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An Uneasy Balance: Personal Information and Crowdfunding under the JOBS Act

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I. INTRODUCTION

[1] "Crowdfunding" is the raising of small amounts of money from many different sources for a particular purpose.[1] Today, this usually takes place online.[2] Crowdfunding has become a popular means of raising funds for a wide variety of projects, causes, and business ventures. Websites like Kickstarter, Indiegogo, and Crowdfunder allow people to create a profile for their project and solicit contributions from the general public in support.

[2] As with online commercial activities in general, crowdfunding's emergence raises issues regarding data privacy and the protection of personal information. For example, how should the government regulate these websites? What information should these websites collect? Should there be established safeguards to ensure the security of that information?

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* LL.M, Information Technology and Intellectual Property, University of Colorado Law School. I would like to thank Professors Andrew Schwartz and Brad Bernthal at the University of Colorado School of Law for their input on this topic. Special thanks go to Professor Paul Ohm for his guidance and feedback.

1 *See* C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 10 (2012).

2 *See id.*; *see also* C. Steven Bradford, *The New Federal Crowdfunding Exemption: Promise Unfulfilled*, 40 SEC. REG. L.J. 195, 196 (2012) ("Crowdfunding is the use of the Internet to raise money through small donations from a large number of people—the 'crowd' in crowdfunding.").

[3] As this process has gained more popularity and attention, observers have highlighted crowdfunding's potential to support entrepreneurs, small businesses, and startups that have historically struggled to raise the capital they need to survive. However, Securities Exchange Commission ("SEC") regulations have prohibited using crowdfunding to raise capital in exchange for equity (i.e., ownership) in the respective business without first registering with the SEC.[3] Specifically, those regulations have prohibited: 1) the "general solicitation" of investment;[4] and 2) accepting investments by anyone without considerable wealth (referred to as "accredited investors").[5] "Hence, financing for fledgling firms is generally obtained from the so-called 'three Fs': 'family, friends, and fools.'"[6]

[4] In other words, individuals trying to start a business via crowdfunding were dependent on donors' pure generosity, or the offer of a small reward (e.g., one of their products once the company got off the ground). However strong these incentives may be, they are probably weaker than the opportunity to share in the profits of the business if it is successful. Accordingly, securities regulation prohibited many of these emerging businesses from offering the strongest incentive through crowdfunding—ownership.

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[3] *See* Bradford, *supra* note 1, at 42 (Offered securities "must be registered with the SEC unless an exemption is available.").

[4] *Id.* at 46 ("Rule 506 prohibits 'general solicitation' and 'general advertising' of the offering. The SEC and its staff take the position that any solicitation of an investor with whom the issuer or its sales representatives do not have a preexisting relationship violates the general solicitation restriction.").

[5] *Id.* ("Section 4(5) of the Securities Act . . . is similar to Rule 506. It allows offers and sales solely to accredited investors provided that there is no 'advertising or public solicitation.'"); *see also* Andrew A. Schwartz, *Crowdfunding Securities*, 88 NOTRE DAME L. REV. 1457, 1461 (2013) ("The Securities Act has long exempted from its registration requirement securities sold to the founder's friends and relations, or unrelated wealthy investors.").

[6] Schwartz, *supra* note 5, at 1461.

[5] President Obama believed equity crowdfunding could increase capital formation if existing regulation allowed it, and signed the Jumpstart Our Business Startups ("JOBS") Act in April 2012.[7] Title II allows businesses that are not registered with the SEC to publicly solicit investment from wealthy "accredited investors."[8] Title III—the "Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure" ("CROWDFUND") Act—allows individual *non*-accredited investors to invest limited amounts via crowdfunding websites.[9] This new freedom, however, does not go into effect until the SEC adopts implementing regulations.[10]

[6] The CROWDFUND Act is not an absolute green light for crowdfunding investment. It places significant restrictions on the amounts most people may invest based on their income and net worth.[11] The crowdfunding platforms (e.g., websites) are responsible for making sure

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[7] *See* Press Release, The White House, President Obama To Sign Jumpstart Our Business Startups (JOBS) Act (Apr. 5, 2012), *available at* http://www.whitehouse.gov/the-press-office/2012/04/05/president-obama-sign-jumpstart-our-business-startups-jobs-act, *archived at* http://perma.cc/JP7E-A96M ("The JOBS Act will allow Main Street small businesses and high-growth enterprises to raise capital from investors more efficiently, allowing small and young firms across the country to grow and hire faster.").

[8] *See* Usha Rodrigues, *In Search of Safe Harbor: Suggestions for the New Rule 506(c)*, 66 VAND. L. REV. EN BANC 29, 32 (2013).

[9] *See* Schwartz, *supra* note 5, at 1461–62 ("[T]he maximum annual aggregate amount of crowdfunded securities that any one investor may purchase is limited based on a sliding scale. If an investor's net worth or annual income is under $100,000, she can invest the greater of $2,000, or five percent of her annual income, in crowdfunded securities each year. If her net worth or annual income is over $100,000, she can invest 10% of her annual salary, capped at $100,000, per year.").

[10] *See, e.g.*, Andrew A. Schwartz, *Keep It Light, Chairman White: SEC Rulemaking Under the CROWDFUND Act*, 66 VAND. L. REV. EN BANC 43, 44 (2013) (The JOBS Act provisions "will go into effect once the [SEC] promulgates rules and regulations to govern the new marketplace for crowdfunded securities.").

[11] *See* 15 U.S.C. § 77d(a)(6)(B) (2012).

that individual investors do not exceed those limitations, and the SEC is required to make rules to help the websites meet that obligation.[12] Many consider these limitations central to the regulatory structure envisioned by the statute.[13] Congress imposed the limits "to shield investors from losses of devastating magnitude. It is practically impossible to lose one's 'life savings' in crowdfunding, no matter how unwise or unlucky one's choices may be."[14] Because the limitations are tied to investors' income and net worth, effective enforcement might require investors to disclose significant personal information—including tax documents—"to ensure that no investor . . . exceed[s] the investment limits . . . ."[15]

[7] This requirement intensifies the privacy-related issues identified above. While intrinsically related, "privacy" and data "security" are separable concepts. Generally speaking, "privacy" issues concern what information we disclose and what we keep to ourselves. "Security," on the other hand, refers to the ways our information is held and protected. These concepts will be described and distinguished in greater detail below. Centrally, the SEC—the agency tasked with constructing the applicable rules—must balance ensuring enforcement of the investment caps with investors' *privacy* concern of releasing inherently personal information. On a related note, the SEC must also make a *security* decision concerning requirements "to protect the privacy of information collected from investors . . . ."[16]

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[12] *See* 15 U.S.C. § 77d-1(a)(8) (2012).

[13] *See, e.g.*, Schwartz, *supra* note 10, at 59 ("The Act's annual investment cap of $5,000 is a bedrock statutory protection for crowdfunding investors . . . so enforcing this limit will be very important to the overall success of the Act."); *see also* 158 CONG. REC. S5476 (daily ed. July 26, 2012) (statement of Sen. Merkley), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2012-07-26/html/CREC-2012-07-26-pt1-PgS5474-3.htm, *archived at* http://perma.cc/HCG5-65JN (stating that the investment caps are "an important investor protection . . . for persons of lower income.").

[14] Schwartz, *supra* note 10, at 45.

[15] 15 U.S.C. § 77d-1(a)(8) (2012).

[16] 15 U.S.C. § 77d-1(a)(9) (2012).

[8] This paper proceeds as follows: Part I discusses the crowdfunding concept and its historical development. Part II introduces the JOBS Act and its privacy-related implications. Part III describes the regulations the SEC proposed to implement the JOBS Act. Part IV analyzes those proposed regulations, analyzes their privacy and security treatment, and recommends certain modifications.

II. CROWDFUNDING

A. What is Crowdfunding?

[9] Fundamentally, "crowdfunding" is the raising of money for particular projects from a wide range of sources.[17] Today, the concept is inextricably linked to the Internet.[18] "Companies can pitch their company, set a funding goal amount, and leverage the power of the Internet to raise money through a large number of people (aka, the 'crowd')."[19]

B. History

[10] The concept behind crowdfunding is nothing new, and has actually been used for centuries. Many people credit Jonathan Swift as the father of the "microfinance" concept.[20] Swift began making very small loans to

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[17] *See* Bradford, *supra* note 1, at 5.

[18] *See id.*; *see also* Tanya Prive, *What Is Crowdfunding And How Does It Benefit the Economy*, FORBES (Nov. 27, 2012, 10:50 AM), http://www.forbes.com/sites/tanyaprive/2012/11/27/what-is-crowdfunding-and-how-does-it-benefit-the-economy/, *archived at* http://perma.cc/XC74-MA2B.

[19] *About Crowdfunding*, STARTUPVALLEY, http://www.startupvalley.com/moreinfo/about-crowdfunding.htm, *archived at* http://perma.cc/XU5G-CBR6 (last visited Jan. 21, 2015).

[20] *See, e.g.*, *Was Crowd Funding Really Invented In Ireland?*, LINKED FINANCE (Feb. 10, 2013), https://linkedfinance.wordpress.com/2013/02/10/was-crowd-funding-really-invented-in-ireland/, *archived at* https://perma.cc/J8S7-WSS8; *see also About Crowdfunding*, *supra* note 19 ("Crowdfunding can be traced as far back as the 1700s. An idea we now call Microfinancing, was started by Jonathan Swift in Ireland. Here, Swift

tradesmen who had fallen on hard times but was nevertheless good in the community.[21] The German publishing practice of "Praenumeration" is another 18th century example of the general crowdfunding concept.[22] In other words, publishers offered a small reward to a group of donors in exchange for their financial support. Crowdfunding also helped Joseph Pulitzer get the Statue of Liberty to the United States.[23]

C. Contemporary Uses

[11] As noted above, crowdfunding has become associated with the Internet. That progression was probably predictable given the exposure opportunities the Internet can provide. Raising money from a crowd of people will likely be more successful, all other things being equal, the bigger the "crowd" becomes. In that sense, the Internet was practically made for the development of crowdfunding. Individuals and businesses are using crowdfunding to finance a staggering array of activities on almost countless websites.[24] These efforts include:

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began a fund that gave loans to low-income families throughout Ireland."); M. Ibberson, *Time For A History Lesson: The Evolution Of Crowdfunding*, CROWDCLAN BLOG (Aug. 22, 2013), http://www.crowdclan.com/time-for-a-history-lesson-the-evolution-of-crowdfunding/, *archived at* http://perma.cc/9NHP-9ZAM ("You could say the evolution of crowdfunding started in the 1700s, a man by the name of Jonathan Swift created the Irish Loan Fund for low-income families.").

[21] *See* LINKED FINANCE, *supra* note 20 (The Irish Loan Fund provided "loans to low-income rural-based families who had no credit history and little collateral but were considered creditworthy.").

[22] *See Praenumeration*, ENCYCLO.CO.UK, http://www.encyclo.co.uk/define/Praenumeration, *archived at* http://perma.cc/45Y5-2N7D (last visited Jan. 22, 2015) (relating that book publishers "offered to sell a book that was planned but had not yet been printed, usually at a discount, so as to cover their costs in advance.").

[23] *See Statue of Liberty*, UNESCO WORLD HERITAGE CENTRE, http://whc.unesco.org/en/list/307 (last visited Jan. 21, 2015); *Statue Of Liberty: Pulitzer-In Depth*, NATIONAL PARK SERVICE, http://www.nps.gov/stli/historyculture/pulitzer-in-depth.htm, *archived at* http://perma.cc/5WHU-LNLS (last updated Jan. 21, 2015).

- Medical expenses;
- Charitable causes (e.g., natural disaster relief);
- College financing;
- Artistic endeavors (e.g., film production, recording projects, and book publication);
- Food (e.g., restaurants, food trucks, and edible goods); and
- Technology startups.

D. Surge

[12] These activities have recently exploded. In 2012, global crowdfunding increased eighty-one percent from 2011.[25] "Overall, crowd funding platforms raised $2.7 billion worldwide in 2012, a figure expected to hit $5.1 billion this year . . . ."[26] Websites facilitating crowdfunding have proliferated as well. "According to industry estimates, there are currently over 500 active crowdfunding platforms—some sources have quoted 9,000 registered domain names related to crowdfunding."[27]

[24] *See, e.g.*, Ryan Caldbeck, *Crowdfunding Trends: Which Crowdfunding Sites Will Survive*, FORBES (June 23, 2013, 6:40 PM), http://www.forbes.com/sites/ryancaldbeck/2013/06/23/crowdfunding-trends-which-crowdfunding-sites-will-survive/, *archived at* http://perma.cc/QFE3-HHLD (As of June 23, 2013, "[a]ccording to industry estimates, there are . . . over 500 active crowdfunding platforms [and] some sources have quoted 9,000 registered domain names related to crowdfunding.").

[25] *See* Kylie MacLellan, *Global Crowdfunding Volumes Rise 81 Percent in 2012*, REUTERS (Apr. 8, 2013, 12:32 PM), http://www.reuters.com/article/2013/04/08/us-crowdfunding-data-idUSBRE9370QY20130408, *archived at* http://perma.cc/R4BC-8PWX.

