

ARTICLES

CROWDFUNDING IN WONDERLAND: ISSUER AND INVESTOR RISKS IN NON- FRAUDULENT CREATIVE ARTS CAMPAIGNS UNDER THE JOBS ACT

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INTRODUCTION

Consider the following scenario: a down-on-his-luck Broadway producer seeks funds from elderly ladies to finance a theatrical production. The elderly ladies are not sophisticated, and the producer comes up with a scheme to defraud them. In each case, the producer seduces the woman into investing a 100% share in a new production. The problem, of course, is that the producer is overselling the show. Only one woman can purchase 100% of the production, but he seeks that same amount from many investors. The first part of this scheme was a common practice in the 1920s. Some say it helped precipitate the stock market crash of 1929. Even in a film like *The Cocoanuts*, Groucho Marx is selling the same piece of real estate in Florida over and over again. But the scheme hatched by our Broadway producer, inspired by the musings of his sidekick accountant, has an especially interesting twist. Instead of simply running away with all of the money invested by the elderly women, the producer and his sidekick decide that they can avoid the appearance of fraud by mounting a show that would be so unappealing to audiences so as to represent a total loss of each woman's investment. Since the women do not know about each other, each investor will think that she lost all of the money that she put into the show and walk away. And since there were no profits flowing from the Broadway flop, the producer and the accountant can simply split the remainder of the capital invested by the women.

By now, you can see that this is the plot of Mel Brooks' 1968 film *The Producers*, which, perhaps ironically, was later adapted into a smash hit on Broadway. The plot twist that makes *The Producers* a brilliant comedy is that the performance that producer Max Bialystock chooses as his intended flop turned out to be a great success as a campy farce. It is this last element of Mel Brooks' plot that reveals a pressing challenge for regulating the sales of securities when it comes to creative artistry, such as theatrical or filmic productions. The comedy of *The Producers* is ultimately predicated on the reality that art is subjective. No one can tell you what is good art or not good art, and it is difficult to tell if a producer's effort is worthwhile or lackluster in the production of that art.

Enter the Jumpstart Our Business Startups ("JOBS") Act of April 5, 2012, which Congress passed to spur investment in creative content and ultimately help create jobs in our economy.¹ Indeed many independent producers in the entertainment industry have been awaiting the opportunity to solicit capital from the public for their projects. On October 23, 2013,

1. Jumpstart Our Business Startups Act (JOBS Act), Pub. L. No. 112-106, 126 Stat. 306 (2012) [hereinafter JOBS Act].

the Securities & Exchange Commission (“SEC”) proposed new rules and forms to implement Title III of the JOBS Act.² Finally, on October 30, 2015, after years of anticipation and commentary on the proposed rules, the SEC promulgated the final rules, known as “Regulation Crowdfunding,” which went into effect on May 16, 2016.³ Title III of the JOBS Act added section 4(a)(6) to the Securities Act of 1933.⁴ Section 4(a)(6) provides a registration exemption for crowdfunding offerings up to \$1 million per year.⁵ Crowdfunding is a fundraising method where small amounts of capital are raised from a large number of accredited and non-accredited investors to finance a new business venture through authorized intermediaries, such as funding portals.⁶ Prior to the JOBS Act, the only way to sell interests in creative content was through a public offering or a private placement under section 4(a)(2) of the Securities Act of 1933.⁷ Companies and investors could also rely on the safe harbor provided by Regulation D, which set forth a number of rules that sophisticated companies and investors could follow to avoid an action by the SEC. Post-JOBS Act, subject to certain conditions and depending on the amount of the offering, issuers of crowdfunded campaigns are exempt from registration and there are decreased disclosure requirements.⁸ Now,

2. JOBS Act, Title III, Pub. L. No. 112–106, § 302, 126 Stat. 306, 315 (2012) (codified as amended at 15 U.S.C. 77d(a)(6)).

3. Crowdfunding Final Rules for SEC, 80 Fed. Reg. 71387, 71387–71615 (Nov. 16, 2015) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240, 249, 269, 274). The forms enabling funding portals to register with SEC went into effect on Jan. 29, 2016. *Id.*

4. *Id.*

5. Crowdfunding Final Rules for SEC, *supra* note 3.

6. 80 Fed. Reg. at 71388–71615 (stating that the following issuers are prohibited from taking advantage of the crowdfunding exemption under section 4(a)(6): (1) issuers that are not organized under the laws of a state or territory of the United States or the District of Columbia; (2) issuers that are subject to Exchange Act reporting requirements; (3) investment companies as defined in the Investment Company Act of 1940 (the “Investment Company Act”) or companies that are excluded from the definition of investment company under Section 3(b) or 3(c) of the Investment Company Act; (4) issuers that are disqualified from relying on Section 4(a)(6) pursuant to the disqualification provision in Rule 503(a) of Regulation Crowdfunding; (5) issuers that have sold securities in reliance on Section 4(a)(6) if they have not filed with the Commission and provided to investors, to the extent required, the ongoing annual reports required by Regulation Crowdfunding during the two years immediately preceding the filing of the required new offering statement; and (6) issuers that have no specific business plan or that have indicated that their business plan is to engage in a merger or acquisition with an unidentified company or companies; and (7) any other issuer that the Commission, by rule or regulation, determines appropriate).

7. Formerly, section 4(2), but re-designated as section 4(a)(2) by the JOBS Act.

8. See 80 Fed. Reg. 71387, 71387–71615 (providing that for offerings up to \$100,000, issuers must “file with the Commission and provide to investors and the relevant intermediary income tax returns filed by the issuer for the most recently

issuers may seek:

- 1) the greater of: \$2,000 or 5 percent of the lesser of the investor's annual income or net worth if either the investor's annual income or net worth is less than \$100,000; or 2) 10 percent of the lesser of the investor's annual income or net worth, not to exceed an amount sold of \$100,000, if both the investor's annual income and net worth are equal to or more than \$100,000.⁹

Implementation of the JOBS Act has caused crowdfunding and the number of funding platforms to consistently grow in numbers year by year.¹⁰ Today, there are nearly 200 platforms in the United States alone.¹¹

Now imagine that Max Bialystock and his sidekick had engaged in the same scheme, except that there was no evidence of fraudulent intent. Imagine that they had solicited, without overselling, funds from multiple women to create a hit show, but the show just happened to be a flop based on their arrogance, incompetence, or inexperience, or simply because their work was misconceived or undervalued. At the end of the day, the JOBS Act, despite its good intentions for artists, invites unsophisticated industry outsiders to entrust their money on websites in the hopes that content creators will develop some type of artistic product that will give them a return, whatever that may be, on their investment. Part II of this article argues that although fraud is a likely consequence of the JOBS Act, investors of fraudulent campaigns are protected under federal and state laws. The difficult cases are those that are just short of fraud. Part III examines those cases where the investor does not feel that the producer put enough effort into creating the production or the content simply turns out not to be "good enough." There, we explore the potential recourse an investor has against a diligent and honest issuer who only partially performs or creates an unprofitable project, and we examine the risk of unjust litigation against these issuers. We analyze how federal or state

completed year (if any) and financial statements that are certified by the principal executive officer to be true and complete in all material respects." For offerings greater than \$100,000 but less than \$500,000, the issuer must "file with the Commission and provide to investors and the relevant intermediary financial statements reviewed by a public accountant that is independent of the issuer." For offerings greater than \$500,000, the issuer must "file with the Commission and provide to investors and the relevant intermediary financial statements audited by a public accountant that is independent of the issuer").

9. 80 Fed. Reg. 71387, 71387–71615.

10. Chance Barnett, *Trends Show Crowdfunding to Surpass VC in 2016*, FORBES (Jun. 9, 2015, 5:33 PM), <http://www.forbes.com/sites/chancebarnett/2015/06/09/trends-show-crowdfunding-to-surpass-vc-in-2016>.

11. Salvador Briggman, *The History of Crowdfunding and the JOBS Act*, CROWDFUNDING AND THE JOBS ACT (last visited Aug. 3, 2016), <http://www.crowdfunder.com/the-history-of-crowdfunding-and-the-jobs-act>.

regulators can impose liability on an artist's creative process or the content itself absent fraud, and how artists can protect themselves against unwarranted litigation. Part IV examines potential content-based regulations that the SEC could promulgate and questions whether such regulations would run afoul of the First Amendment right to free speech. Part IV also explores alternative regulations that would impose greater requirements on the funding portals, rather than the work-product.

