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# CROWDFUNDING AND SPORT: HOW SOON UNTIL THE FANS OWN THE FRANCHISE?

EDWARD A. FALLONE\*

## I. INTRODUCTION

The Green Bay Packers football team operates as a nonprofit corporation that has been publicly owned since 1923.<sup>1</sup> Since that time, the franchise has raised capital by selling shares of stock in five different stock offerings,<sup>2</sup> and there are currently over 350,000 individual members of the public who are shareholders of the team.<sup>3</sup> These shareholders are the joint owners of a sports franchise that is currently valued at \$1.38 billion.<sup>4</sup>

The public ownership of the Green Bay Packers is often noted in the media,<sup>5</sup> and it is generally praised for contributing to the team's strong tie to the surrounding community.<sup>6</sup> However, it is highly unlikely that any other National Football League (NFL) team will follow in Green Bay's footsteps. Public ownership of franchises is actually prohibited under the current NFL Constitution and Green Bay's ownership structure persists solely because of a grandfather clause that excludes the Packers from the prohibition.<sup>7</sup> Moreover, the unique

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<sup>1</sup> GIL FRIED, TIMOTHY D. DESCHRIEVER & MICHAEL MONDELLO, *SPORT FINANCE* 181 (Myles Schrag et al. eds., 3d ed. 2013) [hereinafter *SPORT FINANCE*].

<sup>2</sup> The Green Bay Packers have held stock offerings in 1923, 1935, 1950, 1997 and 2011. *Id.* See also GREEN BAY PACKERS INC., *SHAREHOLDER HISTORY & FINANCIAL HISTORY* (2012), available at <http://www.packers.com/assets/docs/2012shareholder-history.pdf>. Shares do not appreciate in value, do not pay dividends and transfer of shares is restricted. Jeff Sharon, *How Crowdfunding Can Save Pro Sports*, JEFF SHARON (July 22, 2014), <http://www.jeffsharon.net/crowdfunding-can-save-pro-sports/>.

<sup>3</sup> *Shareholders*, PACKERS.COM, <http://www.packers.com/community/shareholders.html> (last visited Dec. 2, 2014).

<sup>4</sup> *NFL Team Valuations*, FORBES (Aug. 2014), <http://www.forbes.com/teams/green-bay-packers/>.

<sup>5</sup> See generally Patrick Hruby, *The Right Way? The Green Bay Way*, ESPN (Jan. 31, 2011), <http://sports.espn.go.com/espn/commentary/news/story?page=hruby/110131>.

<sup>6</sup> See generally Daniel J. Alesch, *The Green Bay Packers: America's Only Not-For-Profit, Major League Sports Franchise*, Wis. Pol'y Res. Inst. Inc. (1995), available at <http://www.wpri.org/WPRI-Files/Special-Reports/Reports-Documents/Vol8no9.pdf>.

<sup>7</sup> The NFL Constitution states that "[n]o corporation . . . not operated for a profit . . . not presently a member of the League shall be eligible for membership." CONSTITUTION AND BYLAWS OF THE NATIONAL FOOTBALL LEAGUE art. 3.2(A) (2010) [hereinafter *NFL CONSTITUTION*].

nature of the Packers' public ownership structure extends beyond the boundaries of the NFL. The Green Bay Packers are currently the only wholly, publicly owned franchise among all of the four major sports leagues (football, baseball, basketball, and hockey) in the United States.<sup>8</sup>

There is no reason why publicly owned professional sports teams cannot thrive and succeed at the same level as privately owned teams. While public ownership of professional sports teams is relatively rare in the United States, it is common overseas. Notable examples of publicly owned soccer teams are Real Madrid and F.C. Barcelona, both of which play in Spain's Liga Nacional de Fútbol Profesional, commonly known as "La Liga."<sup>9</sup> These teams are operated as "socios," a form of nonprofit organization where fans of the club pay an annual membership fee for the right to buy season tickets in a special section of the stadium and the right to vote on certain management decisions.<sup>10</sup> Another team that plays in La Liga, Real Oviedo, has maintained consistent and significant numbers of public owners despite the relative disadvantage of being based in the region of Asturias, far from Spain's major population centers.<sup>11</sup>

It is not just that the United States lacks more than one example of a major league team that is wholly owned by the public. It is also uncommon for American major league sports teams to have a minority ownership stake comprised

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<sup>8</sup> In contrast to the major leagues, there are multiple minor league franchises that are owned by the public in some form. See *Community Owned Sports Teams – Examples*, INST. FOR LOCAL SELF-RELIANCE (May 15, 2009), <http://www.ilsr.org/rule/sports/2789-2/>. One commentator described the ownership structure of these teams as follows:

(1) [A] for-profit model which creates the possibility of giving stock ownership to the community while allowing for common stock rights of a for-profit company (e.g., Syracuse Chiefs and Rochester Red Wings); (2) a pro sports team as a centerpiece of a non-profit corporation used to promote the community (e.g., Memphis Redbirds, Wisconsin Timber Rattlers, and Toledo Mud Hens); and (3) a government entity, such as a county or municipality acquires a franchise, technically making local taxpayers the owners (e.g., Harrisburg Senators and Columbus Clippers).

Ronald L. Barabas & Michael K. Wheeler, *Guest Post: Harnessing the Power of Fans in Sports Franchise Ownership through Crowdfunding*, VAND. J. OF ENT. & TECH. L. (Apr. 18, 2014), <http://www.jetlaw.org/2014/04/18/guest-post-harnessing-the-power-of-fans-in-sports-franchise-ownership-through-crowdfunding/>.

<sup>9</sup> See Neil deMause, *Ditch the Owners*, SPORTSONEARTH.COM (Jan. 31, 2014), <http://www.sportsonearth.com/article/67267322/can-fan-owned-teams-and-no-rich-owners-solve-sports-problems#!bEbwCW>. See also Bruce Schoenfeld, *F.C. Barcelona: By the Fans, for the Fans*, SPORTSBUSINESS J. (May 29, 2000), <http://www.sportsbusinessdaily.com/Journal/Issues/2000/05/20000529/No-Topic-Name/FC-Barcelona-By-The-Fans-For-The-Fans.aspx>.

<sup>10</sup> deMause, *supra* note 9.

<sup>11</sup> See Sid Lowe, *Real Oviedo – The Remarkable Story of a Club the World United to Save*, GUARDIAN (Nov. 29 2012, 2:25 PM), <http://www.theguardian.com/football/blog/2012/nov/29/real-oviedo-spain-premier-league>.

of public shareholders. In recent decades, the private owners of several major league franchises have experimented with establishing and maintaining a publicly owned minority stake, seeking to inject additional capital into their teams whilst still maintaining control over the enterprises.<sup>12</sup> However, in each instance the private ownership group used a stock offering to create a minority interest, only to subsequently abandon the structure and negotiate the sale of the entire team to new owners.<sup>13</sup> For example, the Cleveland Indians baseball team held a public offering of shares in 1998 but went wholly private again in 1999.<sup>14</sup> The Boston Celtics basketball team had a longer run with minority public shareholders, holding a public stock offering in 1986, but eventually reverting to wholly private ownership in 2002.<sup>15</sup>

Today, the ownership of major league sports teams in the United States remains almost exclusively the province of large corporations,<sup>16</sup> wealthy individuals, or ownership groups comprised of these same two actors. What explains the failure of more major league teams to pursue and maintain some component of public ownership? Certainly, the increased public scrutiny of team and owner finances that comes with public ownership can act as a deterrent. However, the biggest barrier to public ownership may be the combination of high valuations of professional sports teams, which today can run into the billions of dollars, and the effort and expense necessary to sell large amounts of stock through the public markets. Simply put, buying a majority or minority stake in a major league team requires raising a great deal of money, and the traditional method of selling stock to the general public through a registered public offering adds significant legal, accounting, and underwriting fees on top of the amount to be raised.

Recently, some commentators have pointed to crowdfunding as an innovative capital-raising technique that could be used to create more publicly owned sports teams in the United States.<sup>17</sup> “Crowdfunding” is the term used to refer to

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<sup>12</sup> See Eric Volkman, *For Sports Fans, Investing in Teams Is a Hit or Miss Affair*, DAILYFINANCE (May 20, 2014), <http://www.dailyfinance.com/2014/05/20/investing-sports-teams-publicly-trade-stock/>.

<sup>13</sup> See *id.*

<sup>14</sup> SPORT FINANCE, *supra* note 1, at 182–83.