[26] Arlene Weintraub, *Find Money for College on Crowd Funding Sites*, U.S. NEWS & WORLD REPORT (Sept. 20, 2013, 9:30 AM), http://www.usnews.com/education/best-colleges/paying-for-college/articles/2013/09/20/find-money-for-college-on-crowd-funding-sites, *archived at* http://perma.cc/3NDF-NRKZ.

[27] Caldbeck, *supra* note 24.

III. JUMPSTART OUR BUSINESS STARTUPS (“JOBS”) ACT

[13] The remainder of this paper is about a balance between competing investor concerns. In the JOBS Act, Congress decided to employ crowdfunding as a tool to trigger the national economy. But in doing so, it imposed investment limits to protect investors from severe economic damage caused by bad investments. The SEC is tasked with creating regulations that enforce these limitations while also facilitating capital formation. In carrying out those responsibilities, the SEC seems to have seriously undermined those protections by failing to require the information disclosures necessary to make them effective. That decision, however, might protect investors in other ways, namely by promoting their privacy interests by limiting the amount and sensitivity of information investors must provide to crowdfunding intermediaries before they may participate.

[14] Without necessarily even trying, the SEC might have actually struck the proper balance. There is evidence that the small entities that are likely to drive crowdfunding are particularly vulnerable to the data breaches we have seen of late. There are also few legal restrictions on how these intermediaries may use the information they collect from investors. The rise in data brokers, and the relative lack of attention they have received, might also support limiting the information investors must provide. Finally, the actual limits Congress set seem generally arbitrary. That is, there is little indication that these amounts are necessary or narrowly tailored to prevent the sort of harm envisioned. In that case, the limits might not be worth enforcing.

[15] Having introduced the crowdfunding concept, Section III of this paper describes how Congress and the President sought to harness its potential, and the information privacy issues that created. The JOBS Act sought to ease the impact of traditional securities regulation that significantly constrained crowdfunding as a means of raising capital. Congress, however, was also concerned that unsophisticated investors could lose devastating amounts of money if left to their own devices in the crowdfunding marketplace. As a result, it chose to limit annual

investments to levels it considered safe based on individual investors' income and/or net worth.

A. Need

[16] The White House, along with many others, describes small businesses as "the engines of job creation and essential to strengthening our national economy."[28] As a result, helping them start, survive, and grow is a policy priority,[29] and freeing capital for small businesses is a key component of that policy priority. Many people have also touted crowdfunding as a potentially powerful means of accomplishing this objective.[30] Two components of traditional securities regulation concerning registration and investor qualifications precluded businesses from using crowdfunding to raise capital in exchange for ownership of their venture.[31] The following two subsections describe these regulations and their practical effects.

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[28] *Supporting Small Businesses*, THE WHITE HOUSE, http://www.whitehouse.gov/economy/business/small-business, *archived at* http://perma.cc/KF24-LCNM (last visited Jan. 21, 2015).

[29] *See, e.g.*, Chairman Steve Chabot, *Access to Capital*, HOUSE COMMITTEE ON SMALL BUSINESS, http://smallbusiness.house.gov/issues/issue/?IssueID=5958, *archived at* http://perma.cc/RY5P-P7QX (last visited Jan. 21, 2015) (acknowledging that "[o]ne of the biggest issues faced by small businesses is the inability to access sufficient credit and capital.").

[30] *See, e.g.*, The White House, *supra* note 7 (The JOBS Act "will help growing businesses access financing while maintaining investor protections . . . in several ways . . . ." including through crowdfunding.); Eric Markowitz, *Why the Crowdfunding Bill is Good for Start-ups*, INC., http://www.inc.com/articles/201112/why-the-crowdfunding-legislation-is-good-for-start-ups.html, *archived at* http://perma.cc/2XC8-HPLM (last updated Dec. 8, 2011) (quoting Sen. Scott Brown describing crowdfunding as "the grease that keeps the gears in the American economy churning."); Prive, *supra* note 18 ("In a seemingly nonstop recession wave, small businesses are struggling more than ever to stay afloat, and entrepreneurs are not facing great odds. Crowdfunding offers these individuals a chance at success, by showcasing their businesses and projects to the entire world.").

1. Traditional Regulation

[17] "The Securities Act of 1933 . . . as amended, requires that any offer or sale of securities be registered with the [SEC] unless there is an exemption available."[32] Securities include "any . . . certificate of interest or participation in any profit-sharing agreement . . . transferable share, investment contract . . . [and] any instrument commonly known as a 'security' . . . ."[33] "The term . . . is broadly defined to include many instruments that might be bought or sold for investment."[34]

[18] The registration requirement has restricted crowdfunding's potential to provide entrepreneurs, small businesses and startups with additional capital they need in two ways. First, businesses generally had to register with the SEC before it could offer a "security" to the public.[35] The registration process alone is extremely expensive, and then the company had to pay for the actual solicitation of investment.[36] Second,

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[31] *See, e.g.*, Crowdfunding, 78 Fed. Reg. 66,428, 66,429 (Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240 and 249) ("Limitations under existing regulations, including restrictions on general solicitation and general advertising and purchaser qualification requirements, have made private placement exemptions generally unavailable for crowdfunding transactions, which are intended to be made to a large number of potential investors and not limited to investors that meet specific qualifications.")

[32] Douglas S. Ellenoff, *Making Crowdfunding Credible*, 66 VAND. L. REV. EN BANC 19, 19 (2013); *see also* Rodrigues, *supra* note 8, at 31 ("Securities law requires companies to register the offer or sale of their shares with the SEC prior to sale, unless they can find an exemption from registration.").

[33] 15 U.S.C. § 78c(a)(10) (2012).

[34] 14 WILLIAM MEADE FLETCHER ET AL., FLETCHER CYCLOPEDIA OF THE LAW OF CORPORATIONS § 6833 (perm. ed., rev. vol. 2012).

[35] *See* Bradford, *supra* note 1, at 6 ("[S]ecurities offerings must be registered under the Securities Act of 1933 . . . unless an exemption is available.").

[36] *See* Schwartz, *supra* note 5, at 1468.

outside of friends and family, SEC Regulation D generally only allowed businesses to accept investment from wealthy individuals and entities, known as "accredited investors."[37] As applied to natural persons, "accredited investor[s]" are generally those with a net worth of $1 million, or who made more than $200,000 in each of the previous two years.[38]

2. Restrictions Caused by the Traditional Regulatory Structure

[19] Traditionally, based on these regulations, you had two choices. You could cough up a ton of cash, and then offer ownership in your company to non-friends or family in exchange for investment.[39] Or, you could skip the substantial expense of SEC registration, but you could only sell ownership in the company to friends, family, and incredibly rich people (or entities like venture capital firms).[40]

[20] Forcing startups, small businesses, and entrepreneurs to make this choice had predictable consequences. Most young businesses simply

[37] *See id.* at 1467–68; *see also* Devin Thorpe, *SEC Issues New Regulations for Crowdfunding; Panel Comments Live*, FORBES (Oct. 24, 2013, 10:13 AM), http://www.forbes.com/sites/devinthorpe/2013/10/24/sec-issues-new-regs-for-crowdfunding-panel-comments-live/, *archived at* perma.cc/5AS7-94V9 ("Limits are set by the Act on the amount of money non-accredited (those without a million-dollar net worth excluding their home or without a $200,000 personal income) investors may invest.").

[38] *See* 17 C.F.R. § 230.501(a)(5)–(6) (2014) (Marital status can affect these threshold amounts).

[39] *See* Schwartz, *supra* note 5, at 1466 ("The federal securities laws require that stocks, bonds, or other securities be registered with the SEC before being offered for sale to the public.").

[40] *See id.* at 1461 ("The Securities Act has long exempted from its registration requirement securities sold to the founder's friends and relations, or unrelated wealthy investors.").

cannot afford to go through the SEC registration process.[41] The SEC cited commentary it received from interested parties arguing:

> [T]hat registered offerings are not feasible for raising smaller amounts of capital, as is done in a typical crowdfunding transaction, because of the costs of conducting a registered offering and the resulting ongoing reporting obligations under the Securities Exchange Act of 1934 . . . that may arise as a result of the offering.[42]

As a result, they are not allowed to raise funds by selling ownership in their business except to friends, family, and the wealthy accredited investors like angel investors and venture capitalists. Unfortunately, most emerging business owners do not have the good fortune of a wealthy friend or family member willing to bankroll their entrepreneurial ventures.[43] Similarly, an incredibly small percentage successfully raise funds from venture capital.[44] Worse still, startups and entrepreneurs received less in loans in 2011 than they did in 2008 in the depths of the financial crisis.[45]

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

[42] Crowdfunding, 78 Fed. Reg. at 66,429.

[43] *See* Bradford, *supra* note 1, at 5.

[44] *See id.*; *see also* Bradford, *supra* note 2, at 196 ("Traditional sources of business financing—bank lending, venture capital, and angel investors—are unavailable to many startups and other very small offerings.").

[45] *See* Tanya Prive, *Inside the JOBS Act: Equity Crowdfunding*, FORBES (Nov. 6, 2012, 11:57 AM) http://www.forbes.com/sites/tanyaprive/2012/11/06/inside-the-jobs-act-equity-crowdfunding-2/, *archived at* http://perma.cc/S56T-J6VY.

B. Provisions

[21] The JOBS Act intended to ease those restrictions and make equity crowdfunding a viable source of capital for small and emerging businesses.[46] With that goal in mind, the JOBS Act allows businesses to: 1) "solicit" investment (but only accept money from the rich accredited investors);[47] and 2) accept limited investment from unaccredited investors.[48] The statute "seeks to more intelligently align capital formation with the way modern society operates and interacts on a daily basis."[49] The following subsections explain the important crowdfunding actors, and describe the actual provisions and goals of the JOBS Act.

[46] *See* Crowdfunding, 78 Fed. Reg. at 66,429 ("The crowdfunding provisions of the JOBS Act were designed to help provide startups and small businesses with capital by making relatively low dollar offerings of securities less costly."); *see also* James J. Williamson, Comment, *The JOBS Act and Middle-Income Investors: Why it Doesn't Go Far Enough*, 122 YALE L.J. 2069, 2071 (2013) ("The JOBS Act was designed to allow a wider class of Americans to invest in start-ups."); National Crowdfunding Association, *National Crowdfunding Association Welcomes SEC's Proposed Investment Crowdfunding Rules*, PR NEWSWIRE SERVICES (Oct. 23, 2013), http://www.prnewswire.com/news-releases/national-crowdfunding-association-welcomes-secs-proposed-investment-crowdfunding-rules-229027541.html, *archived at* http://perma.cc/GP6T-494U ("As [SEC] Commissioner Daniel M. Gallagher stated . . . 'In Title III of the JOBS Act, Congress recognized the potential of the Internet to facilitate capital formation for very small companies at a critical stage of their growth.'").

[47] *See* Chance Barnett, *The Crowdfunder's Guide To General Solicitation And Title II of the JOBS Act*, FORBES (Sept. 23, 2013, 10:40 AM), http://www.forbes.com/sites/chancebarnett/2013/09/23/the-crowdfunders-guide-to-general-solicitation-title-ii-of-the-jobs-act/, *archived at* http://perma.cc/M7JD-G5ZZ ("Only accredited investors can actually invest in fundraising rounds where companies generally solicit . . . .").

[48] *See* 15 U.S.C. § 77d(a)(6) (2012).

[49] Ellenoff, *supra* note 32, at 19.

1. Terms

[22] The three primary actors in the equity crowdfunding process are: 1) issuers; 2) investors; and 3) intermediaries. An "issuer," generally speaking, is any "person who issues or proposes to issue any security . . . ."[50] In the crowdfunding context, these are the companies offering ownership in exchange for investment.[51] Investors are simply the people purchasing ownership in the crowdfunded businesses (i.e., the "crowd").

[23] Financial intermediaries are the middlemen who actually facilitate the sale of crowdfunded securities to investors.[52] They will serve the same general function that non-equity crowdfunding sites like Kickstarter currently perform. Under the statute, intermediaries may operate as either a "broker" or "funding portal."[53] "[A] third party that operates a Web site to effect the purchase and sale of securities for the account of others generally would, under existing regulations, be required to register with the [SEC] as a broker-dealer and comply with the laws and regulations applicable to broker-dealers."[54]

[24] At the same time, "[a] person that operates such a Web site only for the purchase of securities of startups and small businesses . . . may find it impractical in view of the limited nature of that person's activities and business to register as a broker-dealer and operate under the full set of regulatory obligations that apply . . . ."[55] Accordingly, the statute provided

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[50] 15 U.S.C. § 77b(a)(4) (2012).

[51] *See* Schwartz, *supra* note 10, at 48.

[52] *See* Schwartz, *supra* note 5, at 1462.

[53] 15 U.S.C. § 77d-1(a)(1) (2012).

[54] Crowdfunding, 78 Fed. Reg. 66,428, 66,429 (Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240 and 249).