This article argues that the JOBS Act may ultimately open the doors to investors being attracted to, and artists being burdened by, the subjective appeal of artistic production, just as those elderly women (and Max) were seduced by the lights of Broadway in *The Producers*, and that these investors will have limited remedies, if any, against issuers of failed, yet non-fraudulent creative arts campaigns. For the SEC, this may be more than an occasional case of a savvy investor seeking redress for an artist's egregious underperformance. As equity crowdfunding grows in popularity, less sophisticated investors may flood the agency with subjective complaints that they were the victims of artistic underperformance, creating a system-wide problem that affects not only the disappointed investor who was looking for a bargain, but also the undervalued artist who performed competently and in good faith.

II. INVESTOR RISKS AFTER THE JOBS ACT: FRAUD IS THE "EASY CASE"

Many authors have written that fraud is a major potential consequence of the JOBS Act based on the naive nature of crowdfunding investors, most of whom are non-accredited, "financially illiterate and in need of the protections provided by state and federal securities laws."¹² As Benjamin P. Siegel wrote, the JOBS Act "allow[s] unsophisticated investors to participate in unregistered crowdfunding opportunities" and "distribut[e] the reduced number of issuer disclosures to investors in a dense and difficult-to-understand way, thus decreasing issuer transparency." Van S. Wiltz has stated that "[b]ecause crowdfunding is transacted online, it is difficult for investors to know whether a start-up company is legitimate."¹³ "[I]nvestor[s] must rely on the transparency and accuracy of the project creators' voluntary disclosures to determine if a funded project will actually be followed through to completion."¹⁴ There is a greater need for disclosure requirements and transparency for these non-accredited

12. Benjamin P. Siegel, Note, *Title III of the JOBS Act: Using Unsophisticated Wealth to Crowdfund Small Business Capital or Fraudsters' Bank Accounts?*, 41 HOFSTRA L. REV. 777, 794 (2013).

13. Van S. Wiltz, *Will the JOBS Act Jump-Start the Video Game Industry? Crowdfunding Start-Up Capital*, 16 TUL. J. TECH. & INTELL. PROP. 141, 161 (2013).

14. *Id.* at 162.

investors, but the JOBS Act dismisses this fact, hopeful for an improved economy. While fraud is a likely consequence of the JOBS Act, outright fraud may not be as big an issue as others have suggested. Investors of plainly fraudulent campaigns are entitled to legitimate protections and remedies under federal and state laws.

A. Established Protections and Recourse Against Fraudulent Campaigns

Besides being allowed to establish their own criteria or algorithms to identify and monitor fraud, the funding portals, which behave as the intermediaries between the investors and the business, are subject to various SEC promulgated rules in an effort to minimize the risk of fraud in crowdfunding. The portals are required to register with the SEC and the relevant self-regulatory organization (“SRO”), and ensure that proceeds are only offered to the issuer when the target amount is reached.¹⁵ They must obtain basic identifying contact information, at the very least, from each start-up company, which cannot use more than one portal for each offering.¹⁶ Portals must deny access if there is a reasonable belief that they cannot “adequately or effectively assess the risk of fraud of the issuer or its potential offering.”¹⁷ The portals must conduct a background check on the start-up company’s management and twenty percent beneficial owners to view their financials and ensure past compliance with securities laws and regulations.¹⁸ Portals must also make available to the SEC and potential investors information provided by the issuer.¹⁹ They must provide a means for communication among the entire general public on their platforms, but only those who have actually opened accounts may post comments.²⁰

Funding portals must ensure that investors understand the risk of the loss of their entire investment by requiring each to read education materials that comply with SEC standards before accepting any commitment, which must be subject to cancellation until 48 hours prior to the campaign’s deadline.²¹ The educational materials must communicate “effectively and accurately” and explain in plain language the mechanism for purchasing stock of the issuer; the risks of purchasing stock; the types of securities offered on the

15. 80 Fed. Reg. 71387, 71387–71615.

16. *Id.*

17. *Id.*

18. *Id.*

19. *Id.*

20. *Id.*

21. *Id.*

platform and the risks of each type; the restrictions on resale imposed by law or contract; the kinds of information the issuer is required to provide; the per-investor limitations on investment; the investor's right to cancel the investment, and the limitations on those rights; the need for the investor to think about whether the investment is appropriate; and that following the investor's purchase of stock, there might be no further relationship between the investor and the portal.²² Where an issuer fails to complete an offering, the portal must give each investor a notification within five business days disclosing the cancellation, the reason therefor, and the refund amount the investors should expect.²³ Any material changes to the campaign must also be disclosed to the investor, who has at least five business days to reconfirm the commitment.²⁴

As Jacques F. Baritot points out, the new SEC rules offer education materials for investors, increased due diligence, interactive investor communities, SROs, and intermediary escrow accounts.²⁵ In addition, investors of fraudulent campaigns have remedies under both federal and state laws. These investors can enjoy the safeguards of Rule 10b-5,²⁶ commerce protection laws, consumer trade laws, and anti-fraud statutes. Unscrupulous issuers could be punished both civilly and criminally under most of these laws. Thus, while fraud is a potential consequence of the JOBS Act, there are avenues for protection and resolution.

B. The Relatively Easy Case of "The Doom That Came to Atlantic City!"

As illustrated in the case of the crowdfunded board game "The Doom That Came to Atlantic City!", where a campaign is an outright scheme to defraud, investors will have a less difficult time establishing anti-fraud statutes' element of scienter, e.g., deceitful or manipulative intent.²⁷ This was a donation-based campaign, thereby creating different expectations and obligations than in an equity-based campaign. The latter "appeals to investors interested in contributing to commercial ventures in exchange for a share of the financial reward."²⁸ The former "appeals to people who are

22. *Id.*

23. *Id.*

24. *Id.*

25. Jacques F. Baritot, *Increasing Protection for Crowdfunding Investors Under the JOBS Act*, 13 U.C. DAVIS BUS. L.J. 259, 275-80 (2013).

26. 17 C.F.R. § 240.10b-5 (2015).

27. See generally *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564 (9th Cir. 1990).

28. Shahrokh Sheik, *Fast Forward On Crowd Funding, Although Donation-Based Crowdfunding Has Experienced Some Success, Questions Remain About the Practicality of Equity-Based Crowdfunding*, 36 L.A. L. 34, 39 (2013).

motivated to donate based on the artistic or humanitarian nature of the project and have no expectation of financial return.”²⁹ Unlike an equity-based offering, a donation-based offering “allow[s] people to donate in return for nonmonetary consideration.”³⁰ For this reason, the participants are not considered “investors” in the true sense of the term; rather, they are “donators.” While this article is written in the context of equity-based crowdfunding, this particular campaign provides a useful analog for the underlying issue of fraud. The case of “The Doom That Came to Atlantic City!” illustrates the availability of a greater opportunity for relief against a deceitful issuer, whether an equity- or donation-based offering.

In this case, the issuer, Erik Chevalier, “represented to consumers that they would receive certain reward deliverables, such as a copy of the board game and certain figurines, if the campaign reached its funding goal of \$35,000.”³¹ Chevalier “represented that money raised would be used primarily for the development, production, completion, and distribution of the board game”³² Chevalier “raised nearly four times his original goal for a total of over \$122,000.”³³ However, “[i]nstead of producing the game or providing the reward deliverables to consumers, [he] announced that the game would not be produced and that refunds would be issued.”³⁴ Few, if any, investors were issued refunds.³⁵ The Federal Trade Commission (“FTC”), an independent federal agency created by statute³⁶ to monitor unfair or deceptive acts or practices in or affecting commerce,³⁷ brought a civil action against Chevalier requesting restitution, disgorgement of ill-gotten gains, and a permanent injunction against future violations of the FTC Act.³⁸ It became clear in the FTC’s complaint that Chevalier had “never hired artists for the board game and instead used the consumers’ funds for miscellaneous personal equipment, rent for a personal residence, and licenses for a separate project.”³⁹

Chevalier and the FTC eventually came to a settlement agreement, prohibiting him from making misrepresentations about crowdfunding

29. *Id.*

30. *Id.*

31. FTC v. Chevalier, No. 3:15-cv-01029-AC (D. Or. June 10, 2015).

32. *Id.*

33. *Id.*

34. *Id.*

35. *Id.*

36. 15 U.S.C. §§ 41–58 (2012).

37. *Id.* § 45(a).

38. *Chevalier*, No. 3:15-cv-01029-AC (D. Or. Jun. 10, 2015).