<sup>15</sup> *Id.* at 183.

<sup>16</sup> In contrast to the public ownership of a sports franchise as “pure play,” there have been several examples of large public corporations owning a sports franchise as part of a diversified portfolio of other assets, i.e., the New York Knicks (Madison Square Garden, Inc.), the Mighty Ducks (Walt Disney Co.) and the Chicago Cubs (Chicago Tribune). *Id.* at 184–85. Owners of stock in the parent company are, in a sense, indirect part owners of the team, but have little control or influence over how the corporation manages its assets.

<sup>17</sup> See generally Tanner Simkins, *How Equity Crowdfunding Could Change How People Invest in*

raising significant amounts of capital by taking advantage of the World-Wide Web; funds are solicited in small amounts from a broad segment of the general public using the vehicle of the internet.<sup>18</sup> Private individuals and entrepreneurs have been turning to crowdfunding in recent years to raise money for a variety of profit-making enterprises, such as the creation of digital music, movies, and small businesses.

In the sports world, crowdfunding has become a popular fundraising vehicle in several contexts. It rapidly has become one of the primary means whereby individual amateur athletes solicit donations to support their training and competition costs. It is also increasingly being used by amateur and professional sports teams to raise money and build community ties. In one instance, crowdfunding was an integral part of a fledgling professional football league's business plan to create eight franchises, each one with a public ownership component.<sup>19</sup> Crowdfunding was even advocated as a way for the general public to remove Donald Sterling as the owner of the Los Angeles Clippers basketball team, by providing the funds necessary for the purchase of the team.<sup>20</sup>

This Article will discuss the future potential and limitations of crowdfunding as a means of financing the public ownership of professional sports teams in the United States. Part II of the Article explains the different models of crowdfunding (pure donation, reward/membership, and equity-owner) and the legal environment that applies to each model, including provisions of the federal securities laws that, until recently, have constrained the use of equity crowdfunding. In Part III, this Article examines the changes enacted by the federal

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*Sports*, MOTLEY FOOL (June 13, 2014), <http://www.fool.com/investing/general/2014/06/13/how-equity-crowdfunding-could-change-how-people-in.aspx>.

<sup>18</sup> C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 1, 5 (2012). See generally David M. Freedman & Matthew R. Nutting, *A Brief History of Crowdfunding: Including, Rewards, Donation, Debt, and Equity Platforms in the USA*, FREEDMAN-CHI., <http://freedman-chicago.com/ec4i/History-of-Crowdfunding.pdf> (last updated Oct. 3, 2014).

<sup>19</sup> Ryan Cane, *Crowdfunded Professional Football League Targets Hartford*, HARTFORD COURANT (Apr. 13, 2012), [http://articles.courant.com/2012-04-13/business/hc-crowdfunded-professional-football-league-targets-hartford-20120416\\_1\\_city-groups-professional-football-league-private-investors](http://articles.courant.com/2012-04-13/business/hc-crowdfunded-professional-football-league-targets-hartford-20120416_1_city-groups-professional-football-league-private-investors). An effort to start a professional A-11 Football League using crowdfunding to sell partial ownership of each franchise to the public began with high hopes and an ESPN contract in 2012 but appears to have fizzled out. *New Spring National A11 Football League Announces Teams, National ESPN Sports Broadcast Agreement*, BUS. WIRE (Feb. 6, 2014), <http://www.businesswire.com/news/home/20140206006349/en/Spring-National-A11-Football-League-Announces-Teams#.VG9tSsmgpVI>. Potential investors were promised perks such as game tickets, locker room tours and the opportunity to help name the team mascot.

<sup>20</sup> Travis Waldron, *Newt Gingrich Calls for Public Ownership of Professional Sports Teams*, THINKPROGRESS (May 2, 2014), <http://thinkprogress.org/sports/2014/05/02/3433616/newt-gingrich-calls-for-public-ownership-of-professional-sports-teams/>; Evan Zepfel, *Why Don't the Sterlings IPO the Clippers?*, SPORTS AGENT BLOG (May 29, 2014), <http://sportsagentblog.com/2014/05/29/why-dont-the-sterlings-ipo-the-clippers/>.

Jumpstart Our Business Startups (JOBS) Act, as well as recent developments in state law. These reforms were intended to lessen the legal constraints on crowdfunding when used to sell ownership shares in a business. Whether or not these legal reforms will prove sufficient to inspire more professional sports teams to sell stock to the public is the subject of Part IV. Finally, Part V of this Article concludes that, while it is unlikely that the Green Bay Packers will be joined by any other major league teams with public shareholders, the adoption of minor amendments to the JOBS Act and to state laws could facilitate the use of crowdfunding in ways that lead to the increased public ownership of sports teams in the minor leagues or in newly created professional sports leagues. In this way, crowdfunding eventually may allow the fantasy of many fans—to be an owner of the team that they root for—to become a reality.

## II. CROWDFUNDING MODELS FOR ATHLETES AND SPORTS TEAMS

Crowdfunding is an umbrella term that includes several different models for raising funds, all of which share one common characteristic. All models of crowdfunding involve making an appeal to the general public for money, typically in small amounts, through the vehicle of a website that facilitates the collection of funds.<sup>21</sup> These websites are called “portals,” and they provide an internet location operated by third parties that allows potential contributors to browse through multiple solicitations posted by a variety of individuals and organizations seeking funds.<sup>22</sup> In addition to providing a clearinghouse for internet solicitations, these portals also facilitate the exchange of funds.<sup>23</sup> The portals transmit money from the contributor to the person or entity making the solicitation and, if the contributor is promised a financial return on their contribution, the portals provide a vehicle for the recipients of funds to make future payments back to their contributors.<sup>24</sup>

One of the most popular crowdfunding portals is Kickstarter, which specializes in raising money for creative projects that fall within thirteen categories related to art, theater, music, and other forms of creative expression.<sup>25</sup> The site

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<sup>21</sup> Bradford, *supra* note 18, at 5.

<sup>22</sup> Peter C. Sumners, *Crowdfunding America's Small Businesses After the JOBS Act of 2012*, 32 REV. BANKING & FIN. L. 38, 40–41 (2012).

<sup>23</sup> See Bradford, *supra* note 18, at 10.

<sup>24</sup> *Id.*

<sup>25</sup> Marissa Lambert, *Kickstarting Litigation: What is the Future of Crowdfunded Films?*, HARV. J. SPORTS & ENT. L. (Mar. 27, 2014), <http://harvardjsel.com/2014/03/kickstartinglitigation/>.

has helped to fund the recent movies *Wish I Was Here*<sup>26</sup> and *Veronica Mars*.<sup>27</sup> But crowdfunding can be used to raise funds for almost any purpose. It has been used to raise money for disaster relief, to support nonprofit organizations, and to fund college tuition for high school graduates. Crowdfunding has also shown promise as a means of providing seed capital for start-up businesses that eventually hope to earn a profit for their owners.

The difference in the types of crowdfunding models used turns on the question of what, if anything, the person who contributes funds receives in exchange for their contribution. There are three basic models of crowdfunding: (1) contributions that are pure donations, (2) contributions made in exchange for some type of reward or membership, and (3) contributions that are investments in an ongoing business enterprise.<sup>28</sup> Because the basic nature of the transaction varies among these three models, each type of transaction is governed by a different and a distinctive set of legal rules. The discussion that follows explains the differences between each model and includes examples of how each crowdfunding model has been used to raise money for individual athletes and sports teams.

#### *A. The Pure Donation Model*

Under the pure donation model of crowdfunding, the persons who contribute money expect and receive nothing in return.<sup>29</sup> The person making the donation is motivated solely by altruism, and from the perspective of the donor, their contribution may seem as if it is the equivalent of a charitable contribution.<sup>30</sup> However, the universe of recipients is not limited to charitable organizations. While the recipient of a crowdfunding donation can be a nonprofit organization that is tax exempt under Section 501(c)(3) of the Internal Revenue Code,<sup>31</sup> it often is not. Instead, the recipient is often a person or an entity engaged in artistic endeavors or simply someone seeking financial support to accomplish a personal life goal. Entrepreneurs can even use the donation model

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<sup>26</sup> Zach Braff, *Wish I Was Here*, KICKSTARTER, <https://www.kickstarter.com/projects/1869987317/wish-i-was-here-1> (last visited Dec. 2, 2014).

