . . . is not more than $1,000,000,” and “the aggregate amount sold to any investor by an issuer” cannot exceed “the greater of $2,000 or five percent of the annual income or net worth of such investor if either the annual income or the net worth of the investor is less than $100,000.” Id. § 77d(6)(B) (2012).
11 See infra Part III.
13 Infra Part III.
15 Infra Part III.
16 Infra Part III.
17 Infra Part III.
18 Infra Part III.
JOBS Act and introduces the crowdfunding provisions of the Act. Part II explores the statutory and common law background of fraud litigation. Part III examines litigation options available to defrauded investors in light of the JOBS Act’s crowdfunding provisions, as well as the undesirable impact of the Act’s one-year resale restriction on shareholder litigation, including loss causation. Part IV offers suggestions for dealing with this negative impact, more specifically, showing that, if the restriction on resale is loosened by allowing resale of shares to members already registered with complying funding portals, the loss causation problem discussed in Part III becomes less problematic.

I. BACKGROUND

The JOBS Act has garnered a lot of excitement from investors who impatiently await the SEC’s implementation of certain key provisions, including those relating to crowdfunding. But, the Act has been criticized for loosening regulations at the expense of the investor. This section will explore the historical background of the JOBS Act, and describe certain key provisions.

A. The Economic Environment That Gave Rise to the JOBS Act

Understanding the environment that gave rise to the JOBS Act helps explain the purpose behind its provisions. In 2008, the U.S. economy entered into the worst recession in recent history.


21 See, e.g., Roberta Karmel, Crowd-funding and Related Deregulation, N.Y. L.J. (ONLINE) (Feb. 16, 2012) (“Moreover, such legislation is likely to lead to widespread abuse of investors . . . .”).

Additionally, the first decade of the twenty-first century saw several financial scandals. Many commentators attributed the economic crisis to deregulatory measures, such as the repeal of the Glass-Steagall Act. In response to the crisis, Congress passed the Dodd-Frank Act in 2010, which imposed additional regulatory requirements on securities issuers. Several years later, the SEC is still struggling to implement the Dodd-Frank Act.

In 2012, the economy remained stagnant. The economy’s anemic growth was attributed to investor weariness, which some argued caused investors to withhold capital. All the while, technological companies began lobbying Congress to ease compliance requirements to allow them to enter the public market through Initial Public Offerings. Small businesses, which had been hit hard by the recession, were viewed by some as the way out of the recession. America’s fixation with small businesses and its hope that those businesses would revive the economy were enough to create bipartisan support for the passage of JOBS Act.

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26 For a detailed explanation on the delay of Dodd-Frank, see id., at 1019.


Crowdfunding in many ways symbolizes America’s hope in small businesses.\textsuperscript{32} Crowdfunding is a combination of crowdsourcing and microfinance, enabled by social networking.\textsuperscript{33} Crowdfunding websites solicit investments from ordinary people for projects.\textsuperscript{34} These projects usually involve artistic or gaming endeavors.\textsuperscript{35} Statistics also show that crowdfunding tends to engage younger people.\textsuperscript{36}

Prior to the JOBS Act, small businesses could not solicit investors through crowdfunding websites by promising equity in return for capital.\textsuperscript{37} This is because soliciting investors by promising equity or profits in exchange for buying shares from crowdfunding websites would have violated general solicitation provisions of federal securities laws.\textsuperscript{38} Congress’s ban on general solicitation in the Securities Exchange Act of 1933 was meant primarily to protect investors from fraudsters.\textsuperscript{39} Regulation D, Rule 502 bans non-exempt issuers—businesses that issue shares in exchange for equity—from advertising their offerings over several mediums.\textsuperscript{40} Some have lamented the provisions that ban


\textsuperscript{33} See Bradford, supra note 4, at 27. Microfinancing “involves lending very small amounts of money” whereas crowdsourcing involves combining the efforts of numerous individuals to “achieve a goal.” Id.


\textsuperscript{35} For a more detailed explanation of the history of crowdfunding see Bradford, supra note 4, at 14-27.


\textsuperscript{37} See 17 C.F.R. § 230.502(c) (2011). “[A]n investment contract for the purposes of the Securities Act means a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of a promoter or a third party . . . .” SEC v. W.J. Howey Co., 328 U.S. 293, 298-99 (1946). For a more detailed analysis as to how crowdfunding can count as securities, see Joan MacLeod Heminway & Shelden Ryan Hoffman, \textit{Proceed at Your Own Peril: Crowdfunding and the Securities Act of 1933}, 78 TENN. L. REV. 879, 954 (2011).

\textsuperscript{38} 17 C.F.R. § 230.502(c) (“[N]either the issuer nor any person acting on its behalf shall offer or sell the securities by any form of general solicitation or general advertising.”).

\textsuperscript{39} See, e.g., Thomas Lee Hazen, \textit{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, 1747-48 (2012) (“In large part as a response to these so-called ‘pump and dump’ schemes, the SEC amended Rule 504 to prohibit . . . general solicitation.”).

\textsuperscript{40} This includes “[a]ny advertisement, article, notice or other communication published in any newspaper, magazine, or similar media or broadcast over television or
Critics have cited the transaction costs of finding investors without generally soliciting them. Specifically, critics hope that with easier access to capital, small businesses can thrive.

Further, even if crowdfunding was not per se illegal, small businesses could not feasibly use it as a source of funding. This is because investments that promise equity—profits in exchange for capital—are securities under federal securities law. Thus, many small businesses would be required to register and report to the SEC and become a publicly traded company. The SEC’s compliance requirements are rigid and very expensive for the vast majority of small companies.

To address these issues, the JOBS Act contains provisions that legalize equity crowdfunding, subject to certain conditions.

B. Crowdfunding Provisions

Under the JOBS Act, there are four requirements that must be met to exempt a securities transaction from reporting requirements and the Rule 502 ban on solicitation:

(A) the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under this paragraph during the 12-month period preceding the date of such transaction, is not more than $1,000,000;

(B) the aggregate amount sold to any investor by an issuer, including any amount sold in reliance on the exemption provided under this paragraph, is not more than $100,000.

radio” and “any seminar or meeting” with attendees organized by such solicitation. 17 C.F.R. § 230.502(c) (2011).


The Jumpstart Our Business Startups Act § 302.
paragraph during the 12-month period preceding the date of such transaction, does not exceed—

(i) the greater of $2,000 or 5 percent of the annual income or net worth of such investor, as applicable, if either the annual income or the net worth of the investor is less than $100,000; and

(ii) 10 percent of the annual income or net worth of such investor, as applicable, not to exceed a maximum aggregate amount sold of $100,000, if either the annual income or net worth of the investor is equal to or more than $100,000;

(C) the transaction is conducted through a broker or funding portal that complies with the requirements of section 77d-1(a) of this title; and

(D) the issuer complies with the requirements of section 77d-1(b) of this title.\(^4\)

Section 77d-1 places several requirements on issuers who offer securities through crowdfunding portals.\(^4\) An issuer must meet several disclosure requirements by disclosing its name, the names of its directors, “a description of the business of the issuer,” and its business plan.\(^5\) It must also go through various background checks depending on the size of its securities offering.\(^6\) With some exceptions,\(^7\) securities purchased through crowdfunding cannot be sold for a period of one year.\(^8\)


\(^{4}\) See id. § 77d-1(b).

\(^{5}\) Id. An issuer must:

file with the Commission and provide to investors and the relevant broker or funding portal, and make available to potential investors—(A) the name, legal status, physical address, and website address of the issuer; (B) the names of the directors and officers (and any persons occupying a similar status or performing a similar function), and each person holding more than 20 percent of the shares of the issuer; (C) a description of the business of the issuer and the anticipated business plan of the issuer; (D) a description of [the issuer’s] financial condition . . . ; (E) a description of the stated purpose and intended use of the proceeds of the [securities] offering; (F) the target offering amount, the deadline to reach the target offering amount, . . . ; (G) the price to the public of the securities or the method for determining the price . . . [and] a reasonable opportunity to rescind the commitment to purchase the securities; [and] (H) a description of the ownership and capital structure of the issuer . . . .

\(^{6}\) Id.

\(^{7}\) § 77d-1(b)(1)(D). Depending on the amount, the level of disclosure ranges from income taxes at a minimum to audited financial statements at a maximum. Id.

\(^{8}\) Id. § 77d-1(e)(1). Securities can be transferred to the “issuer of those securities,” “an accredited investor,” “as part of [a] [registered] offering,” and to family members. Id.
The JOBS Act calls for the creation of funding portals. These portals are where the crowdfunding securities will be transacted.54 Section 77d-1 places requirements on funding portals and issuers that must be met to capitalize on the exemptions.55 These portals must “ensure that each investor . . . reviews investor-education information, [and] . . . affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor could bear [the] loss.”56 The investor must answer questions that demonstrate an “understanding of the level of risk” associated with startup investments, illiquidity, and other investment matters.57 Regulation of these funding portals is delegated to the Financial Industry Regulatory Authority (FINRA).58

C. The Ingredients for Fraud

Among the chief concerns of opponents of the JOBS Act is that its crowdfunding exemption creates a new means to defraud investors.59 There is merit to this concern. The JOBS Act exemptions bear some resemblance to the old Rule 504, which allowed “non-reporting issuers to offer and sell securities to an unlimited number of persons without regard to their sophistication or experience and without delivery of any specified information.”60 The old Rule 504 enabled widespread fraud and had to be amended by the SEC.61 Additionally, internet transactions may cater to impulse decision-making rather than careful deliberation over the financial security of investing in a particular project.62 These factors create fertile ground for fraud.