39. *Id.*

campaigns and failing to honor refund policies in the future.⁴⁰ Chevalier was also ordered to pay about \$112,000 in restitution, but that order was suspended based on his inability to pay.⁴¹ According to a press release by the FTC, “[t]he full amount will become due immediately if he is found to have misrepresented his financial condition.”⁴² Notably, Chevalier was never required to admit guilt as a part of the settlement.⁴³ This was the FTC’s “first ever enforcement action against a crowdfunded project,” but it took years to play out.⁴⁴ The project was launched by Chevalier in May 2012 and suspended by Chevalier in June 2013.⁴⁵ The complaint was filed in June 2015, and the settlement occurred immediately thereafter.⁴⁶ Chevalier could have produced a prosaic, amateur game and thereafter closed the campaign. He could have engaged in a scheme similar to *The Producers*. Realistically, Chevalier’s visions for the board game could have been far less impressive than those of his investors and potential consumers. However, this is a relatively simple case where the issuer’s fraudulent intent was readily apparent via an investigation of campaign’s allocation of funds and progress, or lack thereof. Admittedly, the remedy was imperfect, as Chevalier was not financially apt to reconstitute the victims. However, a viable road for recovery still existed. The victims complained, the government stepped in, and restitution was ordered.

The bigger concern appears in those cases that are just short of fraud. The issue with the securities laws is that they are scienter-driven protections.⁴⁷ According to James J. Barney, the securities laws “are based on the ability to restrict untruthful statements.”⁴⁸ Therefore, in the context

40. Andrea Peterson, *Game Over: FTC Goes After Board Game Campaign Gone Wrong in First Crowdfunding Case*, WASH. POST (Jun. 11, 2015), <https://www.washingtonpost.com/news/the-switch/wp/2015/06/11/the-ftcs-first-crowdfunding-enforcement-is-over-a-failed-board-game-on-kickstarter>.

41. *Id.* (“Eventually, after numerous complaints from the backers and the artistic creators of the game, another game developer stepped in and published the game and gave all backers a copy of the board game but not the other, highly-prized deliverables, such as the promised pewter figurines.”); *Chevalier*, No. 3:15-cv-01029-AC (D. Or. Jun. 10, 2015).

42. Peterson, *supra* note 40.

43. *Id.*

44. *Id.*

45. *Id.*

46. Press release, FTC, Crowdfundng Project Creator Settles FTC Charges of Deception (June 11, 2015).

47. See, e.g., William E. Aiken, Jr., *Element of Scienter as Affecting Action to Enjoin Violation of Federal Securities Laws*, 21 A.L.R. Fed. 582 (1974); Shaun Mulreed, *Private Securities Litigation Reform Failure: How Scienter Has Prevented the Private Securities Litigation Reform Act of 1995 From Achieving Its Goals*, 42 SAN DIEGO L. REV. 779 (2005).

48. James J. Barney, *The Mixed Message: The Supreme Court’s Missed*

of crowdfunding under the new exemption, there could be little recourse against an issuer of a failed project where there is no scienter or untruthful conduct. The specific focus of this article is on the grey area in which an artist, without having any fraudulent intent, does not or appears not to complete performance.

III. RISKS TO ISSUERS AND INVESTORS AFTER THE JOBS ACT: THE HARDER CASE OF NO FRAUD

Rather than scrutinize the unscrupulous issuer or the unsophisticated investor, this article focuses on those cases where an investor of creative artistry loses, but not as a result of any fraudulent intent of the issuer or lack of sophistication of his or her own. Where investors are misled by the solicitor's subjective artistic vision/process or disappointed by under-produced content, it is likely that they would merit the protections of anti-fraud statutes. However, investors cannot establish a fraud claim without scienter. Without any evidence of scienter, the road to recovery against honest, yet failed, projects will be rocky. With a content-based product, benchmarks of success can be elusive. A pompous or disorganized filmmaker can spend the investment legitimately, but still run out of money before completing the film. Or a minimalist artist can in good faith and in little time create a "magnificent" painting, which others actually view as dull. Congress did not intend to flood the courts with litigation against issuers whose artistic vision is misunderstood or underappreciated. Nor did Congress intend to prevent investors from seeking redress from arrogant or incompetent creative artists, but absent scienter there would be no restitution or disgorgement of profits under anti-fraud statutes. This section discusses the risk of unfair litigation against skillful and honest artists, especially those with original sensibilities, while questioning whether an investor has any feasible recourse against an issuer who does not intend any harm, but only partially performs or creates an unprofitable project.

In the crowdfunding context, non-performance or under-performance without scienter could be deemed an issue of day-to-day corporate governance that is unrelated to the sale of a security under federal law. If Erik Chevalier never had any intention during the offering to misappropriate investments, but later behaved negligently in expending the funds on objects or services actually related to the board game, the focus would shift from Chevalier's good faith intentions and disclosures during

Opportunity to Address the Confused State of Commercial Speech in Nike, Inc. v. Kasky?, 37 U. WEST. L.A. L. REV. 1, 26, n.156 (2004).

the offering to Chevalier's promises, if any, regarding his post-sale efforts and the work-product. The analysis would hinge on whether there has been a breach of a promise or a duty, not during the solicitation, but at the time of performance, i.e., during the issuer's creative process. After all, investors entrust their money to issuers expecting a return, thereby imposing some sort of trustee relationship between them after the point of sale.

A. *Imperfect Contract Law Remedies*

Without evidence of fraudulent intent, investors of failed projects may seek redress under contract law for a more positive outcome, but a closer look reveals that such optimism may be misplaced. The Contractarian theory relies on the notion that there is a separation of ownership and control between investors and officers, respectively, of a public corporation.⁴⁹ Although in the crowdfunding context the offering is treated as a private placement, the structure of the offering is similar to that of a public corporation because it is made available to the general public and could involve a large number of people. The Contractarian theory therefore provides a useful understanding of the effect of non-fraudulent crowdfunding campaigns under principles of contract law. While there are various interpretations of the theory,⁵⁰ the Contractarian theory of corporate law, in particular, holds that the relationship between the shareholders and managers of a public corporation is contractual in nature.⁵¹ Some Contractarians believe that managers adopt default rules via incorporation in a particular state and then customize these rules via "promises in the articles of incorporation."⁵² Shareholders thereafter accept these rules "by buying shares in the company and implicitly pricing the quality of the firm's governance commitments."⁵³

According to Michael Klausner, while plausible, the Contractarian theory of corporate law "has turned out to be based largely on an . . .

49. Steven Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 862 (1997).

50. Ann Cudd, *Contractarianism*, STANFORD ENCYCLOPEDIA OF PHILOSOPHY (Aug. 2, 2012), <http://plato.stanford.edu/entries/contractarianism>; Minka Woermann, *In Corporations We Trust? A Critique of Contractarian-Based Corporate Social Responsibility Models*, AFRICAN J. BUS. ETHICS (2011); Luke Mastin, *The Basics of Philosophy* (last visited July 27, 2016), http://www.philosophybasics.com/branch_contractarianism.html.

51. Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779, 782 (2006).

52. *Id.* at 782–83.

53. *Id.* at 783.

imaginary world of contracting.”⁵⁴ Sure, “there is ‘wonderful diversity’ among firms with respect to . . . certain corporate governance mechanisms and management structures.”⁵⁵ “These arrangements and others are important elements in a firm’s governance structure.”⁵⁶ However, these arrangements are not contractual, “in the sense the term is used by [C]ontractarians,” between the management and shareholders.⁵⁷ The theory does not account for matters of governance that “are excluded from the corporate contract and left to non-legal enforcement.”⁵⁸ Though “[f]irms innovate and customize non-legal governance arrangements . . . they do not do so in the corporate contract.”⁵⁹ Managers “do not subject their innovation and customization to legal enforcement by shareholders.”⁶⁰

Similarly, in the crowdfunding context, where investors are unhappy with an issuer’s creative process or the final product, the actual obligations accepted by the issuer will probably be insufficient to provide any real insight or remedy. To create an enforceable contract, there must be “adequate consideration” and “mutual assent.” Adequate consideration requires a bargained-for exchange, meaning that one side’s promise cannot be illusory. An “illusory promise” is one that “appears on its face to be so insubstantial as to impose no obligation on the promisor; an expression cloaked in promissory terms but actually containing no commitment by the promisor.”⁶¹ A promise does not qualify as consideration if by its terms the promisor reserves a choice of alternative performances,⁶² or an “unlimited right to determine the nature or extent of its performance . . .”⁶³ An illusory promise leaves future action subject only to the promisor’s own will.⁶⁴ Consideration, however, requires a binding obligation.⁶⁵ Sometimes, if only one promise is illusory, the court will still find a unilateral contract.⁶⁶ In such case, the non-illusory promise serves as the

54. *Id.* at 784.