<sup>27</sup> Rob Thomas, *The Veronica Mars Movie Project*, KICKSTARTER, [https://www.kickstarter.com/projects/559914737/the-veronica-mars-movie-project?ref=nav\\_search](https://www.kickstarter.com/projects/559914737/the-veronica-mars-movie-project?ref=nav_search) (last visited Dec. 2, 2014).

<sup>28</sup> Bradford, *supra* note 18, at 14–15.

<sup>29</sup> *Id.* at 15.

<sup>30</sup> *See id.*

<sup>31</sup> Under the Internal Revenue Code, an organization is exempt from federal taxation if it is “operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment . . . .)” I.R.C. § 501(c)(3) (2012). Contributions to organizations exempt under Section 501(c)(3) may also be tax deductible. *Id.* § 501(a).

to solicit funds for a for-profit business enterprise, although the persons whom they solicit are not promised any financial return and their contributions do not make them owners or creditors of the business.<sup>32</sup>

This pure donation model of crowdfunding has been used extensively by individual athletes and by amateur athletic teams to solicit contributions to cover the expenses of training, equipment, and travel to competitions. Dozens of Olympic athletes from the United States and Canada successfully used the donation model to raise funds in advance of the Sochi Winter Games (as did the Jamaican Bobsled Team).<sup>33</sup> Some of the best-known crowdfunding portals, such as IndieGoGo or GoFundMe, allow individual athletes to use their site to seek donations. Other general crowdfunding portals, such as Kickstarter, do not permit athletes to solicit funds on their sites. A number of specialized crowdfunding portals for athletes and amateur sports teams have proliferated in recent years, including RallyMe, Pursu.It, DreamFuel, SportFunder, and MakeaChamp.

The legal environment that is applicable to the donation model is fairly straightforward. Private individuals and for-profit businesses that seek donations are not charities, and are therefore, not subject to the legal restrictions placed on charities. In these circumstances, the only legal restraint on the solicitation of donations is the common law of fraud. Any fundraiser seeking money from the public must tell the truth about how the funds being solicited will be used. This simple command—to use the funds for the promised purposes—applies whether it is a commercial venture that solicits contributions from the public or a private individual seeking donations for their personal use.

However, entities that meet the definition of a “charitable organization” may face additional legal constraints when soliciting funds from the public via crowdfunding. For example, organizations may solicit contributions from the general public to support the costs of training amateur athletes for national and international competitions. If such organizations operate exclusively for charitable purposes, the organization soliciting the funds may qualify as a 501(c)(3) organization that is exempt from taxation under the Internal Revenue Code.<sup>34</sup>

Charitable organizations are required to comply with state laws requiring registration with the state when soliciting funds within its borders.<sup>35</sup> Charitable

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<sup>32</sup> See Bradford, *supra* note 18, at 15.

<sup>33</sup> See Tony Zerucha, *Crowdfunding Helps Send 35 U.S. Athletes to Sochi*, BANKLESS TIMES (Feb. 10, 2014), <http://www.banklesstimes.com/2014/02/10/crowdfunding-helps-send-35-u-s-athletes-to-sochi/>.

<sup>34</sup> I.R.C. § 501(j) (2012).

<sup>35</sup> It is not clear under the law whether the passive operation of a website that accepts contributions can be viewed as the solicitation of persons nationwide. Therefore, cautious nonprofits might be advised to register their solicitation with all fifty states and the District of Columbia, or at least to file the



solicitation laws typically require charities to file a form that describes their charitable activities and to pay an annual fee.<sup>36</sup> In addition, the charitable purpose of the solicitation does not relieve the recipient of the legal obligation to be truthful regarding how the funds will be used. The common law of fraud applies to the solicitation of monies for charitable purposes when intentionally misleading statements are made which are designed to deceive the listener.<sup>37</sup>

However, because the pure donation model solicits neither an investment with the promise of future financial returns to the donor, nor the purchase of an ongoing ownership interest, transactions made under the pure donation model do not involve the purchase or sale of a security.<sup>38</sup> As a result, state and federal securities laws do not apply to crowdfunding that takes place under the pure donation model.

### *B. Reward/Membership Model*

A second model of crowdfunding promises a tangible reward to contributors in exchange for their donations, or promises the donor a membership that carries with it certain benefits.<sup>39</sup> The rewards or benefits that the contributor receives can consist of a tangible product with monetary value (such as a t-shirt, CD, or digital download),<sup>40</sup> or alternatively, membership status can provide a non-monetary benefit such as public recognition, the right to vote on certain management policies, or the promise that the contributor will receive behind the scenes access to the venture.<sup>41</sup> However, under the reward/membership model of crowdfunding, the contributors do not receive any profit or other monetary return tied to the financial success of the venture soliciting the funds.<sup>42</sup>

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Uniform Registration Form, which is accepted by thirty-six States and the District. *See generally The Charleston Principles: Final Version*, AFP, <http://www.afpnet.org/ResourceCenter/ArticleDetail.cfm?ItemNumber=3309> (last visited Dec. 2, 2014). The National Association of States Charity Officials has suggested that charities should not be subject to the registration requirements of a state unless it conducts activities sufficient to render itself subject to the personal jurisdiction of that state. *Id.*

<sup>36</sup> *See, e.g., Charitable Registration and Other State Laws That Regulate Fundraising*, NAT'L COUNCIL OF NONPROFITS, <http://www.councilofnonprofits.org/resources/fundraising/charitable-registration> (last visited Dec. 2, 2014); Elizabeth Schmidt, *Fundraising: What Laws Apply?*, GUIDESTAR.ORG (Jul. 2003), <http://www.guidestar.org/rxa/news/articles/2003/fundraising-what-laws-apply.aspx>.

<sup>37</sup> *Illinois ex rel. Madigan v. Telemarketing Assocs., Inc.*, 538 U.S. 600, 624 (2003).

<sup>38</sup> Bradford, *supra* note 18, at 31–32.

<sup>39</sup> *Id.* at 16.

<sup>40</sup> *Id.* at 16–18.

<sup>41</sup> *See id.* at 17.

<sup>42</sup> *Id.* at 16.

Reward models operate much the same as pure donation models in the context of crowdfunding for athletes. Contributors might receive clothing with a logo or name recognition on promotional material tied to the athlete. Or members might be promised one on one access to the athletes. Examples of the membership model in the context of professional sports include a membership group for supporters of professional golfers<sup>43</sup> and the crowdfunding of memberships in support of a professional women's cycling team.<sup>44</sup> Some fans have urged using a membership approach for the San Diego Flash of the National Premier Soccer League.<sup>45</sup>

The legal environment applicable to the reward/membership model of crowdfunding is similar to the pure donation model. If the entity soliciting funds is a charitable organization, it should limit tangible rewards to items with only a nominal value, or else risk losing its 501(c)(3) tax exemption.<sup>46</sup> False statements or material omissions made during the solicitation might lead to liability under common law fraud. One additional legal area that applies to the reward/membership model is that disappointed donors might potentially seek relief under state consumer protection laws if they do not receive the promised reward.<sup>47</sup> However, as is the case with the pure donation model, the reward/membership model does not implicate state or federal securities laws because no investment seeking future returns are made and no ownership stake in the venture is sold.<sup>48</sup>

### *C. Equity-Owner or Lending Model*

#### 1. Crowdfunding the Sale of Stock and Peer-to-Peer Lending

The third model of crowdfunding is very different from a donation. In the

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<sup>43</sup> JD Alois, *Crowdsourced Platform "ALIGN" for Professional Athletes, Fans Launched*, CROWDFUND INSIDER (Aug. 28, 2013), <http://www.crowdfundinsider.com/2013/08/21574-crowdsourced-platform-align-for-professional-athletes-fans-launched/>. See, e.g., <http://www.myteamalign.com/member/>.

<sup>44</sup> Spencer Powlison, *Velocio Sports Announces Crowdfunding Campaign*, VELONEWS (July 31, 2014), [http://velonews.competitor.com/2014/07/news/velocio-sports-announces-crowd-funding-campaign\\_339151](http://velonews.competitor.com/2014/07/news/velocio-sports-announces-crowd-funding-campaign_339151); *Project X*, INDIEGOGO, <https://www.indiegogo.com/projects/project-x--13> (last visited Dec. 2, 2014).

<sup>45</sup> See Scott Lewis, *You Guys Do Wanna Bring Big League Soccer to San Diego*, VOICE OF SAN DIEGO (Mar. 5, 2012), <http://voiceofsandiego.org/2012/03/05/you-guys-do-wanna-bring-big-league-soccer-to-san-diego/>.