[55] *Id.*

for a second subcategory of intermediaries called "funding portal[s],"[56] which will "be subject to a new regulatory regime . . . established by SEC rulemaking."[57] Funding portals do not have "to register with the [SEC] as brokers,"[58] but may not engage in certain activities.[59]

2. Title III—CROWDFUND Act

[25] The CROWDFUND Act sought to make crowdfunding a viable means of raising capital without abandoning the investor protections that formed the traditional foundation of securities regulation. This component of the JOBS Act "provides an exemption from the registration requirements of Securities Act Section 5 for certain crowdfunding transactions."[60] But it also imposed investment limits intended to protect investors from catastrophic financial harm. These investment limits—and

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[56] *See* 15 U.S.C. § 77d-1(a)(1) (2012); Crowdfunding, 78 Fed. Reg. at 66,430 ("[T]ransactions must be conducted through an intermediary that either is registered as a broker or is registered as a new type of entity called a 'funding portal.'").

[57] Schwartz, *supra* note 5, at 1462.

[58] *Crowdfunding 101*, NATIONAL CROWDFUNDING ASSOCIATION, http://www.nlcfa.org/crowdfund-101.html, *archived at* http://perma.cc/RR38-94T5 (last visited Jan. 21, 2015).

[59] *See* 15 U.S.C. § 78c(a)(80) (2012) (A "funding portal" is a crowdfunding intermediary "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 appropriate."); *see also* U.S. Securities and Exchange Commission, Division of Trading and Markets, *Jumpstart Our Business Startups Act: Frequently Asked Questions About Crowdfunding Intermediaries*, U.S. SECURITIES AND EXCHANGE COMMISSION (May 7, 2012), http://www.sec.gov/divisions/marketreg/tmjobsact-crowdfundingintermediariesfaq.htm, *archived at* http://perma.cc/NWV2-PGR7.

[60] Crowdfunding, 78 Fed. Reg. at 66,430.

more particularly their enforcement—create the privacy and security issues that could affect the underlying goal of facilitating capital formation. The limits cannot be enforced without requiring investors to disclose significant personal information. The greater the required disclosures, the more investors' privacy interests will be sacrificed. Investors may also shy away from investing through a crowdfunding platform if they have to document things like their income and/or net worth.

[26] The law allows companies to raise up to $1 million per year in exchange for ownership in the business through crowdfunding.[61] Investing in a startup, however, is risky.[62] The majority of these businesses fail, so "much of the money given to [them] ends up being lost."[63] In fact, "[a]bout three quarters of venture-backed firms in the U.S. don't return investors' capital . . . ."[64]

[27] Many also "worr[ied] . . . that inexperienced investors would be much more vulnerable to fraud [and] when one looks at the prospect of investment-based crowdfunding, the potential for fraud . . . is still a scary

[61] *See* 15 U.S.C. § 77d(a)(6)(A) (2012) (establishing an exemption for "transactions involving the offer or sale of securities . . . provided that . . . the aggregate amount sold to all investors by the issuer . . . during the 12-month period preceding the date of such transaction . . . is not more than $1,000,000 . . . ."); *see also* Schwartz, *supra* note 10, at 48.

[62] *See* Timothy Spangler, *Is Crowdfunding Good for Investors?*, THE NEW YORKER (Oct. 30, 2013), http://www.newyorker.com/online/blogs/currency/2013/10/is-crowdfunding-good-for-investors, *archived at* http://perma.cc/NKA4-AXZL ("There's another problem that has gotten less attention, but is likely to be much more common: most startups fail.").

[63] *Id.*

[64] *Id.* (citing Deborah Gage, *The Venture Capital Secret: 3 Out of 4 Start-Ups Fail*, WALL ST. J., *available at* http://online.wsj.com/news/articles/SB10000872396390443720204578004980476429190, *archived at* http://perma.cc/DTB7-XMQM (last updated Sept. 20, 2012, 12:01 AM)(quoting Shikar Ghosh)).

idea."[65] In comments to the SEC, William A. Jacobson—Director of the Cornell Securities Law Clinic—noted that:

> The potential or fraud and negligent misrepresentation in crowdfunding is high. The safeguards and regulatory scrutiny found in registered public offerings are more stringent than what is provided under Regulation Crowdfunding, leaving investors to make decisions with information that is less complete and less vetted. These investors may not have the experience to recognize unusual or outlandish claims and will be less likely to pay for due diligence than wealthier investors negotiating large investments in private equity offerings.[66]

Some have suggested that lowering the regulatory burdens to allow equity crowdfunding "will very nearly legalize fraud in the stock market."[67] Regulators were also skeptical that crowdfunding investors would be able

[65] Diogo Mourato, *Investment Based Crowdfunding & The Knot in Your Stomach*, DAILY CROWDSOURCE, http://dailycrowdsource.com/content/crowdfunding/1042-5-reasons-to-worry-about-investment-based-crowdfunding, *archived at* http://perma.cc/38FS-CPAF (last visited Jan. 22, 2015).

[66] Letter from William A. Jacobson, Clinical Professor of Law, Cornell Sec. Law Clinic, to Elizabeth Murphy, Sec'y, United States Sec. and Exch. Comm'n 9 (Feb. 3, 2014), *available at* https://www.sec.gov/comments/s7-09-13/s70913-219.pdf, *archived at* https://perma.cc/P4R8-HAC2.

[67] Matt Taibbi, *Why Obama's JOBS Act Couldn't Suck Worse*, ROLLING STONE (Apr. 9, 2012), http://www.rollingstone.com/politics/blogs/taibblog/why-obamas-jobs-act-couldnt-suck-worse-20120409, *archived at* http://perma.cc/D4VY-GPJD; *see also* Jesse Hamilton & Phil Mattingly, *Job-Creation Bill Seen Eviscerating U.S. Shareholder Protections*, BLOOMBERG (Mar. 13, 2012, 12:01 AM), http://www.bloomberg.com/news/2012-03-13/job-creation-legislation-seen-eviscerating-shareholder-protections-in-u-s-.html, *archived at* http://perma.cc/88FS-78DF ("U.S. legislation that would roll back securities disclosure and governance rules in the name of job creation is being attacked by consumer advocates and former regulators as an evisceration of investor protections in place since the 1930s.").

to appreciate these risks. William Galvin, Secretary of the Commonwealth of Massachusetts, explained:

> Longstanding problems in the markets for small and speculative stocks show the pitfalls of relying on the wisdom of crowds. It is clearly possible to deceive large groups of investors, and it is definitely possible for fraud operators to swindle individuals. Unscrupulous penny stock promoters have used misrepresentations to market obscure and low-value stocks to individuals, often through pump and dump schemes.[68]

As a result, some controls were necessary to minimize crowdfunding investors' financial exposure.

[28] To minimize the inherent risk of betting on a stranger's business idea on the Internet, Congress limited the amount each individual may invest via crowdfunding each year according to his or her income or net worth.[69] For example, people who make less than $100,000 per year, or are worth less than $100,000, may invest $2,000 or five percent of their income or net worth, whichever is more.[70] Individuals who make, or are worth, more than $100,000 per year may invest ten percent of their annual income or $100,000, whichever is more.[71]

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[68] Comment by William F. Galvin, Secretary of the Commonwealth of Massachusetts, on SEC Regulatory Initiatives Under the JOBS Act: Title III, Crowdfunding, at 1 (Aug. 8, 2012), *available at* http://www.sec.gov/comments/jobs-title-iii/jobstitleiii-121.pdf, *archived at* http://perma.cc/SC73-CWZH.

[69] *See* 158 CONG. REC. S5476 (daily ed. July 26, 2012), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2012-07-26/html/CREC-2012-07-26-pt1-PgS5474-3.htm, *archived at* http://perma.cc/HCG5-65JN; *see also* Schwartz, *supra* note 10, at 45 ("Congress also included an innovative structural protection for investors, specifically a strict annual cap on the aggregate amount that a person may invest in any and all crowdfunded securities.").

[70] *See* 15 U.S.C. § 77d(a)(6)(B)(i) (2012).

[71] *See* 15 U.S.C. § 77d(a)(6)(B)(ii) (2012).

[29] The concrete underpinnings of the investment limits Congress chose are unclear. Senator Jeff Merkley, an active crowdfunding proponent, explained that "[w]ithout aggregate caps, someone could in theory . . . unintentionally wip[e] out their entire savings."[72] The *intermediaries* are responsible for ensuring that investors do not exceed these limits by following rules the SEC will set.[73] Intermediaries must "take such steps to protect the privacy of information collected from investors as the [SEC] shall, by rule, determine appropriate."[74]

[30] Issuers may not sell equity in their business directly to investors. Instead, "[t]he Act requires that all crowdfunded transactions be completed using a registered portal or broker-dealer."[75] These entities must "[r]egister with the SEC and [the Financial Industry Regulatory Authority] as either a portal or a broker-dealer."[76] Subsection D discusses the implication of privacy interests under the JOBS Act and the ways in which the SEC's regulations might address those implications.

C. Privacy Complications

1. Privacy vs. Security

[31] The first information issue confronting the SEC (i.e., determining what personal information should be disclosed to facilitate crowdfunding) is a "privacy" problem. The second (i.e., how that information must be collected, stored, and managed) relates to security. While the two

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[72] 158 CONG. REC. S5476 (daily ed. July 26, 2012), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2012-07-26/html/CREC-2012-07-26-pt1-PgS5474-3.htm, *archived at* http://perma.cc/HCG5-65JN.

[73] *See* 15 U.S.C. § 77d-1(a)(8) (2012).

[74] 15 U.S.C. § 77d-1(a)(9) (2012).

[75] Thorpe, *supra* note 37.

[76] *Id.*

concepts are frequently intertwined, "privacy" and "security" are actually distinct.[77] "Privacy" refers to a "normative framework for deciding who should legitimately have the capability to access and alter information.[78] "Security," on the other hand, describes "the set of technological mechanisms (including, at times, physical ones) that mediates requests for access or control."[79] In other words, privacy and security are intertwined as "[s]ecurity implements [our privacy] choices."[80]

[32] These issues relate to, and affect, one another.[81] For example, "[d]ifferent security architectures make privacy regimes more or less

[77] *See* Derek E. Bambauer, *Privacy Versus Security*, 103 J. CRIM. L. & CRIMINOLOGY 667, 668–69 (2013); *see also* Leigh Nakanishi, *The Difference Between Security and Privacy and Why We Must Better Communicate About Both*, EDELMAN (Oct. 20, 2011), https://web.archive.org/web/20130217100622/http://datasecurity.edelman.com/the-difference-between-security-and-privacy-and-why-we-must-better-communicate-about-both/, *archived at* https://perma.cc/WVC3-6HVL ("[I]n order to really understand and effectively communicate about these issues, it's important to understand or think of them as two separate but related issues.") (accessed by searching for http://datasecurity.edelman.com/the-difference-between-security-and-privacy-and-why-we-must-better-communicate-about-both/ in the Internet Archive Wayback Machine).

[78] *See, e.g.*, Bambauer, *supra* note 77, at 669; *see also* Nakanishi, *supra* note 77 ("Privacy is about governance and use. More specifically, making sure the policies and rules are in place to ensure that information is being collected, shared and used in appropriate ways.").

[79] Bambauer, *supra* note 77, at 669; *see also* Nakanishi, *supra* note 77 ("Security and cybersecurity is about protection. More specifically, it addresses how information is being protected from malicious actors and other unwanted parties who are trying to exploit it for a variety of motives from profit to espionage.").

[80] Bambauer, *supra* note 77, at 669.

[81] *See, e.g.*, *id.* at 677; *see also* Brian Anderson, *The Difference Between Data Privacy and Data Security*, EIQBLOG (Sept. 9, 2013, 5:55 AM), http://blog.eiqnetworks.com/blog/bid/313892/The-Difference-Between-Data-Privacy-and-Data-Security, *archived at* http://perma.cc/C39D-AFNF ("Although data privacy and data security are often used as synonyms, they share more of a symbiotic type of relationship.").

tenable, thereby influencing their development and adoption."[82] In the crowdfunding context, the viability of the SEC's security policies could (and probably *should*) impact what information it requires investors to disclose. Moreover, the SEC's decisions concerning privacy and security have the potential to promote or undermine the statutory goal of facilitating capital formation startup financing. Sacrificing some privacy (i.e., requiring investors to disclose more personal information) could chill investment by making the process more onerous and/or invasive. Effective security within each crowdfunding platform is essential to the credibility of this unfamiliar means of investment. Investors will not invest if they believe the information they provide is insecure. If investors do not invest via crowdfunding platforms, then legalizing it will have little impact. Neither security nor privacy issues related to equity crowdfunding have received significant attention, but both can affect the success of the JOBS Act, perhaps significantly.

2. Enforcement of Investment Limits

[33] The CROWDFUND Act creates potential conflict between investors' privacy interests and the fundamental goals of the statute (i.e., increasing access to capital for small businesses and startups by making investment easier for more people). Congress chose to allow equity crowdfunding, but also imposed limits on the amount individuals could invest.[83] Bypassing income verification "could turn [equity crowdfunding] into a casino with more losers than winners."[84] While generally supportive of a light regulatory approach, Professor Andrew Schwartz explains that "[t]he Act's annual investment cap . . . is a bedrock statutory protection for

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[82] Bambauer, *supra* note 77, at 677.