55. *Id.*

56. *Id.*

57. *Id.* at 785.

58. *Id.*

59. *Id.* at 786.

60. *Id.*

61. *Illusory Promise*, BLACK’S LAW DICTIONARY (2d ed. 2016).

62. *Crewzers Fire Crew Trans., Inc. v. United States*, 741 F.3d 1380, 1382 (Fed. Cir. 2014).

63. *Source Assocs., Inc. v. Valero Energy Corp.*, No. 1:05CV2526, 2007 WL 1235997, at *4 (N.D. Ohio Apr. 26, 2007), *aff’d* 273 F. App’x 425 (6th Cir. 2008).

64. *Stinger Indus., LLC v. Hill-Rom Co. Inc.*, 23 F. App’x 472, 474 (6th Cir. 2001).

65. *Howard v. King’s Crossing, Inc.*, 264 F. App’x 345 (4th Cir. 2008).

66. *Talent Tree, Inc. v. Madlock*, No. 4:07-cv-03735, 2008 WL 4104163, at *4

offer, “which the promisor who made the illusory promise can accept by performance.”⁶⁷ Moreover, mutual assent requires the parties to have a “meeting of the minds,” or same understanding, regarding the essential terms and conditions of their agreement.⁶⁸ It is based on the objective conduct of the parties,⁶⁹ and determined from the reasonable meaning of the words and acts of the parties, not from their unexpressed intentions or understandings.⁷⁰ The parties’ “[s]ecret hopes and wishes count for nothing because the status of a document as a contract depends on what the parties express to each other and to the world, not on what they keep to themselves.”⁷¹

In the crowdfunding context, courts could find that a creative arts campaign does not impose an enforceable contract between the issuer and investor with respect to the issuer’s creative process or the final product. This is because issuers of crowdfunding campaigns do not subject their innovation and creativity to legal enforcement by investors. An example would be an issuer’s promise to create a piece of contemporary rock music. The courts could deem this an illusory promise since the issuer has no objective duty with respect to the composition’s attributes, such as the harmony, melody, form, or rhythm. The issuer’s promise is not restricted, except perhaps as to the subject matter of the music, and he or she asserts full control over the project. The issuer has an unlimited right to determine the nature and extent of the project. The issuer will suffer no legal detriment no matter the quality of the composition because there was never any explicit promise. Conceivably, the courts could find adequate consideration via a unilateral contract to be accepted by the issuer upon completion of the rendition, or alternatively, in the issuer’s implied promise to use reasonable efforts to complete the project.⁷² Regardless, the parties would likely still have a hard time showing mutual assent, as there is no meeting of the minds regarding the essential characteristics of the composition. Even more troubling would be those cases where an issuer explicitly discloses that investors may not be happy with his or her creative process or the work–product. In such cases, investors would not be able to

(S.D. Tex. 2008).

67. See *Source Assocs.*, 273 F. App’x at 427–29.

68. *T & B General Contracting, Inc.*, 833 F.2d 1455, 1459 (11th Cir. 1987).

69. *Laserage Tech. Corp. v. Laserage Labs., Inc.*, 972 F.2d 799, 804 (7th Cir. 1992).

70. *Netbula, LLC v. BindView Dev. Corp.*, 516 F. Supp. 2d 1137, 1155 (N.D. Cal. 2007).

71. *Laserage Tech. Corp.*, 972 F.2d at 802.

72. See *Wood v. Lucy, Lady Duff–Gordon*, 118 N.E. 214, 215 (N.Y. Ct. App. 1917).

assert any legitimate expectations regarding the outcome of the project. Without any indications in the issuer's disclosure statements or representations enumerating the specific qualities of the product, the issuer would be free to create any final product.

Without specificity, not only is the unhappy investor stripped of any potential remedies under contract law, but the legitimate artist could also be at risk. This is because an investor owes no duty to the issuer and may initiate legal proceedings if the work product is unsatisfactory. It is important to note that most investors of crowdfunded projects do not have the capital to initiate litigation.⁷³ In addition, the issues may be too clouded and expensive to attract a securities litigation practice, especially if the probability of a successful outcome is difficult to ascertain. Perhaps if enough online investors come forward to complain, a class of complainants could hire a plaintiffs' securities firm to litigate the case on contingency. Some investors could use their social media presence and established online profiles to solicit and form the class. Even so, most plaintiffs' securities firms would not risk such an investment absent knowledge of a strong probability of success. Alternatively, enough outrage on social media could also facilitate government interest and intervention.

Where investors are able to initiate some sort of litigation, the legitimate artist will be subjected to unfair legal fees and processes. What is particularly troubling about this litigation is that the artists with avant-garde sensibilities will probably carry greater risks than the artists with mainstream ideas. Investors may have an easier time accepting the more conventional projects that conform to society's expectations, as compared to the more innovative undertakings that society has yet to experience. Imagine that Max Bialystock produced in good faith an innovative production that alienated investors, critics, and fans. His conduct would necessarily risk litigation merely because his work was misunderstood. An artist could attempt to minimize these risks by disclosing any creative processes and benchmarks that investors should expect. Although more disclosures could limit artistic freedom by stifling innovation during the creative process, there will be greater protections for all parties. If, for example, a filmmaker is a minimalist, then the amateur effect of the production should be made known to any investor. The artist could also provide disclaimers or guarantees as to the project's turn-around time. While the disappointed investor may still initiate litigation, the artist will have a valid defense and could ultimately prevail earlier in the proceedings. Without these types of disclosures, neither party will have adequate protection under contract law. The investor will have a hard time

73. Siegel, *supra* note 12, at 794.

establishing the contracted-for expectations, and the artist will have a difficult time rebutting any such expectations.

B. Traversing the Logic of Fiduciary Duty

An alternative for the unhappy investor would be to show a breach of fiduciary duty via an analysis of the issuer's performance or the work-product in light of the issuer's particular circumstance. The securities and corporate laws recognize as tantamount fiduciary duties, the primary purpose of which is to protect investors.⁷⁴ Every action taken by a corporate director or officer, or an individual in a similar position, implicates a fiduciary duty.⁷⁵ Although there is disagreement as to whether the Contractarian theory provides a real recourse for shareholders who are dissatisfied with a corporate manager's administrative process, commentators generally agree that corporate managers are subject to the fiduciary duties of loyalty and, particularly relevant, due care.⁷⁶ The duty of due care/diligence refers to the level of judgment that a person would reasonably be expected to exercise under particular circumstances. Due care is the degree of care, effort, or caution in which a person of ordinary prudence would exercise under similar circumstances. In the corporate context, the duty of due care concerns the decision-making process of officers and directors.⁷⁷ Directors and officers must exercise good judgment, using ordinary care and prudence in the operation of the business.⁷⁸ "More specifically, 'directors have a duty to inform themselves, prior to making a business decision, of all material information reasonably available to them.'"⁷⁹ After becoming so informed, "they must then act with requisite care in the discharge of their duties."⁸⁰ Their actions are typically protected by the business judgment rule, which prevents or dismisses shareholder derivative suits for management decisions and processes undertaken in the absence of another breach, gross negligence, or corporate waste.⁸¹ In the securities context, the concept of negligent oversight suggests that even where there is a system of control, conscious

74. See Julian Velasco, *How Many Fiduciary Duties Are There in Corporate Law?*, 83 S. CAL. L. REV. 1231, 1234 (2010).

75. *Id.* at 1236–37.

76. David Rosenberg, *Making Sense of Good Faith in Delaware Corporate Fiduciary Law: A Contractarian Approach*, 29 DEL. J. CORP. L. 2, 491–516 (2005).

77. Velasco, *supra* note 74, at 1238.

78. *Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981).