54 § 77d-1(a).
55 §§ 77d-1(a)-(b).
56 § 77d-1(a)(4).
57 Id.
59 See Hazen, supra note 39, at 1769.
61 See Karmel, supra note 21 (“Due to widespread fraud in the use of this exemption from registration, the SEC amended Rule 504 in 1999 by providing that securities issued under the rule are ‘restricted’ and prohibiting general solicitation and general advertising unless certain conditions are met.”).
1. The JOBS Act and its Similarity to the Old Rule 504

The exemptions created by the JOBS Act do in fact share several similarities to the old Rule 504. Like the new exemption in the JOBS Act, the old Rule 504 limited the aggregate offering price to $1 million in “[a] twelve month period.” The impetus behind the old Rule 504 is also similar to that behind the JOBS Act—that small businesses should have easier access to capital. These similarities have bolstered the argument that crowdfunding will enable fraud.

Nevertheless, the two rules are not identical. There are several notable differences between the old Rule 504 and the general solicitation exemption provided by the JOBS Act. First, as a general matter, the JOBS Act limits general solicitation to “accredited investors.” Second, it dictates the manner in which these companies could solicit capital by imposing several requirements on funding portals and crowdfunding sites. Third, it requires that the issuer “take reasonable steps to ensure” that investors are accredited. Finally, it imposes requirements to ensure that the pool of investors is educated. Thus, the Act takes steps to limit the class of persons who are being solicited, thereby limiting the number and kind of persons who may be defrauded. These steps help to ensure that the investor consults the crowdfunding portal, which holds pertinent information on the securities, before transacting in such securities. Yet, even with these differences, the fact remains that the JOBS Act, by virtue

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64 Rule 504: Fact Sheet, supra note 60.
65 Id. (“T]he limited offering exemption under Regulation D, is designed to help small businesses raise ‘seed capital.”).
67 § 77d(a)(5).
68 § 77d-1(a).
69 § 77d “Modification of Exemption Rules.”
70 § 77d-1. The intermediary must:

ensure that each investor (A) reviews investor-education information, in accordance with standards established by the Commission, by rule; (B) positively affirms that the investor understands that the investor is risking the loss of the entire investment, and that the investor could bear such a loss; and (C) answers questions demonstrating—(i) an understanding of the level of risk generally applicable to investments in startups, emerging businesses, and small issuers; (ii) an understanding of the risk of illiquidity; and (iii) an understanding of such other matters as the Commission determines appropriate, by rule.

§ 77d-1(a)(4).
71 Compare §§ 77d & 77d-1, with Rule 504 Fact Sheet, supra note 60.
72 § 77d-1(a).
of allowing activity that was before illegal, will also create more opportunities for fraud.\textsuperscript{73}

2. “Pump and Dump” Schemes, Internet-User Impulsivity, and Unrealistic Investor Expectations

“Pump and dump” schemes are an avenue to swindle investors. Share prices are “pumped” by building excitement through exaggerated statements and financials, often through cold calls, e-mail solicitations, and other internet media.\textsuperscript{74} Once shares reach a high enough price, they are sold, or “dumped.”\textsuperscript{75} When the truth about the state of the company hits the market the shares become worthless leaving duped investors hanging.\textsuperscript{76} Importantly, the primary means of building excitement for these “pump and dump” schemes is the internet.\textsuperscript{77} Crowdfunding securities, which will be dealt primarily through the internet,\textsuperscript{78} may be vulnerable to such schemes. The JOBS Act contains provisions to help curb these schemes, but they may not be enough to prevent “pump and dumps.” These funding portals need to follow statutory and FINRA requirements meant to deter widespread fraud.\textsuperscript{79}

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{73} See Rule 504: Fact Sheet, supra note 60.
\item \textsuperscript{75} See id.
\item \textsuperscript{76} In the My Baby Vintage scam, the share price went from “40 cents to $2.88.” Barrett, supra note 74. By the time of the dump, one dollar could buy five thousand shares. Id. In 2008, the SEC brought a suit against three defendants involved in the scheme. Id. Although the defendants purported to make almost $9 million in profit, id., ultimately the SEC could only obtain $2 million in assets to satisfy the judgment against the defendant. SEC v. Reynolds, 3:08-CV-438-B, 2011 U.S. Dist. LEXIS 26886, at *26 (N.D. Tex. Mar. 16, 2011).
\item \textsuperscript{77} A cursory look at Circleup.com’s about page is not reassuring,
\begin{quote}
As part of the sign up process for CircleUp, each user must specify . . . which of the accredited investor requirements he/she meets. . . . When making an investment, each investor again represents and warrants in the signed purchase agreement that they are an accredited investor. Finally, prior to accepting any investment, [CircleUp] performs additional identity checks on each investor as required by law.
\end{quote}
\begin{itemize}
\item Frequently Asked Questions on Compliance, CIRCLEUP.COM (last visited Oct. 12, 2013), https://circleup.com/entrepreneur-education/compliance-faq/ (emphasis added). Furthermore, another risk to using the internet to invest is that there may be too much information. Heminway & Hoffman, supra note 37, at 934.
\item \textsuperscript{78} § 77d(a)(6)(C).
\item \textsuperscript{79} The Jumpstart Our Business Startups Act § 301 (“This title may be cited as the ‘Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012’. . ..”).
\end{itemize}
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portals will ensure education of the investor remains to be seen. Yet, the current model seems to evince a lack of such education.\(^{80}\)

In keeping with norms of social media and internet usage,\(^{81}\) crowdfunding websites cater to impulse decision-making.\(^{82}\) The internet has notably enabled and increased impulsive behavior, as demonstrated by the fact that most people tend to click through long online contracts without reading them or really considering their implications.\(^{83}\) If all an investor needs to do is click through some basic requirements,\(^{84}\) then it is quite likely that some investors will skim or ignore lengthy disclosures, reacting to the internet-related impulse to accept most offers at face value.\(^{85}\) Although this is not inherently bad in the context of donations and gratuitous investments, an investor looking for profit will care when the price of their stock falls.\(^{86}\)

Fraudsters are already taking advantage of the JOBS Act. The SEC has initiated actions against penny stock companies that seek to capitalize on the hype of the JOBS Act.\(^{87}\) For example, at the end of October, the SEC charged Caribbean Pacific Marketing with securities fraud.\(^{88}\) Caribbean Pacific Marketing marketed itself online as an “emerging growth company,”\(^{89}\) defrauding investors who were convinced that there was some value in the company. Caribbean Pacific Marketing sold its shares to insiders and then began a public offering that would allow insiders to recoup “over 100 times what [they] paid.”\(^{90}\) This and similar occurrences seem to substantiate claims by those who regard rampant fraud in the crowdfunding market as inevitable.\(^{91}\)


\(^{81}\) See generally Panek, supra note 62.

\(^{82}\) Circleup.com is one such website. One internet source describes circleup.com as a “private social networking setting.” Colleen Taylor, Backed With $1.5M, CircleUp Aims To Be The AngelList For Consumer And Retail Startups, TECHCRUNCH (Apr. 18, 2012) (emphasis added), http://techcrunch.com/2012/04/18/circleup/.

\(^{83}\) See generally Rebecca Smithers, Terms and Conditions: Not Reading the Small Print Can Mean Big Problems, GUARDIAN (May 11, 2011), http://www.guardian.co.uk/money/2011/may/11/terms-conditions-small-print-big-problems.


\(^{85}\) See Smithers supra note 83.

\(^{86}\) As one JOBS Act’s proponent puts it, “people don’t want to believe that they’re wasting their time.” Spinrad, supra note 32.


\(^{88}\) See id.

\(^{89}\) See id.

\(^{90}\) Id.

\(^{91}\) See, e.g., Chris Gay, Equity Crowdfunding: Good for Capitalism or for Fraudsters?, U.S. NEWS (Nov. 21, 2012), http://money.usnews.com/money/personal-
After five years, half of all small businesses die. However, many crowdfunding investors will invest with the expectation (realistic or not) that the company invested in will become the next Facebook. So what are aggrieved investors to do if instead they become victims of a “pump and dump” scheme or are otherwise tricked into buying shares of a failing company? They sue.

II. CROWDFUNDING SECURITIES FRAUD CAUSES OF ACTION

Shares transacted through crowdfunding websites will fall within the scope of federal securities laws. Prior to the JOBS Act, a myriad of remedies existed for defrauded investors under these laws. Thus, investors will benefit from protections provided under both the JOBS Act as well as other federal securities laws. This Part will summarize available securities fraud causes of action, indicating courts' treatment of similar liabilities to those provided for under the JOBS Act. This
overview of the applicable laws provides necessary background for Part III which discusses how the JOBS Act affects this framework for securities fraud litigation.