<sup>46</sup> Schmidt, *supra* note 36.

<sup>47</sup> See Taylor Soper, *Kickstarter Fraud: Washington Files First Consumer Protection Lawsuit Involving Crowdfunding*, GEEKWIRE (May 1, 2014), <http://www.geekwire.com/2014/attorney-general-asylum-playing-cards-crowdfunded-project/>.

<sup>48</sup> Bradford, *supra* note 18, at 32.

equity-owner or lending model of crowdfunding, the purpose of the monetary contribution is to make an investment in an ongoing business enterprise.<sup>49</sup> While it is true that the investor may have an emotional attachment to the issuer, or an affinity for the issuer's product, the transaction includes the promise of a future financial return to the investor. In this model, an internet portal is used to solicit purchases of stock or, alternatively, loans to the company.<sup>50</sup> The money raised is used as capital to fund the operations of the enterprise. In the case of equity-owner crowdfunding, the end result is that the investor is a shareholder in the company.<sup>51</sup> In the case of a loan, sometimes called "peer-to-peer lending," the contributor is promised the eventual return of their principal (oftentimes, but not always, with interest).<sup>52</sup> What makes equity-owner crowdfunding and peer-to-peer lending different from the old-fashioned equity and debt offerings traditionally made by large business enterprises is (1) the use of an internet portal to advertise the offering and (2) the relatively small size of each individual investment.

It is the potential of the equity-owner model of crowdfunding that has generated excitement among sports fans who dream of owning "a piece of the team." An appeal for pure donations to a sports team might not inspire much response from fans who already "support" their favorite team by purchasing game tickets or apparel with the team logo. The crowdfunding of memberships provides fans with a greater incentive to make a financial contribution to their favorite team because many fans will place a value on benefits such as priority seating, behind-the-scenes access, or even participation in team decision-making. However, for many die-hard fans, the strongest motivating factor that would inspire them to write a check would be the prospect of owning a piece of the team.

For some fans, their emotional attachment to the team will be enough to justify the purchase of shares of stock, without regard to an evaluation of the economics of the transaction. The past experience of sales of stock in the Packers, Indians, and Celtics is sufficient to demonstrate that fans often place little weight on the financial merits of this type of investment. However, the ownership of shares in a professional sports team is not necessarily a bad investment, so long as the shares can appreciate in value and are transferable. The business of sport is a \$550 billion industry on a global basis.<sup>53</sup> Professional sports teams

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<sup>49</sup> See *id.* at 20.

<sup>50</sup> *Id.* at 20, 24.

<sup>51</sup> *Id.* at 24.

<sup>52</sup> *Id.* at 20.

<sup>53</sup> Richard Morgan, *Study Says Investing in Sports Franchises a 'Safe Haven,'* N.Y. POST (June 16, 2014), <http://nypost.com/2014/06/16/study-says-investing-in-sports-franchises-a-safe-haven/>.

have immediate revenue streams such as ticket sales and concessions, and in many cases can earn ancillary revenue from media contracts and sales of apparel. Recently, venture capital groups have begun investing in sports teams.<sup>54</sup> If the investment returns for minor league baseball teams are a guide, then the rising valuations for sports teams can lead to significant profits when the team is sold. One consultant familiar with the sale of minor league baseball teams reported in 2007 that the average unaffiliated minor league baseball team was selling for more than four times its purchase price only five years after purchase.<sup>55</sup>

However, another factor likely to motivate fans to buy a share of their favorite team is that public ownership promotes the stability of the franchise. So long as a team is privately owned, the possibility exists that at some future point the owners will relocate the franchise or sell to new owners who are intent on moving the team.<sup>56</sup> Professional sports teams are relentlessly searching for new revenue streams, constantly under pressure to build new stadiums and arenas with greater amenities, and always subject to possible ownership changes resulting from the financial difficulties or the death of the franchise's current owner. Any one of these factors can lead to a team abandoning its community and relocating to a new metropolitan area. The risk of future team relocation also acts as a deterrent that discourages local governments from using taxpayer dollars to subsidize stadiums and infrastructure improvements that benefit the team.<sup>57</sup>

Many team sports across the country look to the Green Bay Packers as an oasis of stability in an ever-changing sports landscape. If there is one certainty in the business of sports, it is that the small metropolitan area of Green Bay, Wisconsin<sup>58</sup> will never face the prospect of losing its beloved football team. The reason is simple: the public owns the team.

## 2. Legal Environment for Crowdfunding Stock Sales and Loans

The legal environment applicable to the equity-owner or lending crowdfunding transaction differs significantly from the legal environment that applies

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<sup>54</sup> See generally Daniel Kaplan, *Equity Fund Will Shop for Farm Teams*, SPORTS BUS. J. (Nov. 18, 2013), <http://www.sportsbusinessdaily.com/Journal/Issues/2013/11/18/Finance/Manhattan.aspx>.

<sup>55</sup> Jay Busbee, *Sports Team Investing 101*, ESQUIRE (May 10, 2007), <http://www.esquire.com/the-side/opinion/sportsteam051007>.

<sup>56</sup> Brad Smith, Note, *How Different Types of Ownership Structures Could Save Major League Baseball Teams from Contraction*, 2 J. INT'L BUS. & L. 86, 107 (2003).

<sup>57</sup> *Id.*

<sup>58</sup> Green Bay has a population of 104,779 according to the 2013 census. *Green Bay (city), Wisconsin*, U.S. CENSUS BUREAU, <http://quickfacts.census.gov/qfd/states/55/5531000.html> (last updated Jul. 8, 2014).

to the pure donation and membership models. This is because the purchaser is making an investment decision, even though non-financial motivations may play a large role in the decision making process.

The common law of fraud still applies to misrepresentations made in connection with soliciting investment transactions. However, the elements of a common law fraud action can be difficult for a deceived investor to meet. Typically, the plaintiff in a fraud action must prove actual reliance on the misrepresentations or omissions of the seller of securities. Proof of actual reliance would require evidence of specific actions taken or forewent by the plaintiff in reliance on particularly identified misrepresentations or omissions.<sup>59</sup> Plaintiffs often have difficulty providing such detailed proof.

However, the fundamental difference between the equity-owner or lending model of crowdfunding, and the other two models, is that federal and state securities laws apply to these transactions. Any business enterprise that uses the equity or lending model of crowdfunding is most likely engaged in the sale of securities to the general public.<sup>60</sup> A sale of stock through a crowdfunding portal will fall within the statutory definition of a “security,” so long as the shares being sold exhibit most of the characteristics typically associated with traditional stock<sup>61</sup> or, alternatively, so long as the stock purchase can be viewed as the purchase of an investment contract.<sup>62</sup> In most instances a sale of stock will meet both of these tests. On the other hand, using an internet portal to borrow funds from the public will be considered the sale of a security if the transaction satisfies the test for whether an investment is a “note,” as set forth by the United States Supreme Court in *Reves v. Ernst & Young*.<sup>63</sup> By using crowdfunding to sell shares of stock to investors or to borrow money from the public, a business enterprise subjects itself to regulation under both state and federal securities laws.

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<sup>59</sup> Alameda Cnty. Emps. Ret. Ass’n v. BP P.L.C. (*In re BP P.L.C.*), No. 4:12-CV-1256, 2013 U.S. Dist. LEXIS 171459, at \*67 (S.D. Tex. 2013), available at <http://blogs.reuters.com/alison-frankel/files/2013/10/bpshareholders-MTDopinion.pdf>.

<sup>60</sup> See Bradford, *supra* note 18, at 33, 35.

<sup>61</sup> These characteristics are an ability to appreciate in value; the right to receive dividends; the right to vote the shares; and the fact that the shares can be negotiated and pledged. *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 686 (1985).

<sup>62</sup> An investment contract is present when there is an investment of money, in a common enterprise, and where profits are derived predominately from the efforts of persons other than those making the investment. *Sec. and Exch. Comm’n v. W.J. Howey Co.*, 328 U.S. 293, 298–99 (1946).

<sup>63</sup> 494 U.S. 56, 66–67 (1990). In the *Reves* case, the Court stated that notes are presumed to be securities unless they bear a strong “family resemblance” to certain types of notes that are generally recognized not to be securities. *Id.* at 67. Factors to consider when evaluating the note are the motivations of the purchaser, the plan of distribution, the reasonable expectations of the investing public, and whether there exists any alternative scheme of regulation that significantly reduces the risk of the instrument. *Id.* at 66–67.