79. See Velasco, *supra* note 74, at 1238.

80. *Id.*

81. *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979); *Benihana of Tokyo, Inc. v. Benihana, Inc.*, 906 A.2d 114 (Del. 2006); *In re The Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006).

failure to monitor or to oversee its operations creates liability.⁸² One cannot prevent liability merely by saying that there are supervisory procedures in place and that he or she has therefore fulfilled the duty to supervise.⁸³ Instead, one must prove that he or she “maintained and enforced a reasonable and proper system of supervision and internal control.”⁸⁴

Where a crowdfunding campaign is short of fraud or disloyal behavior, investors may have a bigger door for recovery by establishing negligent or careless conduct by the issuer. Although governed by objective standards, the breach of the duty of care analysis is fact driven, determined on a case-by-case basis.⁸⁵ While most crowdfunding investors do not have the capital for civil litigation,⁸⁶ where they are able to facilitate litigation or obtain the government’s support, extensive discovery and perhaps even trial would be required to determine the presence and extent of any alleged breach. The loss caused by a prominent painter’s arrogance may not be considered a breach, but the loss caused by an inexperienced painter’s might. Some expenses may be deemed wasteful in a particular offering, even if others are reasonable. An issuer could attempt to thwart or reduce liability by providing specific disclosures about his or her experiences, rather than promises about his or her intentions, thereby adjusting the threshold of reasonable judgment in that particular offering. In such a scenario, the day-to-day operations of the corporation would directly relate to the offering itself, raising the question of how much information issuers of creative arts projects should provide in their disclosure statements, which ultimately govern investors’ expectations relevant to an issuer’s creative process. Admittedly, issuers will not have an easy time conceptualizing their experiences so as to establish the degree of care that is supposedly implicit in their disclosure statements. Where this hurdle is overcome, an issuer who, for example, discloses ample information about his or her inexperience may be subject to less or no liability should it result in investor loss versus an issuer who discloses modestly. Of course, where the issuer misrepresents himself, investors can show scienter and argue

82. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

83. *Hollinger v. Titan Capital Corp.*, 914 F.2d 1564, 1576 (9th Cir. 1990) (citing *Zweig v. Hearst Corp.*, 521 F.2d 1129, 1134–35 (9th Cir. 1975), *cert. denied*, 423 U.S. 1025, and *Paul F. Newton & Co. v. Texas Commerce Bank*, 630 F.2d 1111, 1120 (5th Cir. 1980)).

84. *Id.* (quoting *Zweig*, 521 F.2d at 1134–35).

85. See Mark Klock, *Lighthouse or Hidden Reef? Navigating the Fiduciary Duty of Delaware Corporations’ Directors in the Wake of Malone*, 6 STAN. J.L. BUS. & FIN. 1, 13 (2000) (stating that fiduciary duty “needs to be addressed in the context of specific facts”).

86. Siegel, *supra* note 12, at 794–98.

fraud. The harder cases are those where the disclosures are not fraudulent because they require a detailed, objective analysis of the relevant subjective capabilities and circumstances of each issuer/project. Thus, while fiduciary duty claims create recourse against incompetent artists, they could also lead to lengthy and expensive litigation against competent artists.

But the analysis changes where the investor is unhappy with the work product itself, rather than the issuer's efforts and diligence in creating the work. In the case of *The Producers*, if Max Bialystock and his sidekick had honestly tried to create a profitable film and exercised the proper degree of care in production, but still happened to create a flop, the focus would shift away from their efforts and instead to the creative content of their film. The same shift would also occur if they had made an unprofitable film, but had not oversold 100% of the production, thereby shielding any evidence of fraudulent intent. These are the most difficult cases because the focus shifts to the subjective creative vision of the artist. This will create a huge obstacle for investors of failed, yet diligently produced projects.

The breach of the duty of due care is obvious where an issuer manipulates the collection of investments to serve as a mere pretext for self-enrichment. Manipulation would likely bring one back to the relatively easy case of fraud. The harder case arises where an issuer honestly and diligently tries but ultimately fails to complete a project or make a profitable one. Or where an issuer intends not to complete a project or make a profitable one, but exercises due care and is sufficiently sophisticated to shield any evidence of deceitful intent. Obtaining relief against these issuers is a much murkier road. Where investors are unhappy with the quality of the work, but nevertheless cannot establish an improper degree of care by the issuer, they will be left in the dark, with no other recourse. One must not forget that every investment is a market risk. In the crowdfunding creative arts context, the risk is system-wide. Not only is there a risk of loss for the investor, but there is also a risk of unwarranted litigation for the ethical and careful issuer. Detailed disclosure statements could help to eliminate, or at least minimize, some of these risks pursuant to the principles of fiduciary duty law.

IV. IMPROVING THE JOBS ACT: MORE REGULATIONS, MORE PROBLEMS?

The crowdfunding provisions of the JOBS Act behave as a safe harbor.⁸⁷ While these provisions remove the formalities related to government

87. See generally Crowdfunding Final Rules for SEC, 80 Fed. Reg. 71387, 71387–71615 (Nov. 16, 2015) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240, 249, 269, 274).

intervention and regulation, the shortcomings of this informality are becoming increasingly apparent. This is especially true in the context of creative artistry, where the success and quality of the work depends on the subjective vision and process of the issuer. The next step may be for the SEC to monitor the arrogant or incompetent issuer by imposing regulations on content-based projects. Such regulations could also offer some protection for the misunderstood artists, while helping to distinguish between the con-artists and the failed artists, i.e., those who never intended to make or complete a profitable project and those who merely failed to do so. However, the SEC must be careful because such regulations may run afoul of the First Amendment. Sure, the SEC could attempt to regulate an issuer's good faith efforts. But if the work product is still a flop despite an issuer's good faith effort, then the issue becomes less about effort and more about content and work product. For example, Mozart could develop a masterpiece in just two hours, but a novice might develop a flop over months. As soon as criteria based on finished product are included, it appears as though the SEC is favoring some speech over others. But the government generally cannot question artistic vision or expression. What is dull in the SEC's eyes could have powerful significance for the minimalist artist and his or her audience. This section questions whether content-based regulations of crowdfunding projects, or of funding portals, would violate the First Amendment.

A. *Government Imposition of Criteria on the Work Product*

All speech is either commercial or noncommercial.⁸⁸ If the SEC were to impose criteria on the work product, the constitutionality of these criteria would hinge on whether a crowdfunding campaign constitutes commercial or noncommercial speech.⁸⁹ Commercial speech is directed to an audience and "makes representations of fact about the speaker's business operations for the purpose of promoting sales of its products."⁹⁰ Where there is both economic motivation and reference to a specific product, there is strong support that the speech is commercial.⁹¹ Economic motivation by itself, however, is insufficient to render speech commercial.⁹² For example, books,⁹³ motions pictures,⁹⁴ and religious literature⁹⁵ are considered

88. Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of NY, 447 U.S. 557, 562–63 (1980).

89. *See id.* at 563.

90. Nike, Inc. v. Kasky, 539 U.S. 654, 657 (2003).

91. Bolger v. Youngs Drug Prods. Corp., 463 U.S. 60, 67 (1983).

92. *See Bigelow v. Virginia*, 421 U.S. 809, 818 (1975).

93. *Smith v. California*, 361 U.S. 147, 150 (1959).

94. *Joseph Burstyn, Inc. v. Wilson*, 343 U.S. 495, 501 (1952).

noncommercial speech, even though they may involve a solicitation to purchase or to otherwise pay or contribute money.⁹⁶ Reference to a specific product by itself is also insufficient to render speech commercial.⁹⁷ The U.S. Supreme Court has established different tests for regulations affecting commercial versus noncommercial speech. These different tests are based on “the informational function of advertising” versus the expressive nature of noncommercial speech.⁹⁸ Where the government bans commercial speech more likely to deceive the public than to inform it, or commercial speech related to illegal activity, lenient review is justified.⁹⁹ Where commercial speech is constitutional, i.e., it concerns lawful activity and is truthful, the government’s power is more circumscribed.¹⁰⁰ Where the government “entirely prohibits the dissemination of truthful, non-misleading commercial messages for reasons unrelated to the preservation of a fair bargaining process, there is far less reason to depart from the rigorous review that the First Amendment generally demands.”¹⁰¹ The same goes for regulations affecting misleading, noncommercial speech. Because these regulations foreclose channels of communication, more careful review is appropriate.¹⁰²

According to Antony Page and Katy Yang, plaintiffs rarely, if ever, challenged the securities laws under First Amendment grounds when they first emerged.¹⁰³ It seemed inherent that “preserving the integrity of the capital markets” relied on “the government’s ability to mandate the full and fair disclosure of information by a company.”¹⁰⁴ More recently, First Amendment jurisprudence has been expanded into the realm of securities regulations.¹⁰⁵ Page and Yang base this on a “variety of factors, including a willingness by scholars and the courts to recognize that economic rights can be closely aligned with the traditional rights protected by the First Amendment.”¹⁰⁶ The U.S. Supreme Court first considered applying the

95. *Murdock v. Pennsylvania*, 319 U.S. 105, 111 (1943).