It is noteworthy that, based on the mandated restrictions on individual amounts of investment per year under the JOBS Act, most crowdfunding plaintiffs will likely have little incentive to sue individually. This is because the JOBS Act mandates that securities transactions be relatively small in order to bypass reporting requirements. Thus, most crowdfunding plaintiffs will be reliant on the ability to file class action suits against their defrauders.

A. JOBS Act § 77d-1 versus Securities Act § 12(a)(2) Liability

One JOBS Act provision seeks to remedy a form of fraud or misstatement that arises from the crowdfunding portal itself. The JOBS Act creates liability that is analogous to § 12(a)(2) of the Securities Act of 1933. This liability is codified in 15 U.S.C.A. § 77d-1(c)(2):

An issuer shall be liable in an action under paragraph (1), if the issuer—
(A) by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by any means of any written or oral communication, in the offering or sale of a security in a transaction exempted by the provisions of section 77d (6) of this title, makes an untrue statement of a material fact or omits to state a material fact required to be stated or necessary to make the statements, in the light of the circumstances under which they were made, not misleading, provided that the purchaser did not know of such untruth or omission; and (B) does not sustain the burden of proof that such issuer did not know, and in the exercise of reasonable care could not have known, of such untruth or omission.

Courts characterize § 12(a)(2) as “impos[ing] essentially strict liability for material misstatements contained in registered securities offerings.” However, § 12(a)(2) liability extends only

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97 See § 77d.
98 § 77d-1(c)(1)(B). ("An action brought under this [77d-1] shall be subject to the provisions of section 77l (b) of this title and section 77m of this title, as if the liability were created under section [12] of [the Securities Act].")
99 § 77d-1(c)(2).
100 See, e.g., NECA-IBEW Health and Welfare Fund v. Goldman Sachs & Co., 693 F.3d 145, 148 (2d Cir. 2012). The Second Circuit court held that “[n]either scienter, reliance, nor loss causation” are elements of § 12(a)(2) claims and thus “give[s] rise to liability more readily” than § 10(b) [claims]. Id. at 154 (quoting In re Morgan Stanley Info. Fund Sec. Litig., 592 F.3d 347, 359-60 (2d Cir. 2010)). Although liability is easier with a § 12(a) violation, in reality, there will likely be less violations in virtue of the fact that § 12(a) liability applies to required disclosures. 15 U.S.C. § 77d-1 (c)(2)
to the issuer. In addition, defendants may raise defenses to § 12(a)(2) liability. Notably, one of these defenses, loss causation, also plays a pivotal role in § 11 liability cases.

B. Section 10 Liability

Aggrieved plaintiffs will have a cause of action under § 10 of the Securities and Exchange Act for violations of Rule 10b-5. Rule 10b-5 prohibits “the sale of any security” by means of “any manipulative or deceptive device or contrivance in contravention [of SEC Rules] or [if] appropriate in the public interest or for the protection of investors.” The Supreme Court has ruled that § 10 of the Securities and Exchange Act grants investors a private right of action connected to the fraudulent sale of securities in violation of Rule 10b-5. In order to win a § 10 claim, the plaintiff must meet these six elements:

1. a material misrepresentation (or omission),
2. scienter, i.e., a wrongful state of mind,
3. a connection with the purchase or sale of a security, [i.e., reliance]
4. reliance, often referred to in cases involving public securities markets (fraud-on-the-market cases) as “transaction causation,”
5. economic loss,
6. “loss causation,” i.e., a causal connection between the material misrepresentation and the loss.

(emphasis added). Because the JOBS Act exempts many of these companies from reporting requirements, see 15 U.S.C. § 77d(a)(6), it follows that there will be less of a chance to trigger § 12(a)(2) liability.

See Gustafson v. Alloyd Co., Inc., 513 U.S. 561, 584 (1995) (“In sum, the word ‘prospectus’ is a term of art referring to a document that describes a public offering of securities by an issuer or controlling shareholder. The contract of sale, and its recitations, were not held out to the public and were not a prospectus as the term is used in the 1933 Act.” (emphasis added)).

See, e.g., In re Britannia Bulk Holdings, Inc. Sec. Litig., 665 F. Supp. 2d 404, 418 (S.D.N.Y. 2009) (“Defendants may assert the absence of loss causation as an affirmative defense to claims under Sections 11 and 12(a)(2) by proving that the allegedly misleading representations did not cause the depreciation in the stock’s value.” (internal citations omitted)). The defendant seller may also affirmatively establish that “in the exercise of reasonable care could not have known, of such untruth or omission’ which is ‘necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading.” In re Worldcom, Inc. Sec. Litig. 346 F. Supp. 2d 628, 663 (S.D.N.Y. 2004) (quoting 15 U.S.C. § 77(a)(2)).


103 Dura, 544 U.S. at 341-42 (citations omitted).
1. Janus and the Authority Requirement

The Supreme Court has recently narrowed Rule 10b-5 liability. In Janus Capital Group, Inc. v. First Derivative Traders, the Court required that the “maker of a statement [be] the entity with authority over the content of the statement and whether and how to communicate it.”\(^\text{108}\) This requires a plaintiff to prove that a defendant had ultimate authority over the fraudulent statement’s content and communication.\(^\text{109}\) In today’s corporate landscape, corporations operate through various subsidiaries and limited liability companies. Thus, determining ultimate authority is increasingly difficult.\(^\text{110}\)

2. Scienter and the Private Securities Litigation Reform Act

Securities traded through JOBS Act portals are “covered securities” subject to the Securities and Exchange Act of 1934.\(^\text{111}\) Thus, fraud litigation with respect to crowdfunding securities will

\(^{108}\) 131 S. Ct. 2296, 2303 (2011). In Janus the plaintiffs had sued Janus Capital Group, Inc. (JCG) and its mutual fund investment adviser, Janus Capital Management LLC (JCM), for material misstatements on a prospectus drawn up by JCM but issued by JCG’s investment fund. Janus, 131 S. Ct. at 2300. At issue was whether the plaintiffs could state a claim as to JCM with respect to whether JCM made the misstatement in violation of Rule 10b-5. Id. at 2301.

\(^{109}\) Id. at 2303. Justice Thomas’ majority opinion tried to shed light on this meaning by comparing it to a presidential speech. Id. at 2302. Breyer, in his dissent, stated that the majority opinion would extend immunity to managers of a corporation who write a prospectus that the corporation itself has control over. Id. at 2310 (Breyer, J., dissenting). The majority, as the dissent points out, fails to address the level of control between JCM and JCG’s investment fund. Id. at 2312. JCM is the one that regularly managed JCG’s investment fund portfolio. JCM “furnish[ed] advice and recommendations concerning [investments and administrative compliance]” and JCM employees may have withheld information from JCG about the “market timing facts.” Id. at 2312. Janus may also have implications for crowdfunding. For one thing, the JOBS Act requires certain documents to be filed by the issuer with respect to financial health. 15 U.S.C. § 77d-1. The JOBS Act does not define who can audit a crowdfunder and what liability that auditor may incur. Section 10(b) liability might be the catch all, but under the Janus ruling, an auditor would likely not be liable since it is ultimately the crowdfunding issuer who has authority over the disclosure of the audit. See Janus, 131 S. Ct. at 2303; see also § 77d-1.

\(^{110}\) Some have pointed out that the Janus decision creates a loophole that corporations could exploit to avoid Rule 10b-5 liability. See, e.g., William A. Birdthistle, The Supreme Court’s Theory of the Fund, 37 J. CORP. L. 771, 786 (2012) (“If [a parent corporation] for example, created an external management firm, shifted all current [corporate] assets to a newly formed shell company, and then provided all executive management of the business via contract between those two entities, then could it not also limit its exposure to securities suits by citing Janus?”).

\(^{111}\) 15 U.S.C. § 77r(b)(4) provides that “A security is a covered security with respect to a transaction that is exempt from registration under this subchapter pursuant to—. . . (C) section 77d(a)(6) of this title[,]” Section 77d(a)(6) deals with JOBS Act securities transactions.
be subject to federal statutory and common law.\textsuperscript{112} One such statute is the Private Securities Litigation Reform Act.\textsuperscript{113} The Act heightens pleading requirements with respect to class actions.\textsuperscript{114} One heightened requirement relates to pleading scienter.\textsuperscript{115} Plaintiffs must allege facts that raise a “strong inference” that the issuer intended to defraud the investor.\textsuperscript{116} In \textit{Tellabs, Inc. v. Makor Issues & Rights, Ltd.}, the Supreme Court held that the Act requires a plaintiff to plead facts such that “a reasonable person would deem the inference of scienter . . . at least as compelling as any opposing inference one could draw from the facts alleged.”\textsuperscript{117}

3. \textit{Dura} and Loss Causation

In \textit{Dura Pharmaceuticals, Inc. v. Broudo}, the Supreme Court held that proving loss causation goes beyond simply showing that a misrepresentation affected the price of a stock.\textsuperscript{118} A plaintiff must go beyond alleging that “the price of the security on the date of the purchase was inflated because of the misrepresentation.”\textsuperscript{119} The Court found that, “as a matter of pure logic, at the moment the transaction takes place, the plaintiff has suffered no loss” since the inflated price is “offset by ownership of a share that at that instant

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\textsuperscript{114} See, e.g., Tellabs Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308 (2007) (“As a check against abusive litigation by private parties, Congress enacted . . . [e]xacting pleading requirements . . . in the PSLRA.”).