[83] *See* 15 U.S.C. § 77d(a)(6)(B) (2012).

[84] John Wasik, *Crowdfunding Rule Could Set Dangerous Precedent*, FORBES (Oct. 21, 2013, 4:07 PM), http://www.forbes.com/sites/johnwasik/2013/10/21/crowdfunding-rule-could-set-dangerous-precedent/, *archived at* http://perma.cc/URB9-P6ZW.

crowdfunding investors . . . so enforcing this limit will be very important to the overall success of the Act."[85]

[34] The desire for caps was probably motivated, in part, by recent economic catastrophes involving overextended investors and those who take advantage of them.[86] While protecting investors from economic destruction is a noble goal, the precise caps in the statute may not be well tailored to that objective. The limits proposed in Congress varied widely from $1,000 to $10,000 per person.[87] It is unclear why $1,000 is not enough, $10,000 is too much, but $2,000 to $5,000 is generally an appropriate amount of risk for most investors. For that matter, why should Congress limit crowdfunding investment to $2,000 per year when anyone can buy as many lottery tickets as they can afford?[88] Furthermore, *effective* enforcement of these limits would likely require investors to

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[85] Schwartz, *supra* note 10, at 59.

[86] *See, e.g.*, Jeff Holt, *A Summary of the Primary Causes of the Housing Bubble and the Resulting Credit Crisis: A Non-Technical Paper*, 8 J. BUS. INQUIRY 120, 125, 128 (2009) (quoting Robert Shiller, *Definition of Irrational Exuberance*, IRRATIONAL EXUBERANCE, http://www.irrationalexuberance.com/definition.htm, *archived at* http://perma.cc/P8JJ-RN8Z (last visited Jan. 21, 2015)) ("The one essential cause of the housing bubble was irrational exuberance," defined as "a heightened state of speculative fervor."); *see also* Brian Farnkoff, *Crowdfunding for Biotechs: How the SEC's Proposed Rule May Undermine Capital Formation for Startups*, 30 J. CONTEMP. HEALTH L. & POL'Y 131, 174–75 (2013) (discussing the causes of the mortgage crisis and parallel concerns motivating investor protections in the crowdfunding context).

[87] *See* Barb Darrow, *Senator Brown: The Time to Act on Crowdfunding Bill Is Now*, GIGAOM (Mar. 5, 2012, 9:11 AM), http://gigaom.com/2012/03/05/senator-brown-the-time-to-act-on-crowdsourcing-bill-is-now/, *archived at* http://perma.cc/7RMV-8PUQ.

[88] *See* Andrew Farquharson, *Andrew Farquharson: More of a Hindrance than Help*, WALL ST. J. (Nov. 27, 2013, 8:00 AM), http://blogs.wsj.com/accelerators/2013/11/27/andrew-farquharson-more-of-a-hindrance-than-help/, *archived at* http://perma.cc/C92T-U3Z7 ("Individuals can . . . invest in tickets for the state lottery, with no protection from the government. So why not allow average citizens to have investment access to opportunities that have traditionally been reserved for the wealthy?").

disclose significant personal information to the intermediaries. Thus, the CROWDFUND Act raises an important privacy-related question for the SEC to answer. Namely, what information should investors disclose to facilitate enforcement of the statutory investment limits?[89] If the specific limits are poorly drawn, should the SEC sacrifice investor privacy and easy capital formation to facilitate their enforcement?

[35] Consider two possible regulatory approaches to illustrate the tension between actual enforcement and privacy. The SEC could allow intermediaries to rely on investors to simply report their income or net worth. The House of Representatives version of the JOBS Act actually took this approach, allowing intermediaries to "rely on certifications as to annual income provided by the person to whom the securities are sold to verify the investor's income."[90] That would protect investors' privacy by allowing them to invest without disclosing documentary proof of their income like tax returns. However, it would fall far short of "ensur[ing] that no investor . . . has purchased crowdfunded securities that" exceed the statutory caps because investors could very simply lie.[91] That is possibly troubling given that individuals could invest more by reporting more income or net worth. This approach does little to address the incentive investors have to provide inaccurate information.

[36] Alternatively, the SEC could impose significant obligations on intermediaries—and investors, for that matter—to make sure individual investors do not exceed their investment limits. In the context of investment solicitation and establishing accreditation, "[u]ntil now, investors have 'self-certified' that they qualify for accedited [sic] status. However, the new SEC regulations will require some to start handing over personal financial information, like tax returns, to prove their net worth [or

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[89] *See* Bradford, *supra* note 2, at 202 ("It [was] unclear what the SEC will require intermediaries to do to enforce this aggregate limit.").

[90] H.R. Res. 3606, 112th Cong. § 4A(c) (as passed by House, Apr. 5, 2012) (enacted)*; see also* Farnkoff, *supra* note 86, at 164.

[91] Schwartz, *supra* note 10, at 60 (quoting 15 U.S.C. § 77d-1(a)(8) (2012)).

income]."[92] Under this approach, the SEC could require intermediaries to collect tax returns and/or bank statements and verify the investor's income and/or net worth, and that their investments do not exceed the cap.

[37] Congress and the Consumer Financial Protection Bureau have required this sort of scrutiny in the mortgage context.[93] Creditors providing mortgage loans must make "a reasonable and good faith determination based on verified and documented information that . . . the consumer has a reasonable ability to repay the loan . . . ."[94] In making that determination, the creditor should collect and analyze "the consumer's Internal Revenue Service Form W–2, tax returns, payroll receipts, financial institution records, or other third-party documents that provide reasonably reliable evidence of the consumer's income or assets."[95]

[38] Taking a similar approach to enforce crowdfunding limits would clearly implicate investors' privacy interests to a greater degree, but it might also facilitate enforcement of the investment caps that Congress thought were so important to protecting investors. At the same time, this

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[92] J.D. Harrison, *Can Crowdfunding Fill Stock Market's 'Black Hole' for Startups and Small Businesses?*, WASH. POST (Aug. 26, 2013), http://articles.washingtonpost.com/2013-08-26/business/41447075_1_black-hole-stock-market-most-firms, *archived at* http://perma.cc/5YVT-CB7C.

[93] *See What Is the Ability-to-Repay Rule? Why Is It Important to me?*, CONSUMER FIN. PROTECTION BUREAU, http://www.consumerfinance.gov/askcfpb/1787/what-ability-repay-rule-why-it-important-me.html, *archived at* http://perma.cc/4QH9-ZXKJ (last visited Jan. 21, 2015) ("Congress responded [to housing contributions to the financial crisis] by passing a common-sense law that says mortgage lenders must make a reasonable effort to figure out if a borrower has the ability to repay the mortgage before the loan is made. The CFPB is responsible for enforcing this law, and we have written a rule that says lenders have to make a reasonable and good-faith effort to figure out a borrower's ability to repay a mortgage. In practice this means lenders must generally find out, consider, and document a borrower's income, assets, employment, credit history and monthly expenses.").

[94] 15 U.S.C. § 1639c(a)(1) (2012).

[95] 15 U.S.C. § 1639c(a)(4) (2012).

approach could undermine perhaps the most fundamental purpose of the CROWDFUND Act—making it easier for individuals to invest and businesses to raise capital. Some investors would very likely forego the opportunity to invest instead of gathering and disclosing this sort of documentation, and intermediaries would face additional burdens associated with collecting and scrutinizing the data.

[39] Disconnect among intermediaries could make it extremely difficult to enforce the "aggregate" investment limits set forth in 15 U.S.C. § 77d(a)(6)(B).[96] "The intermediary's records will show how much each investor has purchased through its site, but investors might also have purchased [crowdfunded securities] on other sites."[97] Once again, "[t]he intermediary could ask the investor how much he has invested on other crowdfunding sites, but the answer might be intentionally or unintentionally incorrect."[98] Professor Andrew Schwartz identified even less sinister ways that self-verification could defeat enforcement of the investment caps:

> It may not be enough, for instance, for intermediaries to simply ask investors whether they have reached their annual limit and leave it at that, as crowdfunding investors might not remember or keep records of their past investments. Nor can intermediaries rely solely on their own internal records, as the cap is an aggregate one for all crowdfunding securities purchased on any platform and from any issuer.[99]

[96] *See* 15 U.S.C. 77d(a)(6)(B).

[97] Bradford, *supra* note 2, at 202.

[98] *Id.*

[99] Schwartz, *supra* note 10, at 60; *see also* Letter from Andrea Seidt, President, North Am. Sec. Adm'rs Ass'n, Inc., to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n 3 (Feb. 3, 2014), *available at* https://www.sec.gov/comments/s7-09-13/s70913-286.pdf, *archived at* https://perma.cc/PL4Y-72JP ("First, it is not clear that retail investors will be keeping careful tabs on their individual investment amounts. Given the relatively small

In other words, relying on investors to verify their investment suffers from the same flaws as relying on self-verification of income and net worth.

[40] Accordingly, the SEC faces something of a catch-22. Senator Jeff Merkley, one of the JOBS Act's Senate cosponsors, described two goals in creating the crowdfunding provisions. First, the drafters sought to "enable[e] [the crowdfunding] market to work for startups and small businesses . . . ."[100] Second, they focused on "protecting ordinary investors from fraud and deception."[101] As suggested, these two objectives might conflict with each other. The investor protections implemented by Congress (i.e., investment limits) require information from investors to be effective. Mark Cuban and others, however, have expressed skepticism that people will sacrifice certain personal information in order to invest.[102] Furthermore, enforcing the investment limits may not justify sacrificing investors' privacy and the statutory goal of capital formation if the limits are arbitrarily drawn or only loosely connected to protecting investors. Achieving the statutory goals requires "smart, effective rules and consistent, conscientious oversight by the . . . SEC . . . and the State securities regulators."[103]

investment amounts commonly sought in crowdfunding deals, as low as a single $1 investment in many instances, it would be fairly easy for an active crowdfunding investor to lose track. Second, investors may miscalculate their net income or net worth—for example, an investor could easily assume that net worth includes the value of his or her principal place of business. Without some form of independent, third-party check, there is a significant likelihood that investors, by accident or design, will not report accurate amounts and ultimately exceed statutory limits.").

[100] 158 CONG. REC. S5475 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2012-07-26/html/CREC-2012-07-26-pt1-PgS5474-3.htm, *archived at* http://perma.cc/HCG5-65JN.

[101] *Id.*

[102] *See* Harrison, *supra* note 92; Brown, *infra* note 109.

[41] Unless a sophisticated balance is struck, the SEC regulations may either give up enforcement of important investor protections or undermine the fundamental point of the law.[104] The SEC also recognized the nature of its task. In the notice of its proposed rules under the CROWDFUND Act, it noted, "[r]ules that are unduly burdensome could discourage participation in crowdfunding. Rules that are too permissive, however, may increase the risks for individual investors, thereby undermining the facilitation of capital raising for startups and small businesses."[105]

[42] Professor C. Steven Bradford concludes that "[t]he only totally effective solution would be to establish a central recordkeeping system and require intermediaries to report every . . . purchase."[106] He notes, however, that "a system like that would be expensive [and s]elf-reporting . . . may be the only cost-effective method."[107] The implementation of a centralized collection and monitoring system would also have to be assigned to some governmental or private entity.[108] Finally, deciding to centralize monitoring activities does not dictate what information is necessary to effectively monitor. As a result, we would still have to

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[103] 158 Cong. Rec. S5475 (daily ed. July 26, 2012) (statement of Sen. Jeff Merkley), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2012-07-26/html/CREC-2012-07-26-pt1-PgS5474-3.htm, *archived at* http://perma.cc/HCG5-65JN.

[104] *See* Bradford, *supra* note 1, at 8 ("The devil is in the details. Crafting a crowdfunding exemption [to securities law] requires a careful balancing of investor protection and capital formation.").

[105] Crowdfunding, 78 Fed. Reg. 66,430 (Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240 and 249).

[106] Bradford, *supra* note 2, at 202.

[107] *Id. But see* Schwartz, *supra* note 10, at 60 ("Modern information technology may make it possible to enforce the cap at very low cost, even across different crowdfunding platforms.").

[108] *See* Farnkoff, *supra* note 86, at 177 ("Such a centralized system could ideally be created and staffed by either the Commission itself or some (sole) third party verification service with the blessing of the SEC.").

decide what investors should disclose to intermediaries to allow a central monitoring authority to ensure that they remain within their unique investment boundaries.