The application of the securities laws to the transaction has two primary consequences. First, the solicitation of contributions from the public falls within the anti-fraud rules of both federal and state securities law. Material misstatements and omissions in the description of the enterprise's business or made regarding any fact that might materially impact upon an assessment of the risks and returns of the investment can give rise to a claim for fraud or deception in connection with the purchase or sale of a security. The elements of a cause of action for securities fraud differ slightly from the elements of a common law fraud claim.<sup>64</sup>

A more significant consequence of the application of the securities laws to the transaction, however, is the requirement that any offering of securities to the general public must be registered with the Securities and Exchange Commission (SEC) and with the appropriate state regulatory bodies, or else fall within an exemption from registration.<sup>65</sup> Registration entails the preparation and dissemination of disclosure documents containing detailed information about the issuer's business and financial condition. These disclosures must be both accurate and complete, which typically requires substantial due diligence efforts by lawyers and investment bankers, and the financial statements of the issuer must be audited. When registration is required, these disclosure documents must be filed with the SEC and with the state securities regulator in every state where the securities will be offered. The use of the internet to advertise the sale of securities, using the equity crowdfunding model, would likely be construed to constitute a solicitation of the general public in all fifty states.

To the extent that crowdfunding taps into an underutilized source of business capital—small denomination investments from a large numbers of investors—the costs imposed by requiring registration of the offering acts as a significant barrier to raising funds in this manner. The legal and administrative costs associated with conducting a registered offering are high, especially for small businesses that are going through the registration process for the first time.<sup>66</sup> Congress and the SEC are aware of the burdens that registration imposes upon small businesses, and they have created various statutory and administrative exemptions that allow certain types of offerings to take place without the requirement of federal regulation.<sup>67</sup> Therefore, whether or not equity crowdfunding provides a practical method for selling stock to the general public will

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<sup>64</sup> For example, the “fraud on the market” theory, which facilitates proof of reliance in securities fraud class actions under Section 10(b) of the 1934 Securities Exchange Act, relieves plaintiffs of some of the burden that they would face in bringing a state action alleging common law fraud. *See Halliburton Co. v. Erica P. John Fund, Inc.*, 134 S.Ct. 2398 (2014).

<sup>65</sup> Bradford, *supra* note 18, at 42.

<sup>66</sup> *Id.*

<sup>67</sup> In theory, state laws can impose separate registration requirements on issuers selling securities

depend in large part on whether there are available one or more exemptions that allow offers and sales to take place without registration.

Prior to 2012, offerings of securities sold under the equity crowdfunding model were not a good fit with the available exemptions from registration. At that time, the primary exemptions available for issuers seeking to avoid the cost of a registered offering were Regulation D (comprised of Rule 504, Rule 505, or Rule 506), Regulation A, the intrastate offering exemption, and the private placement. However, the manner in which crowdfunding operated to raise funds conflicted with the requirements necessary to satisfy any one of these exemptions. The result was that most equity crowdfunding transactions could not take place without being registered.

For example, to qualify for the intrastate offering exemption,<sup>68</sup> it is necessary to limit all offers and sales of securities to the residents of the same state where the issuer of the securities is a resident and doing business. Broad based appeals via social media or even the issuer's own website are capable of being viewed by internet users worldwide, which is inconsistent with the requirement to limit offers to residents of the same state as the issuer. In addition, limiting the offering to the relatively small universe of same-state purchasers undermines one of the primary strengths of the crowdfunding model, which is to use the national (and international) reach of the internet to raise small amounts of money from as many people as possible at low cost.

Similarly, both Rule 506 and the private placement<sup>69</sup> exemptions can only be used in conjunction with an offering where all of the purchasers qualify as sophisticated investors. For Rule 506, sophistication can be satisfied by meeting the wealth and income standards set forth in the definition of an "accredited investor" under Regulation D,<sup>70</sup> while for a private placement a purchaser's so-

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within their borders, thereby requiring issuers to create and disseminate disclosure documents even if federal law provides an exemption from registration with the SEC. Seeking to maximize the cost savings available to small issuers that qualify for a federal exemption, Congress has pre-empted state securities laws for offerings that involve "covered securities." States may not require issuers selling "covered securities" to disclose or disseminate any information in connection with the offering beyond that which is required by federal law. Stock sold in a Rule 506 offering and under Regulation A are covered securities. Stock sold under Rule 504 and through a private placement are not covered securities and may have to be registered in each state in which they are offered to the public, unless the offering is exempt under provisions of the relevant state law. In 2012, the JOBS Act added securities sold under the crowdfunding exemption of Section 4(a)(6) to the list of covered securities.

<sup>68</sup> Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at Pub. L. No. 112-106 § 3(a)(11) (2012)).

<sup>69</sup> Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at Pub. L. No. 112-106 § 4(a)(2) (2012)).

<sup>70</sup> The definition of an "accredited investor" includes institutional investors and certain officers and employees of the issuer, but most significantly for purposes of crowdfunding, the definition includes

phistication depends upon less clearly defined factors such as the investor's education, investment experience, and familiarity with the issuer.<sup>71</sup> In either case, out of the universe of people with money to invest, relatively few of the individuals who view a crowdfunding appeal made via an internet portal can be expected to meet either one of these sophistication standards.

In addition, prior to 2012, none of the Regulation D exemptions (Rules 504, 505, and 506) permitted the solicitation of the general public through the use of general advertising. Instead, eligibility for the exemption required that offers and sales be limited to investors with whom the issuer had some sort of pre-existing relationship. This ban on the general solicitation of the public still allowed for sales to be made to current employees, existing shareholders, or wealthy investors who had been pre-screened for Regulation D investments by the issuer's investment bankers. However, a crowdfunding appeal made on an internet portal is not typically designed to limit the offer to investors who have a pre-existing relationship with the issuer, thus complicating compliance Regulation D. The ban on general solicitation under Regulation D has been a continuing frustration for small businesses seeking to use the exemption.<sup>72</sup>

Another exemption available prior to 2012 was Regulation A. Offerings could be made under Regulation A without regard to the residence of the offeree, the sophistication of the purchaser, or whether or not the offering was marketed to the general public. However, under the Regulation A exemption, the issuer was required to prepare and file a simplified disclosure document with the SEC and distribute that same information to all offerees. While the preparation of this document was less onerous than the preparation of the more detailed registration statement associated with a registered offering, Regulation A offerings nonetheless required the expenditure of significant legal and administrative costs.<sup>73</sup> In addition, the amount raised under Regulation A offerings was subject to a maximum cap of \$5 million, while offerings made under Rule 506, the intrastate offering exemption, or the private placement exemption could all raise an unlimited amount of funds. This cap on the maximum amount that could be raised under Regulation A, more than anything else, left this exemption unpopular and underutilized.

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any Individual with a net worth of \$1 million (not including the value of their primary residence) or who has a yearly income of at least \$200,000 (\$300,000 for married couples). 17 C.F.R. § 230.501(a)(5)–(6) (2013).

<sup>71</sup> See *Hill York Corp. v. Am. Int'l Franchises, Inc.*, 448 F.2d 680, 688, 690 (5th Cir. 1971).

<sup>72</sup> See Stuart R. Cohn & Gregory C. Yadley, *Capital Offense: The SEC's Continuing Failure to Address Small Business Financing Concerns*, 4 N.Y.U.J.L. & BUS. 1, 10–12 (2007). Rule 505, which is similar to Rule 506, but which permits purchases by a small number of unsophisticated investors, is similarly unavailable if the offering is marketed to the general public. *Id.* at 12–13.

<sup>73</sup> See Bradford, *supra* note 18, at 48.



Still, the fact that offerings under Regulation A were not subject to a ban on general advertising allowed some issuers to experiment with using the internet to attract investors. The Spring Street Brewing Company conducted Regulation A offerings over its company website in 1996.<sup>74</sup> Potential investors viewed the company website and received copies of the disclosure documents via email. For many, the success that the Spring Street Brewing Company had in raising funds in this manner was a tantalizing example of the ability of the internet to transform the public offering process.<sup>75</sup>

However, the use of a company website to conduct a Regulation A offering was one thing. The use of internet portals where potential investors could review and purchase shares in offerings by multiple issuers was another. Prior to 2012, crowdfunding remained problematic under the securities laws for a reason separate and apart from whether the offering fell within the existing exemptions from registration. The internet portals that facilitated crowdfunding offerings were arguably acting as “broker-dealers” in the transaction, which would have required them to register with the SEC as brokers and to subject themselves to oversight by the Financial Industry Regulatory Authority (FINRA).<sup>76</sup> The possibility that internet portals would be subject to the same rules as broker-dealers deterred greater experimentation with crowdfunding as a means of conducting an exempt offering.