\textsuperscript{115} See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976). Justice Blackmun dissented to this requirement stating that “[i]f negligence is a violation factor when the SEC sues, it must be a violation factor in a private action. \textit{Id.} at 217-18 (Blackmun, J., dissenting). The PLSRA also limits liability through its safe harbor provision. 15 U.S.C. § 77z-2(c). Under this provision a defendant is not liable if “the forward-looking statement is identified as a forward looking statement and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward looking statement; or the plaintiff fails to prove that the forward looking statement was made with actual knowledge that the statement was false or misleading.” Plumbers and Pipefitters Local Union No. 630 Pension Annuity Trust Fund v. Allscripts Misys Healthcare Solutions, Inc., 778 F. Supp. 2d 858, 874 (N.D. Ill. 2011) (alteration in original) (emphasis added) (citing 15 U.S.C. § 78u 5(c)(1)).


\textsuperscript{117} \textit{Tellabs, Inc.}, 551 U.S. at 324.


\textsuperscript{119} \textit{Id.} at 338 (quotations omitted).
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possesses equivalent value.” The misrepresentation must cause, not merely “touch upon a loss.” Thus, if bad market conditions affect the price of shares, the plaintiff will ultimately be unable to make a showing of loss causation.

4. Materiality and Reliance

Reliance, that is, showing a connection between a material representation or omission and the sale or purchase, has been a complicated issue for courts to grapple with. In addition to showing that a representation was material, the misrepresentation must have induced the transaction. “Fraud-on-the-market” gives class action plaintiffs some leeway in arguing reliance. In a securities fraud class action that involves publicly traded securities, courts may grant the plaintiffs a rebuttable presumption of reliance. For a plaintiff to raise this presumption, he or she must show that the securities were traded in an efficient market.

Courts differ on what facts a plaintiff must show to trigger the presumption. The majority approach requires that the plaintiff show that “the market price of the stock fully reflects all publicly available information.” The court has defined “fully reflect,” to “mean [when] market price responds so quickly to new information that ordinary investors cannot

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120 Id. at 342.
121 Id. at 343.
122 See, e.g., Phillips v. Scientific Atlanta, Inc., 489 F. App’x 339, 340-41 (11th Cir. 2012) (affirming summary judgment for defendants since plaintiffs failed to properly allege loss causation where they failed “to disentangle the effect of new information regarding customer inventory levels from [Scientific-Atlanta’s misrepresentation].”)
123 A misrepresentation or omission is material if it is “so obviously important to an investor that reasonable minds cannot differ on the question of materiality.” TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 450 (1976) (quoting Johns Hopkins Univ. v. Hutton, 422 F.2d 1124, 1129 (4th Cir. 1970)).
124 See Basic Inc. v. Levinson, 485 U.S. 224, 243 (1988) (“[R]eliance is an element of a Rule 10b-5 cause of action. Reliance provides the requisite causal connection between a defendant’s misrepresentation and a plaintiff’s injury.” (citation omitted)).
125 See id. at 242 (“Requiring proof of individualized reliance from each member of the proposed plaintiff class effectively would have prevented respondents from proceeding with a class action, since individual issues would have then overwhelmed the common ones.”).
126 See id. at 247. The presumption can be rebutted if the defendant is able to prove that absent the misrepresentation, the plaintiff would have transacted the securities anyway. Id. at 248 (“[I]f, despite petitioners’ allegedly fraudulent attempt to manipulate market price, news of the merger discussions credibly entered the market and dissipated the effects of the misstatements, those who traded Basic shares after [denial of merger discussions] would have no direct or indirect connection with the fraud.”).
127 Id. at 248 n.27.
128 In re PolyMedica Corp. Sec. Litig., 432 F.3d 1, 19 (1st Cir. 2005).
make trading profits on the basis of such information.”\textsuperscript{129} The courts look to the following factors, the first five of which are known as the \textit{Cammer} factors, to make this determination:

(1) the average weekly trading volume expressed as a percentage of total outstanding shares; (2) the number of securities analysts following and reporting on the stock; (3) the extent to which market makers and arbitrageurs trade in the stock; (4) the company’s eligibility to file SEC registration Form S-3 (as opposed to Form S-1 or S-2); (5) the existence of empirical facts “showing a cause and effect relationship between unexpected corporate events or financial releases and an immediate response in the stock price”; (6) the company’s market capitalization; (7) the bid-ask spread for stock sales; and (8) float, the stock’s trading volume without counting insider-owned stock.\textsuperscript{130}

The court must review market efficiency with respect to the contested shares, not general market efficiency.\textsuperscript{131} This usually involves a battle of the experts.\textsuperscript{132} The holder of this presumption gains an important tool in shareholder litigation.\textsuperscript{133}

5. Class Action Requirements

The shareholder class action is the primary way for shareholders to litigate fraud.\textsuperscript{134} To certify a class action,\textsuperscript{135} Rule

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\item \textsuperscript{129} \textit{Id.}
\item \textsuperscript{130} Unger v. Amedisys Inc., 401 F.3d 316, 323 (5th Cir. 2005). The first five of these factors are known as the \textit{Cammer} factors. \textit{See} Cammer v. Bloom, 711 F. Supp. 1264, 1286-87 (D.N.J. 1989). In \textit{Krogman v. Sterritt}, the court applied these factors and determined that stocks traded on an “Over The Counter Bulletin Board” (OTCBB) were not traded in an efficient market for the purpose of raising the “fraud-on-the-market” reliance presumption. Krogman v. Sterritt, 202 F.R.D. 467, 473, 478 (N.D. Tex. 2001).
\item \textsuperscript{131} \textit{Krogman}, 202 F.R.D. 467, 474 (“[T]he inquiry in an individual case remains the development of the market for that stock, and not the location where the stock trades.”) (quoting Harmon v. LyphoMed, Inc., 122 F.R.D. 522, 525 (N.D. Ill. 1988)).
\item \textsuperscript{132} See, \textit{e.g.}, Bell v. Ascendant Solutions, Inc., 422 F.3d 307, 310-11 (5th Cir. 2005) (defendant and plaintiffs both submitted expert reports on the efficiency of the market).
\item \textsuperscript{133} \textit{See} Basic Inc. v. Levinson, 485 U.S. 224, 262 (1988) (White, J., concurring in part and dissenting in part) (“[T]he majority’s [fraud-on-the-market presumption] will lead to large judgments, payable in the last analysis by innocent investors, for the benefit of speculators and their lawyers.” (quotation marks omitted)).
\item \textsuperscript{134} No one doubts the raw power of the class action. Some have called into question the class action’s abilities to adequately represent shareholder interest, arguing that some class actions may harm some shareholders. See, \textit{e.g.}, Richard A. Booth, \textit{Class Conflict in Securities Fraud Litigation}, 14 U. Pa. J. Bus. L. 701, 705-06 (2012) (“From the viewpoint of diversified investors—the great majority of investors—class actions confer no genuine benefit because a diversified investor is equally likely to sell an overpriced stock (and gain) as to buy one (and lose).”). This approach does not take into account two aspects: the inequity of fraud and the common law’s protection of minority shareholder interest. \textit{See}, \textit{e.g.}, Norfolk & Western Ry. Co. v. Am. Train Dispatchers’ Ass’n, 499 U.S. 117, 131 (1991) (“[M]inority rights were as a matter of federal law, accorded recognition in the obligation of the Commission not to approve
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23 of the Federal Rules of Civil Procedure requires that the class be numerous, have common “questions of law or fact,” possess typical claims or defenses, and have its interests “fairly and adequately” represented.\(^\text{136}\) In addition, Rule 23(b)(3) requires that “there be questions of law or fact common to the members of the class [that] predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy.”\(^\text{137}\) Thus, Rule 23(a) requires common questions of law or fact for § 10(b) class claims.\(^\text{138}\)

Rule 23(b) requires that a court ensure that the class action provide common answers to the plaintiffs’ common questions.\(^\text{139}\) With respect to commonality, classes are certified based on a “fraud-on-the-market theory.”\(^\text{140}\) In *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, the Supreme Court clarified that proof of materiality is not appropriate during the class certification stage.\(^\text{141}\) Thus, courts will only require a prima facie showing of reliance to trigger the fraud-on-the-market presumption and save materiality for after certification.\(^\text{142}\)

### III. HOW THE JOBS ACT CHANGES THIS LANDSCAPE

#### A. The One-Year Restriction on Resale Hurts Investors

By opening themselves to the public, corporations are able to raise more capital for projects in hopes that they experience

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\(^{135}\) The reason this note has not mentioned state law class actions is because, with the exception of derivative suits, fraud class actions will be unavailable to plaintiffs. This is because, under the statute, crowdfunding shares are “covered securities.” 15 U.S.C. § 77r(b)(4) (2012) (covered securities include exempted transactions under § 77d). Consequently, such class actions are precluded by SLUSA. *See* *Kircher v. Putnam Funds Trust*, 547 U.S. 633, 636-37 (2006).