96. *New York Times Co. v. Sullivan*, 376 U.S. 254 (1964).

97. *Assoc. Students v. Attorney Gen.*, 368 F. Supp. 11, 24 (C.D. Cal.1973).

98. *See First Nat’l Bank of Boston v. Bellotti*, 435 U.S. 765, 783 (1978).

99. *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of N.Y.*, 447 U.S. 557, 563–64 (1980).

100. *Id.*

101. *44 Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 503 (1996).

102. *Id.*

103. Antony Page & Katy Yang, *Controlling Corporate Speech: Is Regulation Fair Disclosure Unconstitutional?*, 39 U.C. DAVIS L. REV. 1, 33–34 (2005).

104. *Id.* at 34.

105. *Id.*

106. *Id.*

First Amendment to federal securities laws in *Lowe v. SEC*.¹⁰⁷ The SEC sought to enjoin publishers of investment material from continuing to publish the material.¹⁰⁸ The Supreme Court granted certiorari to determine whether the First Amendment prohibits injunctions against the publication and distribution of petitioners' newsletters.¹⁰⁹ The Supreme Court, in an opinion delivered by Justice Stevens, ultimately decided the issue on other grounds without addressing the constitutional question.¹¹⁰ The Court did note, however, that because "expression of opinion about a commercial product such as a loudspeaker is protected by the First Amendment, [internal citation omitted] it is difficult to see why the expression of an opinion about a marketable security should not also be protected."¹¹¹ In Justice White's concurring opinion, joined by Chief Justice Burger and Justice Rehnquist, the Court reasoned that the injunction violated the First Amendment because it "banned legitimate, disinterested investment advice, as well as fraudulent, deceptive, or manipulative advice."¹¹² This constituted a presumptively invalid prior restraint on fully protected speech.¹¹³

Three years following the *Lowe* decision, in *SEC v. Wall Street Publishing Institute*,¹¹⁴ the District of Columbia Circuit Court found that profiles of specific investment prospects featured in a monthly stock market magazine were not commercial speech.¹¹⁵ The featured articles focused primarily on individual companies and portrayed them as appealing investment prospects because of their "market position, product offering, or management strategy."¹¹⁶ The Circuit Court found that the articles, generally two or three pages long, were not commercial speech because they were "not in an advertisement format."¹¹⁷ The articles were "indistinguishable from run-of-the-mill newspaper or magazine stories."¹¹⁸ Although "most of the articles specifically mention the [featured] company's stock along with its price history, not all do this, and

107. *Id.* at 35–36 (citing *Lowe v. SEC*, 472 U.S. 181 (1985)).

108. *Lowe*, 472 U.S. at 184–185.

109. *Id.* at 188.

110. *Id.* at 211.

111. *Id.* at 210, n.58.

112. Page & Yang, *supra* note 103, at 37 (citing *Lowe*, 472 U.S. at 234).

113. *Id.*

114. 851 F.2d 365 (1988).

115. *See, e.g., id.*

116. *Id.* at 366–367.

117. *Id.* at 372.

118. *Id.*

in none is the reference to the company's stock particularly prominent."¹¹⁹ The featured articles therefore were not commercial speech.¹²⁰ The U.S. Supreme Court denied certiorari.¹²¹

Ten years later, in *Commodity Trend Services, Inc. v. Commodity Futures Trading Commission*,¹²² the Seventh Circuit held that impersonal investment advice regarding commodities trading is not commercial speech.¹²³ The District Court had held that the publications containing investment advice were commercial speech because the publications themselves were advertised.¹²⁴ The Circuit Court disagreed, finding that "[a]n advertisement is a separate publication and does not strip the promoted publication of its First Amendment protection."¹²⁵ Otherwise, "even an editorial in *The New York Times* would constitute commercial speech because the newspaper seeks subscribers through advertisements."¹²⁶ The Circuit Court believed that the question was better resolved by focusing on the contents of the publications themselves, which were based on impersonal advice and information.¹²⁷ "The type of investment advice contained in the defendant's newsletter included, among other things, historical price ranges for various markets, 'hot picks' (impersonal trading recommendations and market commentaries), general instructions on how to trade in the commodities markets, methods of reducing trading risk, and extrapolating useful information from long-term market trends."¹²⁸ The Seventh Circuit relied on the narrow definition of commercial speech, namely "speech which does no more than propose a commercial transaction between a speaker and its audience," and found that the publications did not propose such a transaction.¹²⁹ The publications provided information on commodity trading in general and left actual trading to other parties.¹³⁰ The publications were "more closely analogous to a restaurant or performance review, or a *Consumer Reports* article, in the

119. *Id.*

120. *Id.*

121. *Wall Street Pub. Inst., Inc. v. SEC*, 851 F.2d 365 (D.C. Cir. 1988), *cert. denied* 489 U.S. 1066 (1989).

122. 149 F.3d 679 (7th Cir. 1998).

123. *Id.* at 684–85.

124. *Id.* at 685.

125. *Id.*

126. *Id.*

127. *Id.*

128. Page & Yang, *supra* note 103, at 38 (citing *Commodity Trend Servs., Inc.*, 149 F.3d at 684–86).

129. *Id.*

130. *Commodity Trend Servs., Inc.*, 149 F.3d at 686.

context of the commodity markets.”¹³¹ Just like a restaurant review, the publications were noncommercial speech because they did not propose any commodity transaction.¹³²

Today, although the law is not entirely clear as to whether crowdfunding solicitations will receive limited commercial speech protection or traditional First Amendment protection,¹³³ the decisions in *Wall Street* and *Commodity Trend Services* suggest that these campaigns are commercial speech because they propose a commodity transaction and are in advertisement format, despite typically being more than a few pages long. There is economic motivation and reference to a specific product. A crowdfunding solicitation attempts to persuade viewers to invest in a particular venture.¹³⁴ The issuer is a commercial speaker directing a message to an audience for the purpose of engaging that audience in a commercial transaction. Representations of fact may also be present regarding the work product or process. Even if an issuer includes his or her opinions about the work product or topic, the mere fact that an advertisement links a product to public discussion does not render it noncommercial speech.¹³⁵ Whether the campaign is equity or donation based, viewers are presented with some sort of product with the intention of being lured into a transaction.

If a crowdfunding solicitation is deemed commercial speech, then the SEC’s regulations must pass the test set forth in *Central Hudson*.¹³⁶ Where commercial speech is constitutional, the government must show an actual and substantial governmental interest that is directly advanced by the regulation, which must not be more extensive than necessary to serve that interest.¹³⁷ In *Central Hudson*, the New York Commission prohibited utility companies from advertising in a way that urged consumers not to conserve energy.¹³⁸ The Court reasoned that the state had a substantial interest in conserving resources, and that the ban materially advanced that interest.¹³⁹ Despite this interest, the Supreme Court believed that a total

131. *Id.*

132. *Id.*

133. Page & Yang, *supra* note 103, at 36.

134. *See* *Pittsburgh Press Co. v. Human Relations Comm’n*, 413 U.S. 376, 385 (1973).

135. *Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of N.Y.*, 447 U.S. 557, 563 n.5 (1980).

136. *See, e.g. id.* at 564.

137. *Id.*

138. *Id.* at 559–60.

139. *Id.* at 568–69.

prohibition was more extensive than necessary.¹⁴⁰ The Commission had not demonstrated that alternatives would be ineffective.¹⁴¹ Later, this “least restrictive” standard was modified to a “reasonable fit” standard.¹⁴² The Supreme Court modified the “least restrictive” requirement based on the “difficulty of establishing with precision the point at which restrictions become more extensive than their objective requires.”¹⁴³ The Court also noted that the government needed leeway in the field of commercial speech, which is “traditionally subject to government regulation.”¹⁴⁴ Following *Central Hudson*, in *Metromedia Inc. v. City of San Diego*,¹⁴⁵ the Supreme Court struck down an ordinance restricting billboards containing both commercial and noncommercial speech.¹⁴⁶ The Court reasoned that the ordinance restricted too much noncommercial speech, but clearly indicated that it would uphold an ordinance banning only commercial billboards.¹⁴⁷

Central Hudson and its progeny suggest that the SEC may have trouble restricting truthful, creative arts, crowdfunding solicitations if they are deemed commercial speech, although such solicitations were entirely prohibited until the JOBS Act absent a public offering or private placement. It is true that there are substantial governmental interests, such as the protection of interstate commerce from dishonest issuers, that could likely justify SEC regulations against content-based products. In fact, the U.S. Supreme Court has upheld a regulation of commercial speech even where the government failed to show that it served a substantial interest other than preventing deception.¹⁴⁸ However, the SEC may have trouble creating regulations that are limited enough so as not to impede on the noncommercial speech that is inextricably intertwined in a creative arts solicitation. Where an issuer solicits funds for a creative arts project, such as a book, painting, movie, or board game, then the speech necessarily entangles noncommercial elements of artistic expression. Regulating or preventing these solicitations may in turn impede or ban an issuer’s ability to facilitate expression of such content. This may be unacceptable under U.S. Supreme Court standards, where the sale of protected materials is also

140. *Id.* at 570–71.