### III. THE JOBS ACT AND STATE INTRASTATE CROWDFUNDING LAWS

The passage of the JOBS Act<sup>77</sup> in 2012 was intended to remove these barriers to raising capital via crowdfunding, by liberalizing some of the exemptions from registration to accommodate internet solicitation of small dollar investments. This legislation directed the SEC to create a specific registration exemption for crowdfunding; add an alternative form of the Rule 506 exemption that permits the general solicitation of the public; and create a new form of the Regulation A exemption that raises the maximum amount of capital that can be raised subject to the exemption from \$5 million to \$50 million. The JOBS Act also contained two other important provisions. One prevented some owners of stock sold via crowdfunding from counting against the number of shareholders

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<sup>74</sup> See Stephen K. Gregg, Comment, *Regulation a Initial Public Offerings on the Internet: A New Opportunity for Small Business?*, 1 J. SMALL & EMERGING BUS. L. 417, 420 (1997).

<sup>75</sup> See generally *id.* at 420–21.

<sup>76</sup> A “broker” is defined as “any person engaged in the business of effecting transactions in securities for the account of others.” Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at Pub. L. No. 112-158 § 3(a)(4)(A) (2012)). Professor Steven Bradford analyzed the relevant case law and S.E.C. No-Action letters and concluded that internet portals used in connection with crowdfunding would meet this definition. See Bradford, *supra* note 18, at 51–67.

<sup>77</sup> Jumpstart Our Business Startups Act of 2012, Pub. L. No. 112-106, 126 Stat. 306 (2012).

that trigger the reporting obligations of the Securities Exchange Act. The other exempted internet portals from the registration requirements of “broker-dealers” in some instances.

### *A. New Federal Exemptions from Registration*

#### 1. The Crowdfunding Exemption

The JOBS Act enacted new section 4(a)(6) of the 1933 Securities Act, creating a separate crowdfunding exemption and directing the SEC to promulgate rules for its implementation. In October 2013, the SEC issued proposed rules that are expected to become final by the end of 2014.<sup>78</sup> Under the new crowdfunding exemption, offerings of up to \$1 million every 12 months can be conducted by non-reporting companies without registration and without any limit on the number of purchasers. However, there are limits on the amount that each individual person can invest both in a specific crowdfunding offering and in the aggregate of all crowdfunding purchases over a one year period. In order to qualify for the exemption, the offering must be conducted through either a broker-dealer or an internet portal that is registered with the SEC. General advertising and the solicitation of the general public is permitted, so long as potential investors are directed to go to the broker-dealer or the internet portal for more information and to make purchases. Shares sold under Section 4(a)(6) are covered securities and; therefore, state securities laws that might mandate different or additional disclosure of information are preempted.

Those persons who have an annual income and a net worth that are both less than \$100,000 are limited in the total amount that they may invest under Section 4(a)(6) each year. These persons may invest a total of either \$2,000 or 5% of their annual income or net worth, whichever is greater. Investors who have an annual income or a net worth in excess of \$100,000 are permitted to invest the greater of 10% of their annual income or 10% of their net worth, up to a maximum of \$100,000 each year. These maximum investment amounts in a single crowdfunding offering are also the maximum amount that each investor may purchase in total over a twelve month period through crowdfunding. In all cases, the value of the investor’s primary residence is excluded from the calculations of net worth. The statute requires the intermediary—whether a broker or an internet portal—to take reasonable steps to verify that each investor is within their investment limit.

The owners of shares purchased under the crowdfunding exemption do not

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<sup>78</sup> Press Release, Sec. & Exch. Comm’n, Crowdfunding (Oct. 23, 2013), *available at* <http://sec.gov/rules/proposed/2013/33-9470.pdf>.

count against the shareholder limits that are one determinant of whether an issuer of securities becomes a reporting company under Section 12(g) of the 1934 Securities Exchange Act. Once issuers of securities exceed 2,000 total shareholders or 500 unaccredited shareholders, and the issuer has more than \$10 million in assets, the issuer assumes certain continuous reporting obligations, such as filing quarterly and annual reports with the SEC. These filings require detailed disclosures that are the equivalent of the disclosures required in a registered offering of securities. The benefit of an exemption from registration under Section 4(a)(6) would be very short lived if a successful crowdfunding offering created enough new unaccredited shareholders of the issuer to transform the issuer into a reporting company.

Under the JOBS Act, Internet portals that facilitate an offering made under Section 4(a)(6) are not required to register as broker-dealers. However, to satisfy the exemption, internet portals must register with the SEC as a “funding portal” and they are required to obtain membership in FINRA.<sup>79</sup> While it is beneficial for internet portals to avoid the registration requirements that apply to broker-dealers under the securities laws, it is still unclear what kinds of disclosure and oversight will be imposed on funding portals by the SEC and FINRA. These blanks will be filled in later via SEC rulemaking.

In summary, the new crowdfunding exemption under Section 4(a)(6) allows the use of internet portals to raise a limited amount of money annually from large numbers of investors who need not meet the wealth requirements of accredited investors. In this regard, it is an exemption from registration that permits true crowdfunding. Nonetheless, it is estimated that issuers could still end up paying fees and commissions of 13% or more of the total amount raised on offerings under \$100,000 (although these costs would constitute a smaller percentage on larger offerings).<sup>80</sup>

## 2. Rule 506(c)

Pursuant to the JOBS Act, the SEC has subdivided Rule 506 to create Rule 506(b), which continues the pre-existing Rule 506 exemption, and a new Rule

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<sup>79</sup> *JOBS Act Creates Two New Exemptions From Broker-Dealer Registration*, SHEARMAN & STERLING LLP (Apr. 2012), [http://www.shearman.com/~media/Files/NewsInsights/Publications/2012/04/JOBS-Act-Creates-Two-New-Exemptions-from-BrokerD\\_/Files/View-full-memo-JOBS-Act-Creates-Two-New-Exemptio\\_/FileAttachment/JOBSActCreatesTwoNewExemptionsfromBrokerDealerRe\\_.pdf](http://www.shearman.com/~media/Files/NewsInsights/Publications/2012/04/JOBS-Act-Creates-Two-New-Exemptions-from-BrokerD_/Files/View-full-memo-JOBS-Act-Creates-Two-New-Exemptio_/FileAttachment/JOBSActCreatesTwoNewExemptionsfromBrokerDealerRe_.pdf) [hereinafter SHEARMAN & STERLING LLP].

<sup>80</sup> Sherwood Neiss, *It Might Cost You \$39K to Crowdfund \$100K Under the SEC's New Rules*, VENTUREBEAT (Jan. 2, 2014), <http://venturebeat.com/2014/01/02/it-might-cost-you-39k-to-crowdfund-100k-under-the-secs-new-rules/>.

506(c) exemption.<sup>81</sup> Rule 506(c) provides that the ban on the general solicitation of investors imposed on Regulation D offerings will not apply to a Rule 506 offering where all of the purchasers are accredited investors and where the issuer takes reasonable steps to verify the status of purchasers. This variant on Rule 506 effectively permits the solicitation of the general public via internet portals, email, or other website promotions, and it appears that widespread advertising over television and radio also may be permitted. There is neither a cap on the amount of money that can be invested by each individual, nor on the total amount of money that can be raised in the offering. Unlike the other new exemptions created by the JOBS Act, both reporting and non-reporting companies are eligible to use Rule 506(c). Shares sold under Rule 506(c) are “covered securities;” therefore, state securities laws that might mandate different or additional disclosure of information are preempted.

The only significant limitation on the use of the exemption is that all of the purchasers must meet the definition of an accredited investor and that the issuer must make reasonable attempts to verify their status. The SEC has proposed a non-exclusive list of verification efforts that would be presumed reasonable, including review of the investor’s tax forms or bank statements or the receipt of written confirmation of net worth from the investor’s broker, accountant, or lawyer.<sup>82</sup> Some critics have complained of the intrusive nature of this inquiry and the risk that personal financial information might inadvertently become public.