\(^{136}\) *See* Fed. R. Civ. P. 23(a).

\(^{137}\) *Fed. R. Civ. P. 23(b)(3).*


\(^{139}\) *Walmart Stores, Inc. v. Dukes*, 131 S. Ct. 2541, 2551 (2011) (“What matters to class certification . . . is not the raising of common ‘questions’—even in droves—but, rather the capacity of a classwide proceeding to generate common answers apt to drive the resolution of the litigation. Dissimilarities within the proposed class are what have the potential to impede the generation of common answers.” (citations omitted)).

\(^{140}\) *See* *Amgen Inc. v. Conn. Ret. Plans and Trust Funds*, 133 S. Ct. 1184, 1195 (2013) (“[W]ithout the fraud-on-the-market theory, the element of reliance cannot be proved on a classwide basis through evidence common to the class.”).

\(^{141}\) 133 S. Ct. at 1204.

\(^{142}\) *See id.* at 1203-04.
major growth. In return, investors expect returns on the shares, in part because they can sell them whenever they want. On the other hand, some corporations are closed corporations. Closed corporations are businesses that use the corporation as a legal scheme to avoid liability that they may incur as a partnership. They may elect to put restrictions on these shares and limit transferability through various statutory tools. The primary reason is so that control of a closed corporation stays within the family or a limited group of persons. Thus, closed corporations sacrifice a ready market for their shares, and thus value of their shares, in exchange for control.

Crowdfunding securities occupy an awkward crevice between public and private markets. These securities, by virtue of the fact that they are available on online funding portals, possess a public quality. Yet, the only companies that can avail themselves of capital bear resemblance to closed corporations by virtue of their small size. This awkwardness is reflected in some of the JOBS Act provisions. Specifically, the JOBS Act contains a provision that places a restriction on transferability of crowdfunding shares. Crowdfunding shares:

may not be transferred by the purchaser of such securities during the 1-year period beginning on the date of purchase, unless such securities are transferred—(A) to the issuer of the securities; (B) to

143 Frequently Asked Questions: What are the advantages and disadvantages for a company going public?, INVESTOPEDIA, http://www.investopedia.com/ask/questions/06/ipoadvantagedisadvantage.asp#ixzz2BrV6VoOy (last visited Jan. 18, 2012). Other benefits of going public include publicity, increased market share, and the possibility of an exit strategy for founders of a successful small business. Id.

144 See Knowledge@Wharton, Are Public Corporations Passé?, TIME (Oct. 12, 2012), http://business.time.com/2012/10/12/a-premature-eulogy-for-public-companies/.


146 Compare DEL. CODE ANN. tit. 6, § 15-801 (West 2013) [Uniform Partnership Act] (expressing that a partnership is dissolved when a partner dissociates or leaves the partnership), with DEL. CODE ANN. tit. 8, § 275 [Delaware General Corporate Law] (stating that unless the requisite voting takes place or a court intervenes, corporations do not need to wind up their business because a shareholder decides to leave).

147 See, e.g., F.B.I. Farms, Inc. v. Moore, 798 N.E.2d 440, 445 (Ind. 2003) (“Indiana, like virtually all jurisdictions, allows corporations and their shareholders to impose restrictions on transfers of shares.”).

148 See, e.g., Galler v. Galler, 203 N.E.2d 577, 583 (Ill. 1964) (“For our purposes, a close corporation is one in which the stock is held in a few hands, or in a few families, and wherein it is not at all, or only rarely, dealt in by buying or selling.”).

149 E.g., Thomas J. Andre, Jr., Restrictions on the Transfer of Shares: A Search for Public Policy, 53 TUL. L. REV. 776, 785 (1979) (“That transfer restrictions may have a negative impact on the value a shareholder will receive for his shares may be conceded; the value of shares without transfer restrictions will often be greater than the same shares with restrictions.”).


151 § 77d-1.
an accredited investor; (C) as part of an offering registered with the Commission; or (D) to a member of the family of the purchaser or the equivalent, or in connection with the death or divorce of the purchaser or other similar circumstance, in the discretion of the Commission; and

(2) shall be subject to such other limitations as the Commission shall, by rule, establish.\textsuperscript{152}

Some contend that the one-year resale restriction serves an important purpose, arguing that the restriction acts as a deterrent against fraud.\textsuperscript{153} Specifically, the restriction on resale would curb the rise of a fraudulent secondary market on these crowdfunding securities.\textsuperscript{154} The argument is that, in these secondary markets, the buyers “find [themselves] attenuated from an accurate and complete source of information.”\textsuperscript{155} But the provision would dissuade many institutional investors from purchasing these shares, because restrictions on re-sale reduce liquidity of the shares, curbing a major source of investment.\textsuperscript{156} Thus, while the one-year resale restriction tenuously serves an anti-fraud purpose, it ultimately harms investors more than it helps them. The next Section explores the implications of the one-year resale provision on litigating fraud.

B. The Resale Restriction Severely Impacts the Market for Crowdfunding Securities

A cursory look at crowdfunding securities may lead one to believe that the fraud-on-the-market presumption may be available to crowdfunding plaintiffs. In Basic, the Court found

\textsuperscript{152} § 77d-1(e). It is interesting to note that the SEC is tasked with adding other rules to this restriction in transferability. § 77d-1(e)(2). One rule that could be considered is to allow companies to impose further limitations on transferability. This is not to protect the “control” of the business, but because the statute requires that an issuer who reaches two thousand shareholders become a reporting company. 15 U.S.C. § 78l(g)(1)(A)(i).

\textsuperscript{153} See Bradford, supra note 4, at 144 (“Heminway and Hoffman argue that such restrictions are necessary because a resale market may not provide new investors with direct access to the information available on the crowdfunding site itself, so resales are more conducive to fraud.”).

\textsuperscript{154} See Heminway & Hoffman, supra note 37, at 954.

\textsuperscript{155} Id.

\textsuperscript{156} There are other reasons why crowdfunding may be unattractive to institutional investors. Venture capitalists, investors who invest in and manage start ups, may be dissuaded from investing in firms that are owned by a multitude of inexperienced investors. Rohit Arora, \textit{7 Reasons to Avoid Crowdfunding}, FOX BUSINESS (Oct. 23, 2012) http://smallbusiness.foxbusiness.com/finance-accounting/2012/10/23/7-reasons-to-avoid-crowdfunding/; see also Venture Capital definition, INVESTOPEDIA, http://www.investopedia.com/terms/v/venturecapital.asp#axzz2BwwoEatU (last visited Nov. 9, 2012).
that the lack of "face-to-face transactions" justified the "fraud-on-the-market" presumption.\textsuperscript{157} Importantly, the Court found that, for the question of reliance, the question in modern securities is not whether the information misrepresented by the fraudulent actor induced the transaction.\textsuperscript{158} This is because the investor is not evaluating this information; the market is evaluating this information.\textsuperscript{159}

The absence of a face-to-face relationship would also exist between crowdfunding issuers and investors. First, the crowdfunding issuer is not selling directly to investors.\textsuperscript{160} The JOBS Act itself requires a third person, the funding portal intermediary, to be involved in this transaction.\textsuperscript{161} Although the issuer is required to provide the intermediary with information, the issuer must also provide that information to investors.\textsuperscript{162} But a defrauded investor may also argue that he or she relied on the funding portal because the statute requires the intermediary "take such measures to reduce the risk of fraud."\textsuperscript{163} This clause does not bestow ownership over the issuer's fraudulent misrepresentations. It only requires that the intermediary follows SEC rules that reduce the risk of fraud.\textsuperscript{164} The role of an intermediary is similar to that of a broker; it is merely a third party that facilitates the transaction between the issuer and the investor.\textsuperscript{165} Thus, intermediaries do not by themselves create a secondary market.

\textsuperscript{157} Basic Inc. v. Levinson, 485 U.S. 224, 243-44 (1988).

\textsuperscript{158} Id.

\textsuperscript{159} See id. at 244 (quoting \textit{In re LTV Sec. Litig.}, 88 F.R.D. 134, 143 (N.D. Tex. 1980) ("The market is acting as the unpaid agent of the investor, informing him that given all the information available to it, the value of the stock is worth the market price." (internal quotation marks omitted)).

\textsuperscript{160} The statute interposes an intermediary funding portal for crowdfunding transactions. 15 U.S.C. § 77d(a)(6).

\textsuperscript{161} § 77d(a)(6)(C). Furthermore, the statute says that the issuer cannot advertise their offering, but only point the potential investor to the funding portal. 15 U.S.C. § 77d-1(b)(2).