141. *Id.*

142. *Bd. of Trs. of State Univ. of NY v. Fox*, 492 U.S. 469, 480–481 (1989).

143. *Id.*

144. *Id.*

145. 453 U.S. 490 (1981).

146. *Id.* at 512–517.

147. *Id.* at 503–512.

148. *Zauderer v. Office of Disciplinary Counsel*, 471 U.S. 626, 650 (1985).

protected under traditional First Amendment jurisprudence.¹⁴⁹ The Ninth Circuit too has extended traditional First Amendment protection to the “sale of merchandise which is inextricably intertwined with a statement carrying a religious, political, philosophical or ideological message.”¹⁵⁰ The business of tattooing¹⁵¹ and an artist’s sale of original work¹⁵² have also received traditional First Amendment protection. The presence of noncommercial expression in a creative arts solicitation therefore may require the SEC to justify any crowdfunding regulations under the standards set forth for noncommercial speech, rather than commercial speech.

If a crowdfunding solicitation is not commercial speech, then courts must turn to the *O’Brien* test.¹⁵³ *O’Brien* and its progeny allow the government to enforce a structural regulation that may incidentally restrict noncommercial speech content without violating the First Amendment. Under this test, the regulation must be content-neutral and a time, place, or manner restriction.¹⁵⁴ The regulation must further an actual and substantial governmental interest that is unrelated to the suppression of speech, and must not restrict more speech than necessary to further that interest.¹⁵⁵ In *O’Brien*, the Court reasoned that a law criminalizing the destruction of draft cards “no more abridges free speech on its face than a motor vehicle law prohibiting the destruction of drivers’ licenses, or a tax law prohibiting the destruction of books and records.”¹⁵⁶ Many purposes for the draft card would be defeated if it were altered, destroyed, or mutilated.¹⁵⁷ Following *O’Brien*, in *Turner v. FCC*,¹⁵⁸ the Court upheld the Must-Carry provisions of the Cable Television Consumer Protection and Competition Act of 1992.¹⁵⁹ The “Must-Carry Rules” required cable systems to allocate a percentage of their channels to local public broadcast stations.¹⁶⁰ The issue was whether the government violated the First Amendment by compelling

149. *Lakewood v. Plain Dealer Publ. Co.*, 486 U.S. 750, 756 n.5 (1988).

150. *Gaudiya Vaishnava Soc’y v. City & County of San Francisco*, 952 F.2d 1059, 1066 (9th Cir. 1989).

151. *Anderson v. City of Hermosa Beach*, 621 F.3d 1051, 1063 (9th Cir. 2010).

152. *White v. City of Sparks*, 500 F.3d 953, 954 (9th Cir. 2007); *Bery v. New York*, 97 F.3d 689, 695 (2d Cir. 1996).

153. *See, e.g., United States v. O’Brien*, 391 U.S. 367 (1968).

154. *Id.* at 376–377.

155. *Id.*

156. *Id.* at 375.

157. *Id.* at 378.

158. 512 U.S. 622 (1994) (plurality opinion).

159. *Id.* at 636.

160. *Id.*

cable companies to carry other stations.¹⁶¹ On their face, the Must-Carry provisions “impose[d] burdens and confer[ed] benefits without reference to the content of speech.”¹⁶² The design and operation of the provisions confirmed their content neutrality.¹⁶³ The rules were imposed industry-wide, regardless of content; did not require or prohibit any particular point of view; did not penalize based on content; did not compel affirmance of disagreeable points of view; did not decrease the amount of speech; and left open whatever speech the providers wanted on channels not subject to the requirement.¹⁶⁴ In addition to being content-neutral and a proper time, place, and manner restriction, there were three substantial governmental interests that outweighed the minor impact on the cable companies: (1) the preservation of free local broadcast television; (2) the promotion of widespread dissemination of information from multiple sources, rather than just one; and (3) the promotion of fair competition.¹⁶⁵ In *Turner*, the principal opinion applied the *O’Brien* test deferentially to the “predictive judgments” of Congress¹⁶⁶ and determined that “a real threat justified enactment of the Must-Carry provisions.”¹⁶⁷

In the crowdfunding context, the SEC could likely impose regulations on creative arts solicitations without impinging on the issuer’s First Amendment rights, in an effort to minimize potential litigation by disgruntled investors and to protect the legitimate artist. Imposing qualitative performance benchmarks on crowdfunding issuers would be similar to the forced conduct in *Turner*.¹⁶⁸ Ultimately, *Turner* rests on the premise that what was being regulated was a pipeline, i.e., broadcast signals, over which speech flowed. The government was not attempting to regulate the content itself. If an investor, in response to a crowdfunding solicitation, buys into a film or other artistic production, the investment product would also necessarily involve expression. The government would need to make a similar distinction by showing that what is being regulated is the channel over which the speech flows, rather than the speech itself.

161. *Id.*

162. *Id.*

163. *See id.* at 647.

164. *Id.*

165. *Turner Broad. v. FCC*, 910 F. Supp. 734, 751 (D.D.C. 1995), *aff’d*, 520 U.S. 180 (1997); *Turner*, 520 U.S. at 195.

166. *Turner*, 520 U.S. at 195.

167. *Id.* at 196.

168. *See, e.g.,* *Satellite Broad. & Commc’ns. Ass’n v. FCC*, 275 F.3d 337, 353 (4th Cir. 2001); *Cablevision Sys. Corp. v. FCC*, 570 F.3d 83 (2d Cir. 2009) (finding that on the other hand, statutes that discriminate against a small and identifiable number of cable providers have been subject to strict scrutiny); *Time Warner Cable, Inc. v. Hudson*, 667 F.3d 630, 638 (5th Cir. 2012).

Under *Turner*, the fact that funding portals may themselves be used to convey a message is not relevant:

That the video signals can only be used to convey a message is of no particular significance. The same is true of printing presses, or broadcast transmitters; loudspeakers, or movie projectors. Yet no one doubts that Congress could regulate a market in those commodities in danger of chaos or capture without being accused of attempting to infringe the First Amendment freedoms of those by whom they will be used to express protected speech.¹⁶⁹

In circumstances such as those in *Turner*, the First Amendment requires nothing more than a policy supporting content-neutral regulations that is “grounded on reasonable factual findings supported by evidence that is substantial for a legislative determination.”¹⁷⁰ In this context, the government would not be regulating or suppressing creative arts solicitations over every channel. Instead, there would be structural, content-neutral regulations related only to the manner in which funding portals operate. For example, the SEC may not be able to prohibit crowdfunding solicitations for minimalist art projects, though the agency could regulate solicitations that are minimal. In the latter instance, the regulation would apply structurally to a broad spectrum of content, including other, more conventional projects. The SEC could also impose specific completion deadlines depending on the nature of the project; e.g., one year for films and six months for paintings. While creating such regulations will probably be a difficult task itself,¹⁷¹ if accomplished their

169. *Turner*, 819 F. Supp. at 40.

170. *Turner*, 520 U.S. at 224–25.

171. Although it did not involve content neutral, structural regulation, the *NEA v. Finley* case, which challenged government criteria for issuing grants to artists, illustrates the difficulties of subjecting artistic expression to government regulation and oversight. *NEA v. Finley*, 524 U.S. 569 (1998). Congress created the National Endowment for the Arts (“NEA”) as an independent U.S. agency in 1965. *Id.* The NEA offers support and funding for projects exhibiting artistic excellence. *Id.* The NEA reviews grant applications, fundraising guidelines, and leadership initiatives. *Id.* Subsection (d)(1) of 20 U.S.C. section 954 provides that the NEA Chairperson shall ensure that artistic excellence and artistic merit are the criteria by which applications are judged. *Id.* In 1998, the Supreme Court ruled that section 954(d)(1) is facially valid, as it neither inherently interferes with First Amendment rights nor violates constitutional vagueness principles. *Id.* This case arose from the denial of grants based on subject matter to the “NEA Four,” i.e., four artists who claimed that section 954(d)(1) constrains the agency’s ability to fund certain categories of artistic expression. *Id.* The Supreme Court, however, found that the provision simply adds “considerations” to the grant-making process. *Id.* “[T]he agency must take ‘cultural diversity’ into account,” and allocate “on the basis of a wide variety of subjective criteria.” In addition, the provision “does not preclude awards to projects that might be deemed ‘indecent’ or ‘disrespectful,’ nor place conditions on grants, or even specify that those factors must be given any particular weight in reviewing an application.” *Id.* The provision “merely admonishes the NEA to take ‘decency and respect’ into consideration.” *Id.* Because there are “varied interpretations of the ‘decency and

presence could lead to greater protections for both the issuer and investor.