[43] Other observers have also proposed alternatives to—or variations of—the extreme regulatory options discussed above (i.e., self-verification and intensive disclosures). For example, relying on statements by Senator Merkley, Professor J. Robert Brown suggests that self-certification of income and net worth could be used when investment amounts are low.[109] Professor Brown acknowledges that this would not prevent investors from providing false information, or eliminate the information gap among intermediaries.[110] He does note, however, that "the modest nature of the amounts is consistent with the idea of crowdfunding, minimizes the possibility that investors will risk a significant amount in a single offering, and reduces the incentives of third parties to provide false information to intermediaries on behalf of these investors."[111]

[44] Professor Brown has also discussed the possibility of asking for more personal information than a mere statement of income and/or net worth, while stopping short of disclosing sensitive documents.[112] For example, he proposed empowering intermediaries to "require disclosure of the material sources of income and the amount attributed to each."[113] Alternatively, "investors could be asked about the source of the funds that would be used in the offering."[114] Going further, heightened scrutiny by

[109] *See* Memorandum from J. Robert Brown, Jr., Professor of Law, Univ. of Denver Sturm Coll. of Law, on Crowdfunding, Exchange Act Release No. 70741 6 (Jan. 27, 2014), *available at* https://www.sec.gov/comments/s7-09-13/s70913-148.pdf, *archived at* https://perma.cc/4UN2-F77W.

[110] *See id.*

[111] *Id.*

[112] *Id.* at 7.

[113] *Id.*

[114] *Id.*

the intermediaries could complement the additional disclosures. Specifically, "intermediaries should have at least some obligation to engage in 'spot checks' of income and net worth," and "more meaningful guidance on . . . when information would be deemed unreliable."[115]

[45] The sum of slightly more disclosure and slightly more oversight might significantly improve the enforcement of the investment caps. It is unlikely to prevent investors from exceeding their statutory limits, particularly without centralized control over the information they are required to provide. Perfection, however, should not be the enemy of good. Some investors will exceed their investment limits no matter how the SEC structures its rules. The appropriate question should probably be whether an increased enforcement level justifies the additional time, expense and trouble it imposes on investors, intermediaries and the government.[116]

[46] The Cornell Securities Law Clinic suggested specifying the information that intermediaries must collect in order to enforce the investment caps.[117] Doing so would provide intermediaries with a degree of regulatory certainty while "prevent[ing] intermediaries from using an unintended interpretation of an ambiguous standard to justify their failure to collect information that would require them to prevent investors from being involved in an offering."[118] In other words, it serves the potentially competing interests of promoting efficiency and investor protection. At the very least, the Cornell Clinic supported requiring the collection of "identifying information to prevent duplicate or fraudulent accounts as well as information regarding other intermediary accounts and investments."[119] Unfortunately, this does not help identify what specific

[115] Brown, *supra* note 109, at 7.

[116] *See* Jacobson, *supra* note 66, at 1–2.

[117] *See id.* at 10.

[118] *Id.*

[119] *Id.*

information that might include. Furthermore, while this information might prevent investors from exceeding their individual limits across multiple platforms, it would not establish what those respective limits are in the first place. Disclosing personal information up to bank accounts and tax returns would still be necessary.

[47] Lastly, William F. Galvin—Secretary of the Commonwealth of Massachusetts—encouraged the SEC to provide for fines when intermediaries fail to satisfy their enforcement responsibilities.[120] "For example, the Commission could impose a fine if it determines that an intermediary had no reasonable basis for believing that an investor met the required qualifications."[121] This approach is different from the others in that it does not focus on the tools and infrastructure intermediaries would need "to ensure that no investor in a 12-month period has purchased securities . . . that . . . exceed the investment limits . . . ."[122] Instead, it attempts to adjust the incentives intermediaries have to act diligently.[123] Under the proposed regulations, intermediaries have no significant duty to enforce the investment limits, and real incentives to allow investors to spend as much as they would like.[124] Dangling the threat of fines might encourage intermediaries to pay attention to information provided by investors when they would otherwise turn a blind eye.[125]

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[120] *See, e.g.*, Letter from William F. Galvin, Sec'y of the Commonwealth of Mass., to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n 5 (Feb. 3, 2014), *available at* https://www.sec.gov/comments/s7-09-13/s70913-213.pdf, *archived at* https://perma.cc/5A6J-LYF8.

[121] *Id.*

[122] 15 U.S.C. § 77d-1(a)(8) (2012).

[123] *See* Galvin, *supra* note 120, at 5.

[124] *Id.*

[125] *See id.*

3. Information Security

[48] The SEC must also decide how crowdfunding intermediaries handle the personal information they do collect. The SEC has some experience with security issues, so it may not be completely unequipped to address this issue. At the same time, the SEC's staff devoted to privacy issues appears small,[126] and the Commission's experience is limited relative to other federal agencies like the Federal Trade Commission. Finally, the entities the SEC will be regulating in the crowdfunding context will probably differ greatly from those it currently regulates, which could further limit the value of its current experience. As a result, the SEC should seriously consider the applicability of its current rules to crowdfunding and create a new set of security regulations for these intermediaries that restrict the ways they can use investors' personal information.

a. Regulation S-P

[49] SEC Regulation S-P implements the Commission's privacy and security policies by limiting the "nonpublic personal information" a financial institution under the SEC's regulatory purview may disclose to third parties.[127] For example, entities subject to Regulation S-P may not disclose nonpublic personal information to any nonaffiliated third party without first: (1) giving the individual notice of its policies; (2) providing the individual with "a clear and conspicuous notice" that the institution may disclose their information; and (3) giving the individual an

[126] *See About Privacy at the SEC*, SEC. & EXCHANGE COMMISSION, http://www.sec.gov/about/privacy/secprivacyoffice.htm, *archived at* http://perma.cc/Z5JL-9U5N (last modified Mar. 13, 2013) (listing four staffers as contacts).

[127] 17 C.F.R. § 248.1(a) (2014) (noting this regulation applies to all financial institutions subject to SEC regulations beyond simply the crowdfunding context).

opportunity to opt out, and (4) instructions how to opt out of any such disclosures.[128]

[50] The SEC also requires institutions under its control "to adopt appropriate policies and procedures that address safeguards to protect this information" pursuant to Title V of the Gramm-Leach-Bliley Act.[129] Specifically, those policies:

> [M]ust be reasonably designed to:
>
> (1) Insure the security and confidentiality of customer records and information;
> (2) Protect against any anticipated threats or hazards to the security or integrity of customer records and information; and
> (3) Protect against unauthorized access to or use of customer records or information that could result in substantial harm or inconvenience to any customer.[130]

In effect, there are no concrete requirements. Instead, the SEC passes the responsibility of setting those requirements to the regulated entities that have to live by them.

b. Regulation S-ID

[51] SEC Regulation S-ID aims to prevent identity theft. In general, the rule "requires brokers to develop and implement a written identity theft prevention program that is designed to detect, prevent and mitigate

[128] Privacy of Consumer Financial Information (Regulation S-P), 65 Fed. Reg. 40,334, 40,351 (June 29, 2000) (to be codified at 17 C.F.R. pt. 248), *available at* http://www.gpo.gov/fdsys/pkg/FR-2000-06-29/pdf/00-16269.pdf, *archived at* http://perma.cc/2JJ5-F8KP.

[129] *Id.* at 40,334.

[130] 17 C.F.R. § 248.30(a) (2014).

identity theft in connection with certain existing accounts or the opening of new accounts."[131]

[52] Here again, the SEC allows the regulated entities to "develop" their own "identity theft prevention program[s]," but requires "each Program be appropriate to the size and complexity of the financial institution or creditor and the nature and scope of its activities."[132] Regulation S-ID goes slightly further and requires each "Program [to] include reasonable policies and procedures to: (i) Identify relevant Red Flags . . . and incorporate those Red Flags . . . ; (ii) Detect Red Flags that have been incorporated into the Program . . . ; (iii) Respond appropriately to any Red Flags that are detected . . . ; and (iv) Ensure the Program . . . is updated periodically . . . ."[133] Lastly, each entity must implement its Program by:

1. Obtaining approval of the initial Program from "its board of directors or an appropriate committee of the board of directors;"
2. "Involve [at least] a designated employee at the level of senior management in the oversight, development, implementation and administration of the Program;"
3. Adequately train staff "to effectively implement the Program;" and

[131] Crowdfunding, 78 Fed. Reg. 66,428, 66,493 (Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240 and 249); *see also* Identity Theft Red Flags Rules, 78 Fed. Reg. 23,638, 23,638 (Apr. 19, 2013) (17 C.F.R. pt. 248) ("[T]he rules require financial institutions and creditors to develop and implement a written identity theft prevention program designed to detect, prevent, and mitigate identity theft in connection with certain existing accounts or the opening of new accounts.").

[132] Identity Theft Red Flags Rules, 78 Fed. Reg. at 23,645.

[133] 17 C.F.R. § 248.201(d)(2)(2014)*; see also* 17 C.F.R. § 248.201(b)(10) (defining "Red Flag" as "a pattern, practice, or specific activity that indicates the possible existence of identify theft.").

4. Effectively overseeing agreements with the company's service providers.[134]

IV. PROPOSED SEC REGULATIONS AND PERSONAL INFORMATION

[53] The SEC proposed regulations implementing the CROWDFUND Act on October 23, 2013. The proposed rules generally reflect the SEC's goal of balancing investor protection with facilitating crowdfunding as a source of capital.[135] In the 585-page document, the SEC addressed what information investors would have to disclose pursuant to the investment limits, the information intermediaries would have to collect to prevent crimes like money laundering and financing of terrorism and the safeguards intermediaries would have to impose to protect the personal information they collect.[136] This section discusses the collection, handling, and protection of personal information under the SEC's proposed rules implementing Title III of the JOBS Act.

A. Enforcement of Investment Caps

[54] The SEC "recognize[d] that it would be difficult for intermediaries to monitor or independently verify whether each investor remains within his or her investment limits . . . ."[137] Having emphasized the JOBS Act's

[134] 17 C.F.R. § 248.201(e) (2014).

[135] *See, e.g.*, Crowdfunding, 78 Fed. Reg. at 66,430 ("Rules that are unduly burdensome could discourage participation in crowdfunding. Rules that are too permissive, however, may increase the risks for individual investors, thereby undermining the facilitation of capital raising for startups and small businesses."); *see also* Cheryl Conner, *SEC Attempts 'Balance' in Equity Crowdfunding Plan*, FORBES (Oct. 24, 2013, 9:19 AM), http://www.forbes.com/sites/cherylsnappconner/2013/10/24/sec-attempts-balance-in-equity-crowdfunding-plan/, *archived at* http://perma.cc/Q76G-4QRT.

[136] *See* Crowdfunding, 78 Fed. Reg. at 66,428 & 66,491 ("The [Bank Secrecy Act ("BSA")] and its implementing regulations establish the basic framework for [anti-money laundering] obligations imposed on financial institutions. The BSA is intended to facilitate the prevention, detection and prosecution of money laundering, terrorist financing and other financial crimes.").

purpose of freeing capital for startups and small businesses, and recognizing the detrimental effects of significant regulation, the SEC proposed perhaps the smallest possible disclosure burden on investors. Under the proposed rules, investors would be allowed to self-report their income and/or net worth for intermediaries to calculate the applicable investment limit under the statute.[138]

[55] As discussed above, the SEC could have easily chosen to require substantially greater disclosures under the statutory scheme. For example, the SEC could have required intermediaries to collect: (1) tax returns; (2) Form W-2s; (3) pay stubs; and/or (4) bank statements from investors and crosscheck those documents against the income and net worth the investor reported. Actual enforcement of the investment caps probably requires the collection of documents related to investors' income and net worth. Otherwise, intermediaries are left to rely on word of mouth. Collecting documents, however, would probably impose additional (and perhaps costly) recordkeeping obligations on intermediaries to make sure the sensitive documents are kept safe. It would also impose more work on intermediaries in the form of verifying investors' information before allowing investment. Many stakeholders, particularly issuers and intermediaries, have argued that "[i]t is virtually impossible to do income verification for an individual, and that is why we have to rely on self-disclosure . . . ."[139] In effect, the SEC's proposed rule reflects the

[137] *Id.* at 66,470.

[138] *See id.*; *see also* Farnkoff, *supra* note 86, at 168 (noting the regulations "allow for an issuer to rely on the assurances that its investors provide to the intermediary in order to retain the exemption, even if the investor misleads the intermediary and exceeds his income-based or aggregate investment limitations.").

[139] Dave Michaels, *SEC to Issue Crowdfunding Proposal Easing Investor Verification*, BLOOMBERG (Oct. 18, 2013), *available at* http://www.bloomberg.com/news/2013-10-17/sec-to-release-crowdfunding-rule-easing-investor-verification.html, *archived at* http://perma.cc/SE7S-NGZ7 (quoting Sherwood Neiss, principal at consultant Crowdfund Capital Advisors).

reasoning that actual enforcement is unlikely in any event, so why impose any regulatory burden at all?

B. Crime Prevention

[56] The SEC determined "that funding portals could play a critical role in detecting, preventing, and reporting money laundering and other illicit financing, such as market manipulation and fraud."[140] According to the SEC, "a funding portal . . . is in the best position to 'know its customers,' and to identify and monitor for suspicious and potentially illicit activity at the individual customer level . . . ."[141] As a result, "[t]he proposed rules require that funding portals comply with [preventative requirements associated with the Bank Secrecy Act (BSA)]."[142] Under these requirements, funding portals must:

> (1) [e]stablish and maintain an effective [anti-money laundering] program ("AML Program Requirement");
> (2) establish and maintain a Customer Identification Program ("CIP Requirement");
> (3) monitor for and file reports of suspicious activity ("the SAR Requirement"); and
> (4) comply with requests for information from the Financial Crimes Enforcement Network ("FinCEN") (the "Section 314(a) Requirements").[143]

Of these, the SEC anticipates "that the nature of a funding portal's business would typically implicate the AML Program Requirement, the

[140] Crowdfunding, 78 Fed. Reg. at 66,490.