\textsuperscript{162} § 77d-1(b)(1).

\textsuperscript{163} § 77d-1(a)(5).

\textsuperscript{164} Id. Even if this statute imposed some criminal liability, after \textit{Janus} it is unlikely that the court will find this third party liable under Rule 10b-5. See Janus Capital Group, Inc. v. First Derivative Traders, 131 S. Ct. 2296, 2303-04 (2011).

\textsuperscript{165} 15 U.S.C. § 78c(a)(50) ("The term 'funding portal' means any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to section 4(6) [1] of the Securities Act of 1933 (15 U.S.C. 77d (6)), that does not—A) offer investment advice or recommendations; (B) solicit purchases, sales, or offers to buy the securities offered or displayed on its website or portal; (C) compensate employees, agents, or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (D) hold, manage, possess, or otherwise handle investor funds or securities; or (E) engage in such other activities as the Commission, by rule, determines
Even if a secondary market were created, this market would not be open enough to grant plaintiffs the reliance presumption. Under Basic, for the fraud-on-the-market presumption to apply, the markets must be “open and developed.”

Cursorily, crowdfunding may seem like the most “open” market. So long as the requirements are met, almost anyone can become a crowdfunding investor. However, openness is not a matter of who can enter the market. Instead, openness refers to the market’s reaction to information.

A court looking at the five Cammer factors would not apply the “fraud-on-the-market” presumption. First, it is unlikely that there will be a significant following by analysts of crowdfunding securities. Second, the one-year restriction makes it unlikely that crowdfunding stocks will be sold at a sizable volume on a weekly basis. Third, because institutional investors, who are typically market makers, are skeptical of crowdfunding, it is unlikely that there would be many market makers in the field of crowdfunding securities. Fourth, even if the required disclosures for crowdfunding on an offering were analogized to an S-3, the difference between the information provided between the two is vast. Finally, as a result of the four previous factors, it is unlikely that appropriate.

applicable.

166 See Basic Inc. v. Levinson, 485 U.S. 224, 250 (1988). The JOBS Act allows some sales, but only to accredited investors and family. 15 U.S.C. § 77d-1(e). Thus, some resale market may exist, but it would be relatively small.

167 Basic, 485 U.S. at 241 (quoting Peil v. Speiser, 806 F.2d 1154, 1160-61 (3rd Cir. 1986)).

168 See § 77d(a)(6). So long as the investor goes through required education materials, they only need to conform to the investment limits. Id.

169 See, e.g., In re PolyMedica Corp. Sec. Litig., 432 F.3d 1, 19 (1st Cir. 2005).


171 See Yonca Ertimur, Volkam Mushu, & Frank Zhang, Conflicts of Interest or Selection Bias? Evidence from Analysts’, REV. OF ACCT. STUD. 6 (forthcoming), available at https://faculty.fuqua.duke.edu/~yertimur/bio/EMZ_April2009.pdf (“[T]he selection bias explanation posits that analysts follow companies for which they truly have favorable views, giving rise to a higher proportion of favorable recommendations.”).

172 A market maker is:

a dealer who, with respect to a particular security, (i) regularly publishes bona fide, competitive bid and offer quotations in a recognized interdealer quotation system; or (ii) furnishes bona fide competitive bid and offer quotations on request; and, (iii) is ready, willing and able to effect transactions in reasonable quantities at his quoted prices with other brokers or dealers.

173 See Arora, supra note 156.

information in press releases would immediately affect stock price. Further, the JOBS Act requires only that crowdfunding issuers comply with the documents and information needed for the initial offering. Thus, it is very likely that information will not be fully reflected in the stock price to warrant a fraud-on-the-market presumption.

Even if courts decide to grant a different presumption of reliance, there can be no claim of §10(b) liability unless all elements are established. Importantly, the resale restriction presents a new challenge to litigants who are trying to prove loss causation. The importance of loss causation is further boosted by the fact that loss causation also speaks to §12(a)(2) liability, and thus the analogous liability created by the JOBS Act.

C. The Resale Provision Significantly Hinders Proving Loss Causation


A typical loss causation fact pattern should be examined to better understand the impact of intervening causes. In 2001, investor plaintiffs bought stock from defendant, Scientific-Atlanta, Inc. (SA). On January 18, 2001, SA issued a press release stating that it had “record financial results” along with another “press release announcing an increase in manufacturing capacity” in response to consumer demands. SA, through its various agents, contended to make such statements to various financial media. Six months later, in July, SA announced a

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175 Inefficient markets generally do not respond as predictably to information as efficient ones. See, e.g., Krogman v. Sterritt, 202 F.R.D. 467, 473, 478 (N.D. Tex. 2001).
176 See § 77d-1.
177 See, e.g., In re PolyMedica Corp. Sec. Litig., 432 F.3d 1, 19 (1st Cir. 2005).
178 Some courts adopt another theory of reliance dubbed “fraud-created-the-market.” See, e.g., Regents of Univ. of Cal. v. Credit Suisse First Boston (USA), Inc., 482 F.3d 372, 391-92 (5th Cir. 2005). This theory “assumes [that] investors relied on the market itself to prevent the entry of ‘unmarketable’ securities [to the market]”. Michael J. Kaufman & John M. Wunderlich, Fraud Created the Market, 63 A.L.A. L. REV. 275, 281 (2012). But this theory only applies to securities transacted between the issuer and the investor. See id. at 281-82.
180 See id.; see also In re Britannia Bulk Holdings, Inc. Sec. Litig., 665 F. Supp. 2d 404, 418 (S.D.N.Y. 2009); cf. §§ 77d-1(e)(1)-(2).
182 Id. at 340-41.
183 Id.
sales decrease.\textsuperscript{184} SA attributed this decrease to economic uncertainty and a decline in new orders of its cable equipment.\textsuperscript{185} SA then filed its form 10K with the SEC for the year of 2001.\textsuperscript{186} SA's Chief Financial Officer stated that it anticipated some damage for the next fiscal year, attributable to the economic decline.\textsuperscript{187} SA's stock price dropped dramatically.\textsuperscript{188} Plaintiffs then brought suit for violations of Rule 10b-5.\textsuperscript{189}

The district court granted the defendant's motion for summary judgment, finding that the plaintiffs had "presented genuine issues of material fact on all the required elements of their claim, \textit{except} for loss causation."\textsuperscript{190} The Eleventh Circuit affirmed the district court's ruling finding that the plaintiffs failed to adequately plead loss causation.\textsuperscript{191} The \textit{Phillips} court found that the press releases contained pieces of non-fraudulent information that could explain the loss.\textsuperscript{192} The court cited "uncertain economic climate, reduced marketing by SA customers, [and] unexpectedly slow deployment of interactive cable services" as other potential causal factors.\textsuperscript{193} The plaintiffs used expert testimony to attempt to single out the fraudulent press releases from all the other explanatory factors.\textsuperscript{194} However, they were unable to separate the non-fraudulent statements' effects (e.g., economic downturn) that affected SA specifically.\textsuperscript{195} Thus, there was no basis to determine loss causation in connection with the fraudulent statements.\textsuperscript{196}


Crowdfunding is risky. Establishing loss causation for a small business using the aforementioned analysis will be difficult. Small businesses are generally known to fail.\textsuperscript{197} A bad

\textsuperscript{184} Id.
\textsuperscript{185} Id. at 341-42.
\textsuperscript{186} Id.
\textsuperscript{187} Id.
\textsuperscript{188} Id.
\textsuperscript{189} Id.
\textsuperscript{190} Id. (emphasis added).
\textsuperscript{191} Id. at 342.
\textsuperscript{192} Id.
\textsuperscript{193} Id. at 342.
\textsuperscript{194} Id. at 342-43.
\textsuperscript{195} Id. at 343.
\textsuperscript{196} Id. at 343.
\textsuperscript{197} See, e.g., Scott A. Shane, \textit{Failure is a Constant in Entrepreneurship}, N.Y. TIMES, \url{http://boss.blogs.nytimes.com/2009/07/15/failure-is-a-constant-in-entrepreneurship/} (last updated July 17, 2009)("According to U.S. Census data, only 48.8 percent of the new establishments started between 1977 and 2000 were alive at age five.").
economy can certainly affect these small businesses individually. Further, there are other factors that might diminish a plaintiff’s loss causation argument. For example, even if the economy at large is healthy, there are local conditions that may affect a small business. \(^{199}\) Phillips involved securities traded on a public market, yet the defrauded plaintiffs were still unable to show loss causation. \(^{200}\) Crowdfunding securities are riskier and less liquid. \(^{201}\)

The resale restriction allows for other mitigating factors to come into play. \(^{202}\) In fact, it is questionable whether the plaintiff can even be said to have suffered any damage until after the one-year period is over. Evaluating loss causation requires determining “how much . . . the price [would] have been at the time of the challenged transaction had there been full disclosure available.” \(^{203}\) Thus, when the fraudulent statement is made, if the plaintiff could not sell his shares, how could the statement have been said to damage the plaintiff at all? Economic loss is more attenuated from the misrepresentation, since any loss the plaintiff may suffer will only really occur after the one-year resale restriction is over.