As is the case under the new crowdfunding exemption, the JOBS Act provides that internet portals that facilitate an offering under Rule 506(c) are not required to register as broker-dealers.<sup>83</sup> However, portals involved in Rule 506(c) offerings are not required to take the additional steps imposed by the JOBS Act on portals conducting offerings under Section 4(a)(6). Portals facilitating a Rule 506(c) offering are not required to register as a funding portal with the SEC or to obtain FINRA membership.<sup>84</sup>

Taking advantage of the new Rule 506(c) exemption, some crowdfunding

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<sup>81</sup> Press Release, Sec. & Exch. Comm’n, Eliminating the Prohibition Against Gen. Solicitation & Gen. Adver. in Rule 506 and Rule 144A Offerings (Jul. 10, 2013), *available at* <http://sec.gov/rules/final/2013/33-9415.pdf>.

<sup>82</sup> *Id.*

<sup>83</sup> Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at Pub. L. No. 112-106 § 4(b) (2012)); *Jumpstart Our Business Startups Act Frequently Asked Questions About the Exemption from Broker-Dealer Registration in Title II of the JOBS Act*, U.S. SEC. & EXCH. COMM’N., <https://www.sec.gov/divisions/marketreg/exemption-broker-dealer-registration-jobs-act-faq.htm> (last updated Feb. 5, 2013) [hereinafter U.S. SEC. & EXCH. COMM’N].

<sup>84</sup> SHEARMAN & STERLING LLP, *supra* note 79.

portals like MicroVentures<sup>85</sup> and CircleUp<sup>86</sup> have designed their websites specifically to target persons who qualify as accredited investors. One crowdfunding portal, Alchemy Global, even specializes in providing a platform for accredited investors to invest in sports teams and the sports entertainment industry.<sup>87</sup> By pre-qualifying potential investors and limiting purchasers to those who qualify as accredited investors, these internet sites allow issuers to sell securities to the public without registering the offering.

In summary, the new Rule 506(c) exemption permits a form of crowdfunding for wealthy investors, but it does not have the benefit of reaching large numbers of small investors. This new exemption is basically a generally advertised private placement. It allows advertising that directs investors to crowdfunding portals, which will verify income levels and limit purchasers to accredited investors. This is a useful development, but it does not expand the pool of potential investors beyond those who could have already purchased through the prior incarnation of Regulation D.

### 3. Regulation A+

The JOBS Act also created a new variant of Regulation A that is available to non-reporting companies.<sup>88</sup> The legislation enacted Tier II of Regulation A (commonly referred to as Regulation A+), which allows issuers to engage in a simplified IPO process with reduced disclosure requirements compared to registered offerings and to raise more funds than had previously been permitted under the exemption (the previously existing exemption is now called a Tier I Regulation A offering). Under Regulation A+, issuers may raise up to \$50 million in the offering and purchasers do not need to be accredited investors. However, purchasers are limited to investing a maximum of 10% of their income or net worth, whichever is greater. The issuer must provide audited financial statements to investors. Shares sold under Regulation A+ are covered securities and, therefore, state securities laws that might mandate different or additional disclosure of information are preempted. In essence, this exemption allows a sort of mini-registration, but the requirement of preparing audited financial statements, disseminating disclosure, and the limit of its use to non-reporting companies, make Regulation A+ paradoxically too expensive for smaller issuers but off

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<sup>85</sup> *Startup Investing for Angel Investors*, MICROVENTURES, <https://microventures.com/investors> (last visited Dec. 2, 2014).

<sup>86</sup> *What is CircleUp?*, CIRCLEUP, <https://circleup.com/getting-started/> (last visited Dec. 2, 2014).

<sup>87</sup> *Why Alchemy Global*, ALCHEMY GLOBAL, <https://www.alchemyglobal.com/pages/why-alchemy-global> (last visited Dec. 2, 2014).

<sup>88</sup> Press Release, Sec. & Exch. Comm'n., Proposed Rule Amendments for Small and Additional Issues Under Section 3(b) of the Sec. Act (Dec. 18, 2013).

limits to larger issuers.

There is no restriction on general advertising under Regulation A+, so issuers may communicate with potential investors via the internet and social media. However, all communications need to be closely controlled to ensure that investors receive the required disclosure documents prior to investing. Directing all investor contact through an internet portal might alleviate some of these practical challenges for the issuer, but the SEC's proposed rules do not contain an exemption from broker-dealer registration requirements for funding portals engaged in a Regulation A+ offering.<sup>89</sup> The lack of such an exemption may discourage the use of internet portals to conduct offerings under Regulation A+. Unless issuers are free to use internet portals to advertise their offerings to potential investors, Regulation A+ is no more than a modification of the simplified, mini-IPO already available under the existing Tier I Regulation A, and not true crowdfunding at all.<sup>90</sup>

Another impediment to the use of Regulation A+ to conduct a crowdfunding offering is that shareholders who purchase in the offering will count against the 500 unaccredited shareholders of record permitted before an issuer assumes the responsibilities of a reporting company under Section 12(g) of the Securities Exchange Act.<sup>91</sup> The JOBS Act provided that purchasers would not count against this limit in offerings conducted under the crowdfunding exemption of Section 4(a)(6). No similar provision applies to offerings under Regulation A+.

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<sup>89</sup> U.S. SEC. & EXCH. COMM'N, *supra* note 83.

<sup>90</sup> Chris Brummer & Daniel Gorfine, *The JOBS Act Isn't All 'Crowdfunding'*, FORBES (Oct. 8, 2013), <http://www.forbes.com/sites/realspin/2013/10/08/the-jobs-act-isnt-all-crowdfunding/>.

<sup>91</sup> Alexander J. Davie, *The JOBS Act, a Year Later – Part 6: Regulation A+*, STRICTLY BUS., (June 9, 2013), <http://www.strictlybusinesslawblog.com/2013/06/09/the-jobs-act-a-year-later-part-6-regulation-a/>.

### B. State Intrastate Crowdfunding Laws

As of this writing, thirteen states have passed roughly similar laws<sup>92</sup> designed to create a state intrastate crowdfunding exemption: Alabama<sup>93</sup>, Colorado<sup>94</sup>, Georgia,<sup>95</sup> Idaho,<sup>96</sup> Indiana,<sup>97</sup> Kansas,<sup>98</sup> Maine,<sup>99</sup> Maryland,<sup>100</sup> Michigan,<sup>101</sup> Tennessee,<sup>102</sup> Texas,<sup>103</sup> Washington<sup>104</sup> and Wisconsin.<sup>105</sup> Other states are likely to follow their lead.<sup>106</sup> The common goal of these state laws is to create a state exemption from registration that applies to offerings conducted over the internet and that also allows the offering to qualify for an exemption from registration under federal law, typically the intrastate offering provision contained in Section 3(a)(11) of the Securities Act.<sup>107</sup> Not all of these state laws

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<sup>92</sup> Andrew Stephenson, *Updated Summaries of Intrastate Crowdfunding Exemptions*, CROWDCHECK (July 14, 2014), <http://www.crowdcheck.com/blog/updated-summaries-intrastate-crowdfunding-exemptions>.

<sup>93</sup> ALA. CODE § 8-6-11 (2002 & Supp. I 2013).

<sup>94</sup> COLO. REV. STAT. ANN. § 11-51-304(6) (West 2014); Russ McKelvey, *Colorado Red Tape Responses to Crowdfunding Exemption*, EYE OF THE CROWD BLOG (MAR. 8, 2014), <http://www.eyeofthecrowd.com/category/crowdfunding-exemptions/>.

<sup>95</sup> GA COMP. R. & REGS. 590-4-2-.08 (2012).

<sup>96</sup> IDAHO CODE ANN. §§ 30-14-203, 30-14-301 (2002); Treasure Valley Angel Fund, LLC, No. 2012-7-02, (Idaho Dep't of Fin. Jan. 20, 2012) (final admin. order), *available at* <http://finance.idaho.gov/securities/Actions/Administrative/2012/2012-7-02.pdf>.

<sup>97</sup> IND. CODE ANN. § 23-19-2-2(27) (LexisNexis 2010 & Supp. I 2014); Ind. Sec. Div., *Crowdfunding- Invest in Indiana*, IN.GOV, <http://www.in.gov/sos/securities/4114.htm> (last visited Dec. 2, 2014).

<sup>98</sup> KAN. ADMIN. REGS. § 81-5-21 (2014)

<sup>99</sup> ME. REV. STAT. tit. 32, § 16304(6-A) (2014).

<sup>100</sup> MD. CODE ANN, CORPS & ASS'NS, §§ 11-101, 601, 606 (2014).

<sup>101</sup> MICH. COMP. LAWS § 451.2102(a) (2014)

<sup>102</sup> TENN. CODE ANN. § 48-1-103(a) (2014).