[141] *Id.*

[142] *Id*.

[143] *Id.* at 66,491 (internal citations omitted).

CIP Requirement, the SAR Requirement and the information sharing provisions of the Section 314(a) Requirements."[144]

[57] Of *those*, the Treasury Department's Financial Crimes Enforcement Network's ("FinCEN") regulations compromise investor privacy the most. In fact, those provisions probably require the disclosure of more personal information than any other part of the crowdfunding process. Intermediaries' FinCEN procedures must:

> [I]nclude[] procedures for:
>
> (1) [o]btaining *customer identifying information* from each customer prior to account opening;
> (2) verifying the identity of each customer, to the extent reasonable and practicable, within a reasonable time before or after account opening;
> (3) *making and maintaining a record of obtained information relating to identity verification*;
> (4) determining, within a reasonable time after account opening or earlier, whether a customer appears on any list of known or suspected terrorist organizations designated by Treasury; and
> (5) providing each customer with adequate notice, prior to opening an account, that information is being requested to verify the customer's identity.[145]

B. Security

[58] Even after acknowledging that existing regulations might not address issues crowdfunding raises, the Commission determined "it is unnecessary to repeat identical, existing requirements, in a separate rule

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[144] *Id*.

[145] Crowdfunding, 78 Fed. Reg. at 66,492 (emphasis added) (internal quotation marks omitted).

proposal . . . *or to propose rules that would apply not only to crowdfunding, but to a broader set of technology-based activity.*"[146] Accordingly, the SEC proposed simply extending its existing "Privacy Rules"—discussed in section II.C.3 above—to funding portals in the crowdfunding arena.[147]

V. ANALYSIS & RECOMMENDATIONS

A. The Proposed SEC Regulations Favor Capital Formation (and Privacy) at the Expense of the Investment Limits

[59] From a normative standpoint, relying on investors' self-reported information strikes a good balance between capital formation and investor protection. This is a "fundamental challenge with any piece of securities regulation . . . ."[148] The chilling effect of regulation on capital formation could be particularly acute in this instance because increased compliance costs could quickly outweigh the relatively small amounts being raised.[149] The SEC's approach tends heavily toward facilitating crowdfunding's capital-raising potential by declining many of the regulatory burdens the Commission could have imposed. Investor privacy is also a tangential beneficiary in that investors will disclose relatively little personal information before they may invest via crowdfunding platforms. In fact, privacy-minded investors would not necessarily have to disclose any personal information. Because the proposed rules do not require any documentary evidence of income or net worth, investors could simply lie. In that case, intermediaries would know no more about the individual investor than they did before any transactions took place. This could also

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[146] *Id.* at 66,493 (emphasis added).

[147] *See id*.

[148] Jacobson, *supra* note 66 at 1.

[149] *See id.* ("Since the capital amounts raised by these offerings will be relatively small, there is greater risk that transaction costs, like regulatory compliance, will make this avenue prohibitively expensive.").

minimize the potential harm caused by any unintentional disclosures or improper uses.

[60] Critics of the SEC's approach can fairly point out that it fundamentally compromises the investment limits.[150] Allowing intermediaries to rely on investors' self-reported income and net worth effectively eliminates the statutory investment caps by making them impossible to effectively enforce. Without some objective documentation, investors can quite easily claim grossly inflated amounts in order to invest greater amounts on an intermediary's website. According to the SEC, "[t]he intermediary could not rely on an investor's representations if the intermediary had reason to question the reliability of the representation,"[151] but without the disclosure of more information, what would give "the intermediary . . . reason to question [its] reliability"?[152] It is also doubtful that an intermediary would have much incentive to question an investor's representation that allowed the investor to invest more money through its site. This may very well be the best policy decision, but it is important to note that it essentially nullifies this "bedrock statutory protection for crowdfunding investors . . . ."[153] While even proponents of a light regulatory approach argue for "a relatively heavy burden on intermediaries to enforce [the limits]," the SEC would essentially regulate enforcement out of the statute.[154]

[61] The fact that the SEC's proposed balance so fundamentally compromises the investment limits could give rise to legal challenges

[150] *See* Schwartz, *supra* note 10, at 59–60.

[151] Crowdfunding, 78 Fed. Reg. at 66,470.

[152] *Id.*

[153] Schwartz, *supra* note 10, at 59.

[154] *Id.* at 60; Thorpe, *supra* note 37 (explaining that while the SEC requires intermediaries to take efforts to ensure that investors comply with the investment limits, "[t]he SEC is rumored to have decided *not* to enforce this provision.").

alleging that it abused its discretion in creating the rules.[155] Courts analyze administrative rules like those the SEC proposed under the two-part *Chevron* evaluation.[156] First, the Court considers whether Congress expressly stated how it expected the agency to implement the statute.[157] Agencies have to follow Congress' instruction in that event.[158] If the relevant statute is ambiguous—that is, "Congress has not directly addressed the precise question at issue"—"the question for the court is whether the agency's answer is based on a permissible construction of the statute."[159] When Congress tells an agency to take a particular action, the way the agency does so is "permissible" unless it is somehow "arbitrary, capricious, or manifestly contrary to the statute."[160] This standard is highly deferential to an agency's interpretation.[161] The fundamental question

[155] *See* Seidt, *supra* note 99, at 1 ("The Commission has no authority to ignore Congressional mandates, and the Commission's proposals to circumvent the issuer and investor investment thresholds, for example, are unauthorized anti-investor propositions that [the North American Securities Administrators Association] cannot support."); Schwartz, *supra* note 10, at 60 ("[E]ven if the cost of effectively enforcing the cap turns out to be a bit high, it is probably worth it, because the whole statutory scheme depends on it."); Farnkoff, *supra* note 86, at 171 ("A self-certification method to satisfy the aggregate investment levels, where an intermediary trusts the word of the investors regarding their investments with other funding portals, arguably does not capture the spirit of Congress's inclusion of the word 'ensure.'").

[156] *See* Chevron v. Natural Res. Def. Council, 467 U.S. 837, 842–43 (1984).

[157] *See id.* at 842.

[158] *See id.* at 842–43.

[159] *Id.* at 843.

[160] *Id.* at 843–44.

[161] *See* City of Arlington v. Fed. Commc'n Comm'n, 133 S. Ct. 1863, 1868 (2013) ("*Chevron* is rooted in a background presumption of congressional intent: namely, 'that Congress, when it left ambiguity in a statute' administered by an agency, 'understood that the ambiguity would be resolved, first and foremost, by the agency, and desired the agency (rather than the courts) to possess whatever degree of discretion the ambiguity allows.'") (quoting Smiley v. Citibank, 517 U.S. 735, 740–41 (1996)).

under *Chevron* "is always, simply, *whether the agency has stayed within the bounds of its statutory authority*."[162]

[62] As explained above, the JOBS Act imposed a difficult balancing act on the SEC.[163] Intermediaries must "make such efforts as the [SEC] determines appropriate, by rule, to ensure that no investor in a 12-month period has purchased securities . . . that . . . exceed the investment limits . . . ."[164] Accordingly, the SEC is responsible for determining what efforts are appropriate.[165] The statute, however, does not identify any efforts that would be *inappropriate*.[166] In other words, the statutory language is ambiguous, and simply defers to the SEC to make the determination.

[63] The SEC exercised its broad discretion and determined that the sort of disclosures that would facilitate effective enforcement of the investment limits were *not* appropriate.[167] In doing so, it seems to have relied on the small, but fundamental, bit of statutory language it could find to guide its decision. The first line of the JOBS Act describes it as "[a]n Act [t]o increase American job creation and economic growth *by improving access to the public capital markets* for emerging growth companies."[168] The investment caps are investor protections "designed to shield [them] from

[162] *Id.*

[163] *See* Schwartz, *supra* note 10, at 60 ("How exactly to regulate intermediaries' policing of the annual cap is a difficult and complex matter that deserves careful attention by the SEC.").

[164] 15 U.S.C. § 77d-1(a)(8) (2012).

[165] *See id.*

[166] *See id.*

[167] *See* Crowdfunding, 78 Fed. Reg. 66,428, 66,470 (Nov. 5, 2013) (to be codified at 17 C.F.R. pts. 200, 227, 232, 239, 240 and 249).

[168] Jumpstart Our Business Startups Act, Pub L. No. 112-106, 126 Stat. 306 (2012) (emphasis added).

losses of devastating magnitude."[169] But extensive enforcement requirements could burden intermediaries and undermine their ability to facilitate capital formation.[170] The SEC might also consider the actual risk of fraud crowdfunding investors face in determining what measures are appropriate. Ethan Mollick, a management professor at The Wharton School of the University of Pennsylvania, "has done extensive research on crowdfunding and was consulted by legislators and the SEC on equity crowdfunding . . . ."[171] According to Professor Mollick, "[l]ess than 1% of funds and 4% of the projects he studied showed signs of fraud."[172] Moreover, the open nature of crowdfunded offerings mitigates against fraud on its own.[173] Low risk and the potential to undermine the statutory goal probably makes imposing a lighter enforcement burden appropriate. Given the tension between enforcement of the limits and the JOBS Act's overarching objective of facilitating capital investment, as well as the considerable discretion it received in the statute, the SEC's proposed rules probably qualify as a "permissible" construction of the statute.

[64] A number of securities law experts would probably disagree with that conclusion, however.[174] The North American Securities Administrators Association ("NASAA") implied that the SEC does not have the statutory discretion to rely on self-certification.[175] Given his view

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[169] Schwartz, *supra* note 10, at 45.

[170] *See* discussion *supra* Part III.C.1.

[171] *The Promise and Perils of Equity Crowdfunding*, KNOWLEDGE@WHARTON (Nov. 7, 2013), http://knowledge.wharton.upenn.edu/article/promise-perils-equity-crowdfunding/, *archived at* http://perma.cc/A5RL-WKE7.

[172] *Id.*

[173] *See id.*

[174] *See, e.g.*, Galvin, *supra* note 120, at 5 ("The Commission suggests that the JOBS Act allows for investor self-monitoring—an entirely untenable position in light of the high risk and complex nature of investments under the JOBS Act.").

that that "the whole statutory scheme depends on [effectively enforcing the investment limits]," and the obvious enforcement gaps in a self-certification scheme, Professor Schwartz might rightly conclude that the SEC's plan is not "reasonable."[176] Brian Farnkoff looked to the legislative history and concluded that Senator Merkley—one of the bill's primary Senate sponsors—"certainly did not seem to contemplate self-verification as an option."[177] These individuals might expect courts to reject the SEC's proposed regulations as either exceeding the scope of the agency's discretion or "arbitrary, capricious, *or manifestly contrary to the statute*."[178]

B. The SEC Should be More Proactive Regarding Information Security

[65] Data security implications are receiving greater scrutiny. On December 19, 2013, Target announced that "[a]pproximately 40 million credit and debit card accounts may have been impacted [in a data breach] between Nov. 27 and Dec. 15, 2013."[179] The breach held the public's attention for months as the details got progressively worse. On December 27, 2014, Target "sa[id] . . . ongoing forensics investigation into the data breach revealed that encrypted debit card PIN information was accessed . .

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[175] *See* Seidt, *supra* note 99, at 1–3 ("[W]e are confused by the Commission's attempt to exercise discretion that it does not have to the detriment of investors in . . . critical areas . . . . It is doubtful that the Commission's investor self-certification approach will be sufficient to meet the standard set forth in the statute.").

[176] Schwartz, *supra* note 10, at 59–60.

[177] Farnkoff, *supra* note 86, at 173.

[178] Chevron v. Natural Res. Def. Council, 467 U.S. 837, 843–44 (1984) (emphasis added).

[179] Press Release, Target, Target Confirms Unauthorized Access to Payment Card Data in U.S. Stores (Dec. 19, 2013), *available at* http://pressroom.target.com/news/target-confirms-unauthorized-access-to-payment-card-data-in-u-s-stores, *archived at* http://perma.cc/VVA8-BJNR.

. ."[180] By January 2014, the company estimated that "70 million to 110 million people" had personal information stolen.[181] Within a week of the breach, the market for stolen credit cards spiked dramatically.[182] This, and other breaches at large corporations, "have sparked concern from U.S. lawmakers and consumers over who should bear the cost of consumer losses and how to improve cybersecurity."[183] Intuitively, this becomes more concerning as the information exposed becomes more personal.

[66] Even though it requires relatively little information from investors to enforce the JOBS Act's investment caps, the SEC could still protect their privacy concerns more effectively. Seizing on the growing visibility of data breaches, securities regulators seem to have started paying attention to the issue. In its comments on the SEC's proposed regulations, NASAA "urge[d]" the SEC to consider the following:

> New Section 4A(a)(9) of the Securities Act of 1933 requires intermediaries to take such steps to protect investor privacy as the Commission deems appropriate, and the proposed rule would require funding portals to comply with

[180] Sara Germano, *Target's Data-Breach Timeline*, WALL ST. J., (Dec. 27, 2013, 6:28 PM), http://blogs.wsj.com/corporate-intelligence/2013/12/27/targets-data-breach-timeline/, *archived at* http://perma.cc/S4YP-PMNK.