B. Government Imposition of Criteria on the Funding Portals

A better alternative may be for the SEC to impose conditions on the funding portals, rather than on the work product. Such requirements on the funding portals would be analogous to the mandates of the Telecommunications Act of 1996.¹⁷² Section 551 of the Telecommunications Act requires the V-Chip to be added to all televisions so that parents or other caregivers can block programming that they do not want children to watch.¹⁷³ Rather than deciding what is and is not appropriate, the government leaves full control over exposure to content in the hands of the people.¹⁷⁴ What is particularly important about the Telecommunications Act is that it still leaves it to the industry to establish and assign ratings, also known as “TV Parental Guidelines.”¹⁷⁵ The Telecommunications Act established a television rating system contingent upon distributors of video programming adopting “voluntary rules” that were “acceptable” to the FCC.¹⁷⁶ Although some Senators were vocal about First Amendment concerns due to the intrusion on content, the media expressed little concern and the Telecommunications Act itself appeared to be conscious of this issue.¹⁷⁷ For example, use of the vague term

respect’ criteria,” the Court did “not perceive a realistic danger that it will be utilized to preclude or punish the expression of particular views.” *Id.* While crowdfunding is not a government grant program, the SEC could add considerations to the creative arts crowdfunding process. For example, the SEC could create a division responsible for evaluating creative arts campaigns based on certain criteria. The division’s purpose would be to determine whether such campaigns may take advantage of the new crowdfunding exemptions. The division would consider cultural diversity and approve campaigns based on a wide variety of subjective criteria, without forgoing “disrespectful” or unconventional content.

172. Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, codified throughout Title 47 of the United States Code (“47 U.S.C.”).

173. *The V-Chip: Putting Restrictions on What Your Children Watch*, FCC (Nov. 4, 2015), <https://www.fcc.gov/guides/v-chip-putting-restrictions-what-your-children-watch>.

174. *See About the TV Ratings and V-Chip*, TV PARENTAL GUIDELINES, <http://www.tvguidelines.org> (last visited July 27, 2016).

175. *Frequently Asked Questions*, TV PARENTAL GUIDELINES, <http://www.tvguidelines.org/faqs.htm> (last visited July 27, 2016).

176. *See* Telecommunications Act of 1996, Pub. L. No. 104–104, § 551(e)(1)(A), 110 Stat. 56 (1996) (providing that early First Amendment academic discussion was concerned about the compelled adoption of the rating system, although the rating system does not favor one type of programming over another); *see, e.g.*, Kevin D. Minskyd, Note, *The Constitutionality and Policy Ramifications of the Violent Programming Rating Provision in the Telecommunication Act of 1996*, 47 SYRACUSE L. REV. 1301, 1314, 1316 (1997).

177. *See* Letter from Jack Valenti, President and CEO, Motion Pictures to William

“acceptable” was likely strategic: “more specific language defining the parameters of a rating system could cause the courts to rule the rating system legislation violated the First Amendment.”¹⁷⁸ According to a few commentators, the lack of an exact definition of “acceptable” in the Telecommunications Act or its legislative history leads to an application of its general meaning.¹⁷⁹ Congress “did not intend for the Commission to demand that an industry–developed system of guidelines conform to the Commission’s own or anyone else’s vision of an ideal program.”¹⁸⁰ As James T. Hamilton wrote, a more exact definition of the content rating system would open the door to more constitutional challenges.¹⁸¹ Other policies and statutes that “direct [government] agencies to rely on voluntary standards and avoid the use of government–unique standards” have also been upheld as constitutional.¹⁸²

In the crowdfunding context, the SEC could require funding portals to issue their own objective restrictions meeting some professional standard. This would be similar to the V–Chip, which does not mandate content ratings, but merely requires broadcasters to have a rating system that will work with its technology. Funding portals would be held responsible for creating specific content and work–process guidelines. For example, the filmmaker must enter the work–product into a recognized film festival, or attempt to; an artist must showcase the work in a gallery, or attempt to; or a composer must present the work in a concert. In addition, the SEC could require funding portals to limit the types of projects that they accept. For example, certain portals would accept only low–budget films or minimalist art, while other portals would exist exclusively for high–budget films or extravagant art. Whatever the standard, any benchmarks or requirements imposed by the SEC should probably also be “voluntary” with a heavy recommendation that they be adopted before the SEC needs to impose its own standards. If the SEC requires that the industry design and adopt “acceptable” standards for benchmarks, that vague mandate could similarly convey that the SEC is not demanding guidelines that conform to its own or

F. Caton (Jan. 17, 1997) [hereinafter Letter from Valenti ET AL., to Caton], https://transition.fcc.gov/Bureaus/Cable/Public_Notices/1997/fcc97034.txt.

178. James T. Hamilton, *Who Will Rate the Ratings?*, in *THE VCHIP DEBATE: CONTENT FILTERING FROM TELEVISION TO THE INTERNET* 133, 133–134 (Monroe E. Price ed., 1998).

179. Letter from Jack Valenti ET AL., to Caton, *supra* note 177.

180. *Id.*

181. Hamilton, *supra* note 178, at 134.

182. *US–EU High–Level Regulatory Cooperation Forum: Report on the Use of Voluntary Standards in Support of Regulation in the United States*, INT’L TRADE ADMIN. 7 (Oct. 2009), <http://trade.gov/td/standards/United%20States/Use-of-Voluntary-Standards-in-Support-of-US-Regulation.pdf>.

someone else's vision of an ideal product.¹⁸³ Even with such a framework, however, the question remains if the SEC would be passing an unworkable responsibility to a non-governmental party. Monitoring and enforcing these or other guidelines could itself prove difficult, expensive, and time-consuming.

CONCLUSION

Though the JOBS Act has worked relatively smoothly thus far, the system is still in its infancy. As issues with crowdfunded campaigns emerge,¹⁸⁴ the optimism that many shared when the JOBS Act was signed into law is slowly diminishing. In addition to concerns surrounding fraud, the JOBS Act could open the floodgates for lengthy, fact-based litigation against honest creative arts projects, creating an uphill battle for issuers and investors. Congress may need to revisit the law's approach to creative arts crowdfunding, in conjunction with industry self-regulation that would require a portal to more clearly specify arts-related risks to all stakeholders in its terms of use. Currently, issuers of, and investors in, good faith, creative arts campaigns are exposed to significant risks — and inadequate remedies — that are not easily resolvable under regulations that are blind to the creative process. Whatever the solution may be, government and industry need to act soon. Since the JOBS Act became law in 2012, crowdfunding has nearly doubled year by year,¹⁸⁵ and the number of crowdfunding platforms has also steadily increased worldwide.¹⁸⁶ If this trend continues, predictions estimate a \$90 billion crowdfunding industry by 2017.¹⁸⁷ Although the number of, or increase in, creative arts campaigns alone is unclear, what remains clear is that creative artists have a legitimate need for crowdfunding that the JOBS Act advances effectively but not always fairly.

183. See Letter from Jack Valenti ET AL., to Caton, *supra* note 177.

184. Jordan Goodson, 7 *Scam-tastic Crowdfunding Campaigns*, GADGET REV. (last updated Aug. 3, 2015), <http://www.gadgetreview.com/7-scamtastic-crowdfunding-campaigns>; Catherine Fredman, *Fund Me or Fraud Me? Crowdfunding Scams Are on the Rise*, CONSUMER REPS. (Oct. 5, 2015), <http://www.consumerreports.org/cro/money/crowdfunding-scam>; Stephanie Grella, *Fraudulent Crowdfunding Campaign Sets Precedent*, OBSERVER INNOVATION (Sept. 14, 2015, 2:32 PM), <http://observer.com/2015/09/kickstarter>.

185. Barnett, *supra* note 10.

186. Briggman, *supra* note 11.

187. Barnett, *supra* note 10.