3. Proof Problems

The Supreme Court distinguished loss causation from efficient market theory in Halliburton. \(^{204}\) However, subsequent court cases show the connection between loss causation and efficient markets. \(^{205}\) Loss causation is a result of the “market’s realization of the circumstances concealed by the [misrepresentation].” \(^{206}\) Plaintiffs’ experts conduct “event studies”

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198 See, e.g., David Conn, Going Bust, GUARDIAN (Dec. 11, 2008), http://www.guardian.co.uk/business/2008/dec/12/recession-small-business.


200 Phillips, 489 F. App’x at 342-43.

201 See 15 U.S.C. § 77d-1(e) (2012); see also Arora, supra note 156.

202 The one-year restriction in sales allows any decent defense attorney to find some sort of fact, economic or otherwise, that may explain a loss. Phillips demonstrates that proving loss causation requires isolating the misrepresentation from all other possible explanations. See Phillips, 489 F. App’x at 343.

203 Thomas L. Hazen, 4 LAW SEC. REG. § 12.11, Causation in Actions Under Rule 10b-5.


205 See, e.g., In re Vivendi Universal , 765 F. Supp. 2d 512, 555 (S.D.N.Y. 2011) (“[Loss Causation] is typically shown by the reaction of the market to a ‘corrective disclosure’ which reveals a prior misleading statement.”).

that inquire as to what the “market price of a stock [would] be but for the fraud.”\textsuperscript{207} “Event studies” require efficient capital markets to be reliable.\textsuperscript{208} As discussed earlier, the one-year resale restriction effectively handicaps the secondary market, making the market for crowdfunding securities inefficient.\textsuperscript{209} Thus, the one-year resale restriction presents proof problems for plaintiffs.

\section*{IV. The One-Year Sale Restriction Should Be Modified}

The SEC should exercise its authority to add to or modify the one-year sale restriction.\textsuperscript{210} The SEC can guard against fraud in the secondary markets, without going beyond its statutory authority, by allowing resales to other members who are registered with complying funding portals.\textsuperscript{211} By doing this, the SEC would ensure that the investor pool in crowdfunding resale markets is educated.\textsuperscript{212} This would protect consumers who are unable to guard against such fraud.\textsuperscript{213} A secondary market for crowdfunding shares might be troublesome in some respects,\textsuperscript{214} but it may also allow for information disseminated by issuers to affect the price more efficiently.\textsuperscript{215} This Part will explore the implications of loosening the one-year sale restriction on secondary markets and proving loss causation.\textsuperscript{216}

\begin{footnotesize}
\textsuperscript{207} Id. at 903.
\textsuperscript{208} Id.
\textsuperscript{209} Supra Part III (applying Cammer factors to crowdfunding market).
\textsuperscript{210} 15 U.S.C. § 77d-1(e)(2) (2012) (“[Resales] shall be subject to such other limitations as the Commission shall, by rule, establish.”).
\textsuperscript{211} The following resale provision explicitly grants the SEC authority to add additional rules to the resale provision: “[resale] shall be subject to such other limitations as the Commission shall, by rule, establish.” § 77d-1(e)(2) (emphasis added).
\textsuperscript{212} See § 77d-1(a)(4).
\textsuperscript{213} The courts have interpreted securities laws loosely when the class of investors can protect themselves. See SEC v. Ralston Purina Co., 346 U.S. 119, 125 (1953) (“[T]he applicability 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.’”).
\textsuperscript{214} See Heminway & Hoffman, supra note 37, at 954.
\textsuperscript{215} See Schleicher v. Wendt, 618 F.3d 679, 684 (7th Cir. 2010) (finding that since defendant’s stock was traded “in a liquid market,” in addition to other factors, it met fraud-on-the-market requirements).
\textsuperscript{216} Additionally, there are other challenges that the resale restriction pose that need to be addressed by the SEC. Bradford argues that there are other reasons why restrictions on resale are harmful. One detrimental effect of resale restrictions are that they may “cause issuers to lose their exemptions.” Bradford, supra note 4, at 144-45. Furthermore, resale restrictions could become a liability trap for unsophisticated investors. Id. at 144.
\end{footnotesize}
A. The Impact of a Loosened Resale Restriction on a Secondary Crowdfunding Securities Market.

Secondary securities markets allow investors to transact with each other instead of the issuer. Many such transactions take place on markets where large public corporations’ shares are traded. Yet, given the rate of failure of small businesses, crowdfunding issuers, who are small businesses, will likely not go public. On the other hand, the crowdfunding issuers, unlike private corporations, are in little control of who can buy their shares. It is in this respect that they resemble private corporations. Yet there is a rising trend for privately held securities to be traded in secondary markets. Thus, crowdfunders may welcome, or at least tolerate, their securities being traded on secondary markets.

_Dura_ and _Basic_ deal with two distinct elements of a 10b-5 claim, but they turn on the same issue. In _Dura_, the Court stated that loss causation turned on the degree and time it takes for information to impact the market. In _Basic_, the Court stated that the presumption of reliance turned on the market’s ability to accurately reflect information. By making the shares transferable, with some limits, the shares gain a

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217 See Secondary Market definition, INVESTOPEDIA, http://www.investopedia.com/terms/v/venturecapital.asp?query=12631 (last visited Nov. 9, 2012) (the NASDAQ, for example, is such a marketplace).


222 If the crowdfunding resales were limited to other crowdfunding investors, issuers likely will have no problem with their shares ending up in hands that could have bought shares when they were first issued.

223 Compare Dura Pharm., Inc. v. Broudo, 544 U.S. 336, 343 (2005) ("[L]ower price may reflect, not the earlier misrepresentation, but changed economic circumstances, changed investor expectations, new industry-specific or firm-specific facts, conditions, or other events, which taken separately or together account for some or all of that lower price."). with _Basic_, 485 U.S. at 246 ("[M]arket price of shares traded on well-developed markets reflects all publicly available information, and, hence, any material misrepresentations.").

224 _Dura_, 544 U.S. at 342.

225 _Basic_, 485 U.S. at 243-44.
higher price.\textsuperscript{226} Liquidity also helps to ensure that any information impacts the price of said stock.\textsuperscript{227} Thus, determining whether the market price of crowdfunding securities reflects information accurately requires evaluating the crowdfunding secondary market.

Secondary market performance plays a pivotal role in securities fraud litigation.\textsuperscript{228} The defrauded crowdfunding investor, through his or her class action, will inevitably need to show that the market for his or her crowdfunding shares is “open and developed.”\textsuperscript{229} The five \textit{Cammer} factors show that, with the one-year restriction, it is unlikely that courts will find that the market for crowdfunding shares would be open and developed.\textsuperscript{230} However, having a looser resale restriction changes that analysis. Specifically, if crowdfunding secondary markets resemble “Over The Counter Bulletin Boards” (OTCBB), then they are unlikely to be open and developed.\textsuperscript{231} The key is to distinguish crowdfunding markets from OTCBB’s.

An OTCBB is an “electronic quotation system that displays real-time quotes, last-sale prices and volume information for many over-the-counter securities that are not listed on a national securities exchange.”\textsuperscript{232} Instead, these markets rely on the traders to supply this information themselves.\textsuperscript{233} This is what makes them “over the counter.” Some courts have decided, as a matter of law, that these markets are undeveloped.\textsuperscript{234} Other courts use the five \textit{Cammer} factors on a case by case basis.\textsuperscript{235} Even applying those factors, most courts conclude that these


\textsuperscript{228} \textit{See Basic}, 485 U.S. at 243-44.

\textsuperscript{229} \textit{Id.} at 241-42 (quoting \textit{Peil}, 806 F.2d at 1160-61).

\textsuperscript{230} \textit{See supra} Part III.


\textsuperscript{233} OTCBB.COM, \textit{Investor Information}, http://www.otcbb.com/investorinformation/investorinfo.stm (last visited Jan. 17, 2012) (“Market Makers will be required to provide the periodic financial reports filed by OTCBB issuers with the SEC or other regulatory authorities pursuant to the Eligibility Rule.”).

\textsuperscript{234} \textit{See In re Data Access Sys. Sec. Litig.}, 103 F.R.D. 130, 138 (D.N.J. 1984), rev’d on other grounds by 848 F.2d 1537 (3d Cir. 1988).