[181] Elizabeth A. Harris & Nicole Perlroth, *For Target, the Breach Numbers Grow*, N.Y. TIMES, Jan. 11, 2014, at B1, *available at* http://www.nytimes.com/2014/01/11/business/target-breach-affected-70-million-customers.html, *archived at* http://perma.cc/WZ7F-X744.

[182] *See* Nicole Perlroth, *Target Customer Information Shows Up on the Black Market*, N.Y. TIMES (Dec. 20, 2013, 3:38 PM), http://bits.blogs.nytimes.com/2013/12/20/target-customer-information-shows-up-on-the-black-market/?_php=true&_type=blogs&_r=0, *archived at* http://perma.cc/5UHM-HZXZ ("Easy Solutions, a company that tracks fraud, noticed a ten- to twentyfold increase in the number of high-value stolen cards on black market web sites, from nearly every bank and credit union.").

[183] *Crowdfunding Website Kickstarter Hacked, Recommends Users Change Passwords,* REUTERS (Feb. 16, 2014, 8:18 AM), http://www.reuters.com/article/2014/02/16/us-usa-kickstarter-idUSBREA1F03320140216, *archived at* http://perma.cc/PWC5-9D3C.

> the same privacy rules that are applicable to brokers. *Given the recent breaches in consumer financial data, the proliferation of identity theft, and the possibility that the lack of data security may lead to losses far greater than the amount invested, the proposed privacy requirement is a critical safeguard for investor data*. It will also enhance the overall integrity of intermediary platforms for the benefit of issuers.[184]

As noted above, the SEC proposed essentially extending the privacy regulations currently applicable to established securities brokers.[185] Also noted above, however, is the fact that crowdfunding intermediaries are not necessarily comparable to established securities brokers.[186] Describing its proposed recordkeeping requirements on funding portals, the SEC bluntly stated, "[b]ecause funding portals would be engaged in a more limited range of activities than brokers and *a relatively high proportion of funding portals would be new market entrants that may not have formal recordkeeping practices in place*, the proposed requirements are relatively streamlined, compared to those for brokers."[187] This acknowledgement brings into question the wisdom of applying the Privacy Rules applicable to brokers to all intermediaries (i.e., including funding portals).

1. Protection of Personal Information Collected

[67] The SEC currently allows brokers to craft their own policies governing how they use and protect their customers' personal information within some broad parameters.[188] This approach is designed to provide a

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[184] Seidt, *supra* note 99, at 4 (emphasis added).

[185] *See* Crowdfunding, 78 Fed. Reg. 66, 428, 66,493 (Nov. 5, 2013) (to be codified at 17 CFR Parts 200, 227, 232, 239, 240 and 249).

[186] *See id.*

[187] *Id.* at 66,495 (emphasis added).

great deal of flexibility to determine the appropriate policies in light of the unique considerations of individual brokers.[189] It also reduces the regulatory burden by allowing brokers to bypass more specific regulations that may not be appropriate for each entity.[190] The SEC's proposed crowdfunding regulations would generally pass these benefits on to the emerging funding portals.[191] In theory, that would also promote the growth of the crowdfunding industry as a whole by making it easier for a great many intermediaries (i.e., "funding portals") to operate by reducing the number of absolute requirements with which they have to comply.

[68] The SEC should apply more specific, and perhaps more exacting, standards to these "new market entrants" lacking "formal recordkeeping practices in place . . . ."[192] At the very least, the SEC should specify baseline elements that each privacy and data protection program should include. As the Commission has suggested—if not said explicitly—many of the crowdfunding intermediaries are young entities with little experience collecting, holding and protecting consumer information.[193] The proposed rules, however, treat those entities like banks and brokerage firms even though they may not have the experience and expertise of banks and brokerage firms.[194]

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188 *See, e.g.*, Identity Theft Red Flags Rules, 78 Fed. Reg. 23,645 (Apr. 19, 2013) (to be codified at 17 CFR 248).

189 *See id.*

190 *See id.*

191 *See* Crowdfunding, 78 Fed. Reg. at 66,493 ("The proposed rules would implement the requirements of Section 4A(a)(9) by subjecting funding portals, as brokers, to the same privacy rules applicable to brokers.").

192 *Id.* at 66,495.

193 *See id.*

194 *See id.* at 66,493.

[69] Opponents to greater regulation could make several reasonable arguments. First, risks to consumer information are inherent in today's Internet-centric world. Sony suffered at least seven data breaches on multiple websites in April and May 2011 alone.[195] More recently, in 2013, Adobe suffered a data breach that "impacted at least 38 million users . . . ."[196] If companies like Adobe and Sony are susceptible, maybe we should not hamstring crowdfunding's potential with burdensome protective measures. But the fact that wealthy, established, sophisticated companies like Adobe and Sony are vulnerable is all the more reason to *require* baseline protective measures by many young, inexperienced companies that might not have the knowledge or incentives to implement them on their own initiative.

[70] On a related note, some might argue that people give personal—including financial—information to web-based businesses every single day. Why should crowdfunding platforms be subject to unique, additional requirements? It is equally reasonable, however, to ask whether those other businesses *should be* subject to more specific requirements to safeguard the personal information they collect from customers. But more specific to the point, as a new and already incredibly diverse industry, crowdfunding platforms *and investors* would benefit from some standard regulation. Intermediaries would receive some sort of baseline guidance concerning the privacy protections they should implement. Investors would receive the assurance of some fundamental protection, and the fact

[195] *See* Matthew J. Schwartz, *Sony Data Breach Cleanup To Cost $171 Million*, DARK READING (May 23, 2011, 1:39 PM), http://www.darkreading.com/attacks-and-breaches/sony-data-breach-cleanup-to-cost-$171-million/d/d-id/1097898?, *archived at* http://perma.cc/GXB6-PQ9F. Sony also drew worldwide attention for the November 24, 2014 breach it suffered surrounding the release of THE INTERVIEW. Kevin Johnson, Oren Dorell, and Elizabeth Wise, *Official: North Korea Behind Sony Attack*, USA TODAY (Dec. 18, 2014), http://www.usatoday.com/story/news/world/2014/12/17/north-korea-sony-hack/20558135/, *archived at* http://perma.cc/RS9S-B2UB. In this recent Sony breach, hackers obtained access to some of the company's most sensitive information, further highlighting the vulnerability of even the world's largest corporations. *See id.*

[196] Brian Krebs, *Adobe Breach Impacted at Least 38 Million Users*, KREBS ON SECURITY (Oct. 29, 2013) http://krebsonsecurity.com/2013/10/adobe-breach-impacted-at-least-38-million-users/, *archived at* http://perma.cc/H2BW-92DQ.

that they are not entering some sort of deregulated investment wasteland. In fact, skeptics of equity crowdfunding have frequently described it as "the Wild West of fundraising."[197] In reality, if this new avenue is going to succeed in creating capital opportunities as its advocates hope, investors must feel that risks of fraud and privacy breaches are small.[198] Some proactive regulation could promote that interest in crowdfunding's early stages.

[71] In some areas of its proposed rules, the SEC seems content to rely on intermediaries' interest in "the reputational integrity of its platform and crowdfunding . . . in general . . ." to essentially self-regulate.[199] This alone probably will not provide effective assurance across the entire crowdfunding spectrum. Many of the crowdfunding platforms emerging probably have interests competing with their incentives to provide diligent privacy protections. Specifically, many would probably rather spend resources establishing the business than invest in preventing seemingly speculative security risks. Others might simply underestimate those risks and decide that they do not merit the expenditure of significant resources. At the very least, the behavioral impact of these reputational interests are speculative and should not be relied upon at this early stage of the crowdfunding industry as an effective replacement for real governmental oversight.

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[197] Emily Patterson, *Crowdfunding Sites Grapple with Fraud*, BETTER BUSINESS BUREAU (June 21, 2013), http://www.bbb.org/blog/2013/06/crowdfunding-sites-grapple-with-fraud/, *archived at* http://perma.cc/69R8-Y7RA.

[198] Congress apparently recognized the importance of investor confidence when it passed the CROWDFUND Act. *See, e.g.*, 158 CONG. REC. S5474 (daily ed. July 26, 2012) (statement of Sen. Merkley), *available at* http://www.gpo.gov/fdsys/pkg/CREC-2012-07-26/pdf/CREC-2012-07-26-pt1-PgS5474-3.pdf, *archived at* http://perma.cc/HCG5-65JN ("[i]f crowdfunding is going to take off, this new market needs to inspire confidence in both investors and small businesses."); *see also* Scott Brown, *Sen. Scott Brown: Creating a Nation of Venture Capitalists Through Crowdfunding*, WIRED (Nov. 30, 2011, 10:40 AM), http://www.wired.com/business/2011/11/scott-brown-next-steve-jobs/2/, *archived at* http://perma.cc/SFE3-YGX2 ("For this new market to flourish, it's important that every participant has confidence in the integrity of the system.").

[199] Crowdfunding, 78 Fed. Reg. at 66,463.

[72] The size of an entity matters when it comes to protecting the personal information it collects. Smaller entities are frequently more vulnerable than their larger counterparts. "With limited budgets and few or no technical experts on staff, small businesses generally have weak security."[200] Many smaller operations also seem to believe that their lack of visibility provides protection from security threats. For example, in 2011, the Wall Street Journal interviewed the owner of two magazine shops in the Chicago area. Hackers "planted a software program on the cash registers at his . . . shops that sent customer credit-card numbers to Russia."[201] After the attack, the owner explained, "[w]ho would want to break into us? . . . [w]e're not running a bank."[202]

[73] Minimal resources combined with naiveté creates a playground for computer criminals and a major problem concerning the protection of personal information. Hackers apparently recognize the opportunity, and "are expanding their sights beyond multinationals to include any business that stores data in electronic form."[203] Sixty-three percent of the 761 data breaches the U.S. Secret Service and Verizon forensic analysis unit responded to in 2010 occurred "at companies with 100 employees or fewer."[204] According to Visa, "about 95% of the credit-card data breaches it discovers are on its smallest business customers."[205]

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[200] Geoffrey A. Fowler & Ben Worthen, *Hackers Shift Attacks to Small Firms*, WALL ST. J. (July 21, 2011), *available at* http://www.wsj.com/articles/SB10001424052702304567604576454173706460768, *archived at* http://perma.cc/U3TK-JGX6.

[201] *Id.*

[202] *Id.*

[203] *Id.*

[204] *Id.*

[205] Fowler & Worthen, *supra* note 200.

[74] Tech startups are no exception to this problem. Like companies in other industries, young Internet-based companies have to survive before they grow, which shapes their priorities.[206] With limited resources and other priorities, data security does not receive the attention that the companies and their customers would probably prefer.[207] This tendency makes perfect sense. As the owner of a startup, why would you invest in data security to protect your reputation and customers if the required investment takes a large chunk out of your profits? "[A]ll too often, security researchers and analysts say founders' approach to security is still simply to pray . . . their company is not hacked, and to ask for forgiveness if it is."[208]

[75] Moreover, like young companies elsewhere, tech startups are frequently unaware of the threats they face. "Often start-ups can be in over their heads before they know it."[209] These companies frequently remain in the dark, even as they collect more personal information, "rival[ing] what the government itself can collect."[210] Unfortunately, those "government agencies have no jurisdiction to protect it, or even the ability to share classified threat information with the companies, leaving the onus to protect personal data from cybercriminals and nation-states upon the

[206] *See* Jenna Wortham & Nicole Perlroth, *When Start-Ups Don't Lock the Doors*, N.Y. TIMES, Mar. 3, 2014, at B1, *available at* http://www.nytimes.com/2014/03/03/technology/when-start-ups-dont-lock-the-doors.html?ref=technology&_r=0, *archived at* http://perma.cc/433C-UAQQ ("Young tech companies have a long list of to-dos. Signing up users and raising money are usually at the top of the list.").

[207] *See id.* (quoting Tripp Jones, a partner at August Capital, "There's so much focus on acquiring and delivering products and services that security is not top of mind . . . For many companies, a security breach would almost be a nice problem to have [because i]t means you have enough customers for someone to care.") (internal quotations omitted).

[208] *Id.*

[209] *Id.*

[210] *Id.*

companies themselves."[211] That assignment of responsibility leaves consumers at risk if the companies' focus lies elsewhere.

[76] Wortham and Perlroth also provide a number of examples that highlight tech startups' vulnerability. "Snapchat . . . repeatedly ignored warnings about a data breach that exposed millions of user names and phone numbers . . . ."[212] Tinder—a dating application that uses a phone's location to identify nearby singles—"acknowledged flaws in its software that would let hackers pinpoint the exact locations of people using the service."[213] And Kickstarter, one of the most recognized crowdfunding platforms, "said . . . that hackers had gained access to customer data, including passwords and phone numbers."[214]

[77] We have seen this effect in other areas as well. The American Recovery and Reinvestment Act of 2009 required the U.S. Department of Health and Human Services ("DHHS") to perform periodic audits to ensure covered entities and businesses are complying with the [Health Insurance Portability and Accountability Act] Privacy and Security Rules and Breach Notification Standards.[215] The DHHS Office of Civil Rights released the results of its initial audit in March 2012. The initial audit results "confirmed" that *security* violations were the most common, and

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[211] Wortham & Perlroth, supra note 206.

[212] *Id.*

[213] *Id.*

[214] *Id.*; *see also* Chris Michaud, *Crowdfunding Website Kickstarter Hacked, Recommends Users Change Passwords*, REUTERS (Feb. 16, 2014), http://www.reuters.com/article/2014/02/16/us-usa-kickstarter-idUSBREA1F03320140216, *archived at* http://perma.cc/PS3R-VAVD ("Kickstarter's information that was accessed without authority included user names, email addresses, mailing addresses, phone numbers and encrypted passwords . . . . ").

[215] *See Health Information Privacy: Protection of Information Created Through the HIPPA Audit Program*, U.S. DEP'T OF HEALTH & HUMAN SERV., http://www.hhs.gov/ocr/privacy/hipaa/enforcement/audit/confidentialitystatement.html, *archived at* http://perma.cc/93H5-6C4V (last visited Jan. 21, 2015).

"[*s*]*mall covered entities had a lot more issues than large ones*."[216] According to QI Partners, a healthcare information consulting firm, "small organizations are often the easiest target and source of data."[217] These entities "often lack the resources to know what tools to put in place to avoid cyber attacks and data breaches."[218]

[78] Small businesses are not only more vulnerable to data breaches, but also suffer disproportionately when they occur. The average cost of a data breach in the United States is $188 per record.[219] This cost can add up quickly for a small business even with relatively few records in its possession.[220] These businesses also might not "have the financial cushion to deal with the costs of a breach."[221] A breach can also harm a business'

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[216] Adam H. Greene & Rebecca L. Williams, *HIPAA Audits Results Released: We Still Have Work to Do*, JDSUPRA (June 13, 2012), http://www.jdsupra.com/legalnews/hipaa-audits-results-released-we-still-03600/, *archived at* http://perma.cc/HUG9-CA95 (emphasis added).

[217] Robert Zimmerman, *Risks to Small Providers are Risks to All*, ROCKVILLE, MARYLAND PATCH (July 24, 2013, 9:53 AM), http://patch.com/maryland/rockville/risks-to-small-providers-are-risks-to-all#.VDaj5ildVU8, *archived at* https://perma.cc/6HNE-PKCV.

[218] *Id.*

[219] *See* PONEMON INSTITUTE, 2013 COST OF DATA BREACH STUDY: GLOBAL ANALYSIS at 1 (May 2013), *available at* https://www4.symantec.com/mktginfo/whitepaper/053013_GL_NA_WP_Ponemon-2013-Cost-of-a-Data-Breach-Report_daiNA_cta72382.pdf, *archived at* https://perma.cc/G2BH-GUSG.

[220] *See, e.g.*, David Nelson, *The Cost of a Data Breach Can Bankrupt Small Businesses*, SPEAK OUT SMALL BUSINESS (June 25, 2013) https://web.archive.org/web/20140411034414/http://www.speakoutsmallbusiness.com/view-post/The-Cost-of-a-Data-Breach-Can-Bankrupt-Small-Business, *archived at* https://perma.cc/R27L-4HES (accessed by searching for http://www.speakoutsmallbusiness.com/view-post/The-Cost-of-a-Data-Breach-Can-Bankrupt-Small-Business in the Internet Archive Wayback Machine)

[221] *Id.*

reputation and cause a loss of customers that small and developing businesses need to avoid.[222] At least some startups recognize "the gravity of security missteps."[223] "Everyone would acknowledge that one misstep and you're toast . . . ."[224] Congress and President Obama hoped that equity crowdfunding could become an engine of capital formation for small businesses and startups. This will never happen if the companies facilitating transactions are overly exposed to financially devastating cyber threats, and investors cannot trust those companies with their personal information.

2. The SEC Should Restrict How Crowdfunding Platforms May Use Personal Information

[79] The SEC's proposed rules would allow intermediaries collecting personal information from investors to become huge players in the exploding market for personal information. That market "comprises a menagerie of advertisers, marketers, ad networks, data brokers, website publishers, social networks, and online tracking and targeting companies, for all of which the main currency—what they buy, sell, and trade—is personal data."[225] "Virtually every piece of personal information that [individuals] provide online (and much that you provide offline) will end up being bought and sold, segmented, packaged, analyzed, repackaged, and sold again."[226] The questions then become whether this phenomenon

[222] *See* PONEMON INSTITUTE, *supra* note 219, at 17.

[223] Wortham & Perlroth, *supra* note 206.

[224] *Id.* (quoting Ashvin Kumar).

[225] Mark Sullivan, *Data Snatchers! The Booming Market for Your Online Identity*, PCWORLD (June 26, 2012, 8:01 AM), http://www.pcworld.com/article/258034/data_snatchers_the_booming_market_for_your_online_identity.html, *archived at* http://perma.cc/F6L3-VXXS.

[226] *Id.*

is dangerous or beneficial, and whether crowdfunding intermediaries should participate?

a. Dangers & Benefits of the Consumer Data Industry

[80] Consumer advocates are concerned that companies can buy and sell personal information for inappropriate purposes. For example, "[p]eople are using data broker information to make important decisions about the real you based on the virtual you, decisions like your credit score, your insurance rates, and even whether you get a job."[227] "[T]his data is frequently inaccurate," so people could be unfairly penalized based on false assumptions.[228]

[81] Adding new data brokers also compounds existing information security problems by putting even more personal information at risk. Take Acxiom for example. Acxiom is a data broker with a "database contain[ing] information about 500 million active consumers worldwide, with about 1,500 data points per person."[229] While it controls this huge catalogue of information, "cybersecurity experts who examined Acxiom's Web site for The [New York] Times found basic security lapses on an online form for consumers seeking access to their own profiles."[230] Allowing vulnerable companies to buy and sell additional information puts that additional information at risk. Information inherently becomes

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[227] Sarah A. Downey, *Abine on CNN: Why Big Companies Buy and Sell Your Data*, THE ONLINE PRIVACY BLOG (Aug. 23, 2012), https://www.abine.com/blog/2012/why-big-companies-sell-your-data/, *archived at* https://perma.cc/JF7W-UTP3.

[228] *Id.*

[229] Natasha Singer, *Mapping, and Sharing, the Consumer Genome*, N.Y. TIMES, June 17, 2012, at BU1, *available at* http://www.nytimes.com/2012/06/17/technology/acxiom-the-quiet-giant-of-consumer-database-marketing.html, *archived at* http://perma.cc/9RR7-47GK.

[230] *Id.*

less secure each time it is shared or exchanged because it provides at least one more point of potential access.

[82] There are potential benefits of this industry. Companies use large amounts of personal data to "improve the relevance of ads people see on [sites like] Facebook and the efficacy of marketing campaigns."[231] Proponents argue that consumers "ultimately" benefit because "[t]hey get to see better, more relevant ads from brands and businesses they care about and that they have a prior relationship with."[232] Companies are also willing to pay more for targeted ads based on consumers' personal information, which allows sites like Dictionary.com and Facebook to avoid charging users for access.[233]

[83] However, consumers are ultimately still paying a price when companies trade off of their personal information. Many consumers probably do not view targeted advertisements as some great privilege. To those consumers, the ads are still simply invitations to spend their hard-earned money for the benefit of the advertiser. Moreover, consumers pay for sites like Facebook and Dictionary.com with at least some autonomy, as users do not receive any explicit choice between control over their personal information and access.[234]

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[231] Somni Sengupta, *What You Didn't Post, Facebook May Still Know*, N.Y. TIMES, Mar. 25, 2013, at B1 (quoting Gokul Rajaram, Facebook's director for advertisements), *available at* http://www.nytimes.com/2013/03/26/technology/facebook-expands-targeted-advertising-through-outside-data-sources.html?_r=0, *archived at* http://perma.cc/MPK4-YX4D.

[232] *Id.* (quoting Gokul Rajaram).

[233] *See* Julia Angwin, *The Web's New Gold Mine: Your Secrets*, WALL ST. J. (July 30, 2010), *available at* http://online.wsj.com/articles/SB10001424052748703940904575395073512989404, *archived at* http://perma.cc/H3XM-SFUG.

[234] *See* Press Release, Fed. Trade Comm'n, FTC to Study Data Broker Industry's Collection and Use of Consumer Data (Dec. 18, 2012), *available at* http://www.ftc.gov/news-events/press-releases/2012/12/ftc-study-data-broker-industrys-collection-use-consumer-data, *archived at* http://perma.cc/KVJ7-22PC.

b. Should Crowdfunding Intermediaries Participate as Brokers of Personal Information?

[84] The SEC should seize this opportunity to provide crowdfunding investors greater control over the personal information they disclose to crowdfunding intermediaries. "[C]onsumers are often unaware of the existence of data brokers as well as the purposes for which they collect and use consumers data."[235] In December 2012, "[t]he Federal Trade Commission issued orders requiring nine data brokerage companies to provide the agency with information about how they collect and use data about consumers."[236] The FTC intended to take the information provided by the companies "to prepare a study and to make recommendations on whether, and how, the data broker industry could improve its privacy practices."[237] So, most do not realize this is happening, they do not expect it to happen and regulators do not fully understand the potential risks.[238] Meanwhile, the general public is "accepting more privacy intrusions each day, sometimes because we don't realize what we're giving out, other times because we don't feel we have a choice, [and] other times because the harm of this isolated transaction seems so remote."[239]

[85] The White House has echoed many of the FTC's observations of the growing data brokerage industry. These entities gather and analyze a growing amount of personal information about American consumers without any "direct relationship with the consumers whose information

[235] *Id.*

[236] *Id.*

[237] *Id.*

[238] *See id.*

[239] Sullivan, *supra* note 225 (quoting Sarah Downey, an attorney for the online privacy products firm Abine).

they collect."[240] There are also reasons to doubt that this information is always used in desirable ways.[241] "Consumers deserve more transparency about how their data is shared beyond the entities with which they do business directly . . . ."[242] With this landscape in mind, the SEC should consider precluding intermediaries from selling, sharing, or otherwise disclosing investors' personal information beyond what is absolutely necessary to facilitate crowdfunding investment. Doing so would limit disclosures from one significant pool of information, and comport with the privacy expectations most investors probably have when they interact with crowdfunding intermediaries. It would also promote the FTC's goal of making the data brokerage industry more transparent by giving crowdfunding investors a concrete understanding of how their information will, and will not, be shared. Lastly, from a broader perspective, this is an opportunity to start moving back toward personal control over personal information, rather than accepting a lack of any control whatsoever as the norm.

VI. CONCLUSION

[86] Congress passed, and the President signed, the JOBS Act to facilitate capital formation for emerging businesses that lacked access to the capital they needed. In doing so, they also called on the SEC to strike a tricky balancing act between that goal of capital formation and investors' privacy interests. The SEC's proposed rules seem to reflect that fundamental objective by imposing a relatively light regulatory burden on crowdfunding participants and thereby making their participation easier.

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[240] EXEC. OFFICE OF THE PRESIDENT, BIG DATA: SEIZING OPPORTUNITIES, PRESERVING VALUES 43 (2014), *available at* http://www.whitehouse.gov/sites/default/files/docs/big_data_privacy_report_5.1.14_final_print.pdf, *archived at* http://perma.cc/3URF-6AZW.

[241] *See, e.g.*, *id.* at 46–47 (discussing the facilitation of possible price discrimination).

[242] *Id.* at 62.

[87] That approach favors individual privacy interests because investors may participate by making minimal personal disclosures that do not even have to be true. At the same time, the proposed rules may compromise security interests by not requiring any concrete actions by the intermediaries who collect personal information. The SEC should go further than rely upon the unproven judgment of hundreds of emerging businesses with little track record of handling that information. Instead, specifying—and *requiring*—some basic threshold collection, handling, and protective measures is appropriate, *particularly* at this stage of crowdfunding's development.

[88] At this point, equity crowdfunding is a great unknown. Proponents characterize it as a great, untapped resource of financing that can drive a wave of small businesses and startups and the job opportunities that go along with them. Skeptics, on the other hand, portray it as a wild west of investment where cunning schemesters will dupe, defraud, and abuse unwitting rube investors. For the optimistic outlook to become a reality, equity crowdfunding must be credible and reliable. While widespread fraud would certainly undermine that credibility, data security is another potential pitfall. Potential investors simply will not participate if the information they provide is not (or not perceived to be) secure. Meanwhile, data breaches seem to be growing in number and visibility, and tech startups—which include all of the hundreds of crowdfunding platforms—are frequently ill equipped to face the threat. Accordingly, the SEC should be proactive and require any equity crowdfunding portal to take certain baseline measures to protect investors' information. In the end, the success of this new means of capital formation could depend on it.