\textsuperscript{235} \textit{See}, e.g., Unger v. Amedisys Inc., 401 F.3d 316, 323 (5th Cir. 2005) (listing eight factors, the first five of which are the \textit{Cammer} factors).
OTCBB markets are inefficient when compared with more traditional secondary markets.\(^{236}\)

OTCBBs are not the only avenue for reselling stock. A new type of secondary market has been on the rise that caters to private placements.\(^{237}\) Second Market is one example.\(^{238}\) These markets rely on two factors—(1) the investor’s knowledge and sophistication and (2) the investor’s access to information—to exempt transactions from reporting requirements.\(^{239}\) Using these factors, these marketplaces “match[]” buyers and sellers of [private securities].\(^{240}\) Second Market is different from OTCBBs because it provides information for valuing stock.\(^{241}\) Second Market also allows for investors to create profiles for themselves.\(^{242}\) This decreases the chances of the investor being an anonymous backroom dealer.\(^{243}\) Second Market has also “integrated aspects of social media” into its interface.\(^{244}\) And finally, Second Market has begun to “offer[]” and pay for analyst coverage of certain companies.”\(^{245}\)

The funding portals created by the JOBS Act have the potential to resemble Second Market. Funding portals cater to a special class of investors because they are required to ensure that investors are educated.\(^{246}\) Further, these funding portals already interact with crowdfunding issuers by virtue of the fact that the primary sale takes place through these portals.\(^{247}\) Resale markets for crowdfunding shares may also benefit from social networking.\(^{248}\)

\(^{236}\) See id. (“[S]uch holdings are indicative of the wide gulf between the type of markets for stocks that trade millions of shares daily, [citations omitted], and the much less active [OTCBB] market for stocks.”).

\(^{237}\) See Pollman, supra note 221, at 193.

\(^{238}\) See id. Eighty percent of the sellers in Second Market are former employees. Id. at 196.

\(^{239}\) See id. at 189.

\(^{240}\) See id. at 195.

\(^{241}\) See id. at 203. This is done by involving the issuer. See id.

\(^{242}\) See id. at 195.

\(^{243}\) In Basic the court, in evaluating whether or not a fraud-on-the-market presumption was warranted, took note of the fact that face-to-face transactions differed from faceless ones. Basic v. Levinson, 485 U.S. 224, 243-44 (1988). It is no jump in logic to conclude that allowing investors to create profiles allows for a higher degree of personal interaction between seller and buyer. Furthermore, many of the websites pitching themselves as crowdfunding intermediaries already resemble social media sites. See, e.g., Taylor, supra note 82.

\(^{244}\) See Pollman, supra note 221, at 199.

\(^{245}\) See id. at 198-99.


\(^{248}\) Social networking could be the equivalent of press for these crowdfunding issuers. In fact, many companies now advocate social networking as a way to spread
Crowdfunding shares may exceed OTCBB shares in numerosity, increasing the trade volume and analyst coverage of those shares. Thus, having a special class of investors in the crowdfunding context would help to guard against fraud while encouraging smarter investments.

It may be early to conclude that a resale market for crowdfunding securities will look like Second Market. But such a market would make for a more open market under the Cammer factors. The resale of crowdfunding securities entails a greater trading volume of such stock. Further, if Second Market is any indication, a resale market in crowdfunding shares would incentivize more analysts in the crowdfunding arena. A less restrictive resale provision would result in greater incentive for Qualified Institutional Buyers to transact in crowdfunding securities.

The informational issues mentioned earlier in this note would still be present. However, this is likely not fatal if, as some scholars have persuasively argued, the SEC mandates the disclosure of additional information. Whether or not this would warrant a fraud-on-the-market presumption is a matter for courts. But, as the next sub-section will show, the efficiency of the secondary market reverberates beyond fraud-on-the-market.

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250 Heminway & Hoffman, supra note 37, at 936 (“Better investor education and stronger enforcement efforts should make the increase in fraud bearable, however.”) (quoting Dale A. Oesterle, 1 ENTREPREN. BUS. L. J. 369, 379 (2006)).


252 See id. at 1286.


254 Darian M. Ibrahim, The New Exit in Venture Capital, 65 VAND. L. REV. 1, 22-23 (Jan. 2012) (“[B]y improving liquidity for individual investors ex post, the direct market has the potential to increase the number of start-ups that will receive [venture capital] funding ex ante.”).

255 See supra Part I (discussing the JOBS Act and fraud).


257 Furthermore, whether or not there should be a fraud-on-the-market presumption in the crowdfunding context is an open question. On the one hand, as mentioned earlier, it is likely that most of litigation in the crowdfunding fraud area will be done in a class action setting. On the other hand, unlike securities that are traded on NASDAQ, usually involving larger corporations that can afford litigation, crowdfunding issuers are small businesses that are unlikely to be able to afford defending a class action suit. See Ian Simmons & Charles E. Borden, The Defense Perspective: The Class Action
B. How an Active Secondary Market Affects Loss Causation

Even if the crowdfunding secondary market is not developed enough to warrant a fraud-on-the-market presumption, a rigorous resale market makes it easier to establish loss causation.\textsuperscript{258} Loosening the resale restriction accomplishes two things. First, it reduces the chances of intervening events affecting market price.\textsuperscript{259} The looser resale restriction narrows the gap between the fraudulent misrepresentation and the economic effect on the investor’s shares. Narrowing that gap further reduces the likelihood that other intervening causes will touch upon the stock price loss.\textsuperscript{260} Per \textit{Dura}, this makes it more likely that the misrepresentation impacted the shares as opposed to other factors.\textsuperscript{261}

Second, loosening the resale restriction also addresses a crucial proof problem.\textsuperscript{262} Greater share liquidity entails a more efficient market.\textsuperscript{263} An efficient crowdfunding securities market helps plaintiffs prove loss causation.\textsuperscript{264} This is because a more efficient crowdfunding securities market means that the plaintiff will be able to isolate the effect of the fraudulent statement from other factors.\textsuperscript{265} Thus, an event study may be more reliable.\textsuperscript{266}

Secondary markets may be vulnerable to informational issues that would lead to “pump and dump” schemes.\textsuperscript{267} But what will happen once the one-year restriction on transfers is over? The SEC surely cannot restrict resale \textit{ad infinitum}. By adopting the aforementioned rule, the SEC can ensure that the

\begin{quote}
\textit{Fairness Act of 2005 and State Law Antitrust Actions, ANTI\text{\textit{TRO}}} \text{\textit{A}}, Fall 2005, at 19, 23. The threat of such a suit may cripple these businesses. Thus, applying the fraud-on-the-market presumption may warp class actions in the crowdfunding context from a tool for investor protection to a tool of investor insurance. See Basic Inc. v. Levinson, 485 U.S. 224, 250-51, 262 (1988) (White, J., concurring in part and dissenting in part) (“This Court and others have previously recognized that ‘inexorably broadening . . . the class of plaintiff[s] who may sue in this area of the law will ultimately result in more harm than good.’” (alterations in original)).

\textsuperscript{258} See Erica P. John Fund v. Halliburton Co., 131 S. Ct. 2179, 2187 (2011) (“As we have explained, loss causation is a familiar and distinct concept in securities law; it is not price impact.”).

\textsuperscript{259} See \textit{Dura} Pharm., Inc. v. Broudo, 544 U.S. 336, 343 (2005) (“Other things being equal, the longer the time between the purchase and sale, . . . the more likely that other [non-fraudulent] factors caused the loss.”).

\textsuperscript{260} See supra III.C.

\textsuperscript{261} See \textit{Dura}, 544 U.S. at 343.

\textsuperscript{262} See supra Part III.C.3.

\textsuperscript{263} See Georgakopoulos, \textit{supra} note 227 at 705.

\textsuperscript{264} Erdlen, \textit{supra} note 206, at 904.

\textsuperscript{265} See supra Part III.

\textsuperscript{266} Erdlen, \textit{supra} note 206, at 904.

\textsuperscript{267} Heminway & Hoffman, \textit{supra} note 37, at 954.
\end{quote}
resale market is continuously informed and educated.\footnote{See \textit{supra} Part IV (discussing the impact of loosening the one-year restriction on the secondary market).} A regulated secondary market with informed investors that more accurately reflects price strikes a proper balance. Honest crowdfunding businesses gain the added benefit of easier access to capital,\footnote{See Ibrahim, \textit{supra} note 254, at 22-23.} while loosening the resale restriction would also make it easier to pursue claims against fraudsters.\footnote{See \textit{supra} Part III.C.3 (discussing the event studies).} The benefit of added investment should well outweigh the fraud that occurs.\footnote{In \textit{Stoneridge Inv. Partners, LLC v. Scientific-Atlanta Justice Stevens, in his dissent, noted:}

\textit{The success of the U.S. securities markets is largely the result of a high level of investor confidence in the integrity and efficiency of our markets. The SEC enforcement program and the availability of private rights of action together provide a means for defrauded investors to recover damages and a powerful deterrent against violations of the securities laws.} 552 U.S. 148, 174 n.10 (2008) (quoting U.S. CODE CONG. & ADMIN. NEWS (1995), 679, 687) (Stevens, J. dissent).}

\section*{CONCLUSION}

The JOBS Act’s crowdfunding provisions may not please everyone. However, there are no signs of Congress legislating otherwise. Critics and proponents of the JOBS Act’s crowdfunding provisions have made important points that the SEC should address as it makes crowdfunding rules. Thus, the SEC should keep litigation hurdles in mind when it makes rules regarding the resale of crowdfunding shares. A looser resale restriction rule that guides the transition of crowdfunding securities into the secondary market serves anti-fraud purposes while providing an incentive for investors to join the crowdfunding market. This would allow crowdfunding laws to better fit the mosaic of federal securities regulation.

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