<sup>103</sup> *See generally* Proposed Rules, CROWDFUNDING LEGAL NEWS (May 9, 2014), <http://crowdfundinglegalnews.files.wordpress.com/2014/05/texas-proposed-crowdfunding-rules.pdf>; Hall T. Martin & Jason Myers, *The Texas Intrastate Crowdfunding Law-- Here Are the Proposed Rules*, TEXAS ENTREPRENEUR NETWORK BLOG (Apr. 24, 2014, 1:24 PM), <http://angelinvestinginaustin.blogspot.com/2014/04/the-texas-intrastate-crowdfunding-law.html>; Teresa McUsic, *Texas Set to Allow Crowdfunding Investments for Small Businesses*, STAR-TELEGRAM (Aug. 12, 2014), <http://www.star-telegram.com/2014/08/08/6030115/texas-set-to-allow-crowdfunding.html?rh=1>; Cynthia Nevels, *Texas Passes New Equity Crowdfunding Rules*, HOUSTON STYLE MAG. (Aug. 22, 2014), <http://stylemagazine.com/news/2014/aug/22/texas-passes-new-equity-crowdfunding-rules/>.

<sup>104</sup> WASH. REV. CODE ANN. § 21.20 (West 2014).

<sup>105</sup> WIS. STAT. §§ 551.102(4m), 551.202(26), 551.205 (2011-12).

<sup>106</sup> Stephenson, *supra* note 92. *See generally* Anthony Zeoli, *State of the States – List of Current Active and Proposed Intrastate Crowdfunding Exemptions*, CROWDFUNDINGLEGALHUB (June 25, 2014), <http://crowdfundinglegalhub.com/2014/06/25/state-of-the-states-list-of-current-active-and-proposed-intrastate-exemptions/>.

<sup>107</sup> Section 3(a)(11) exempts from registration “[a]ny security which is part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a

succeed in this goal, as the following discussion will illustrate.

These state laws share many common characteristics. In most cases, the maximum amount that can be raised under the exemption is \$1 million. The exceptions are Idaho, Indiana, Michigan, and Wisconsin, which permit up to \$2 million to be raised under certain conditions. Under ten of the statutes, the amount that any one individual can invest over a twelve month period is capped at specific amounts that range from \$1,000 to \$10,000 for unaccredited investors. Washington State and Idaho tie the investment limit to the individual's net worth. Colorado's statute is silent as to any individual investment limits. In most cases, accredited investors are not subject to any investment caps. Wisconsin's law is unique in creating an additional category of investors, labeled "certified investors,"<sup>108</sup> who have a lower net worth than accredited investors, yet are not subject to any investment caps.

Under all of the state laws, issuers are required to register with state regulators in advance of beginning any solicitation of the public and to make certain disclosure to investors about the issuer and the offering. Indiana, Michigan, Washington, and Wisconsin require issuers to disseminate ongoing quarterly reports to investors after the offering is complete. Other statutes are silent about any ongoing disclosure obligations.

Under all of the statutes except Maine's, the exemption is only available to issuers who are incorporated and doing business in the state. Similarly, Maine's statute is the only one that does not require purchasers to be state residents. Resales to out-of-state residents are also restricted in most cases, and a requirement to hold the securities for one year after purchase is common. These requirements are intended to make the offering eligible for the federal intrastate offering exemption under Section 3(a)(11).

However, only the Indiana and Wisconsin statutes specify that all purchases in the offering must take place exclusively over an internet portal licensed in the state. Other statutes permit the use of internet portals without mandating it, while still others are silent on whether the use of internet portals is contemplated. Where an internet portal is not made the exclusive means of conducting

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person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory." Securities Act of 1933, ch. 38, 48 Stat. 74 (as amended at P.L. 112-106 § 3(a)(11) (2012)). Of the thirteen state laws, only Maine's is designed to operate in conjunction with a different federal exemption (Rule 504 of Regulation D). ME. REV. STAT. tit. 32, § 16304(6-A); see generally Jenni Bergal, *States Clear Way for Crowdfunding*, PEW CHARITABLE TRUSTS (Aug. 21, 2014), <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2014/08/21/states-clear-way-for-crowdfunding> (discussing the recent spate of state intrastate crowdfunding laws).

<sup>108</sup> Defined as real persons with \$750,000 net worth (*including* the value of their primary residence) or minimum of \$100,000 in income for each of the last 2 years (or \$150,000 combined with spouse). WIS. STAT. § 551.102(4m) (2011–12). These limits are significantly lower than the individual income and net worth limits contained in the federal definition of individual accredited investors.



the offering, the statutes seem to envision the use of social media and other forms of internet communication by the issuer.

Failure to limit the exemption to offerings conducted through the vehicle of an internet portal may cause problems for the issuer under the federal Section 3(a)(11) exemption. While internet portals can take steps to verify that the individuals who peruse their site are state residents who are qualified to purchase under the exemption, broad solicitation of the public via social media and the company website may result in the advertising of the offering to large numbers of persons out of state. The SEC has long taken the position that to qualify for the federal intrastate offering exemption under Section 3(a)(11), an issuer should take steps to ensure that offers are restricted to in-state residents.

In three recent releases, the SEC clarified its view on whether state intrastate crowdfunding laws could be used in conjunction with Section 3(a)(11), so that the offering can take place without registration at either the state or federal level. In the first release, the Division of Corporate Finance reiterated the fact that Section 3(a)(11) and Rule 147 provide an exemption from federal registration in cases where all offers are limited to residents of the same state where the issuer is resident and doing business.<sup>109</sup> In a second release, the Division indicated its view that the use of an internet portal does not necessarily preclude reliance on the federal exemption so long as adequate measures are taken by the portal to prevent any offers to residents outside of the state.<sup>110</sup> However, in a third release, the Division expressed its concern over offerings made over the internet that do not use a portal exclusively, but instead, employ the internet and social media in ways that are accessible to viewers outside of a single state.<sup>111</sup> Taken together, these three releases express the view that the use of a portal will allow offers to be funneled sufficiently to in-state offerees to ensure compliance with the federal exemption, but that a broader use of the internet for solicitations without directing interested investors to a portal interface may not be compliant with the federal exemption. As summarized by one law firm:

The Staff updated previously released C&DI 141.03 to reiterate its position that an issuer may use general solicitation in an intrastate offering, but such solicitation must be made only to persons resident within the state where the issuer is a resident. In new C&DI 141.04, the Staff stated that companies can use a

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<sup>109</sup> *Securities Act Rules: Questions and Answers of General Applicability*, U.S. SEC. & EXCH. COMM'N., <http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm> (last updated Oct. 2, 2014).

<sup>110</sup> *Id.* (answering question 141.04).

<sup>111</sup> *Id.* (answering question 141.05).

third-party Internet portal to promote an intrastate offering as allowed by a state crowdfunding statute if the portal implements specific measures to ensure that offers of securities are made only to persons resident in the relevant state or territory. These measures include the use of disclaimers and legends to notify potential investors of the restrictions and actually limiting access to information about specific investment opportunities to persons who confirm they are residents of the relevant state. But in C&DI 141.05, the Staff took a more narrow position for issuers hoping to avoid the use of an intermediary. The Staff cautioned that whether a communication is an offer depends on the specific facts and circumstances, but due to the “broad, indiscriminate” manner an issuer’s existing website or social media presence are often used, an issuer using these mediums to convey information about specific investment opportunities would likely involve offers to residents outside the particular state in which the issuer does business.<sup>112</sup>

It therefore appears that state laws that fail to include provisions for the use of internet portals might inadvertently encourage issuers to conduct internet offerings that will fail to qualify for the federal intrastate offering exemption.

In addition, none of the state intrastate crowdfunding laws address whether purchasers of shares will become shareholders of record who count against the limit of 500 unaccredited investor shareholders permitted before an issuer becomes a reporting company under Section 12(g) of the Securities Exchange Act. It appears that purchasers of stock under these state laws who are unaccredited investors will count against the 500 limit.<sup>113</sup> This is unsurprising, because the number of shareholders required to make an issuer a reporting company is a question of federal, and not state, law. Therefore, issuers conducting an offering under these state intrastate crowdfunding laws may decide to limit the number of unaccredited purchasers who buy in the offering, not because the state law imposes any such limitation but rather because the issuer does not want to assume the obligations that accompany status as a reporting company.<sup>114</sup>

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<sup>112</sup> Alexander Bowling & Benji Jones, *Recent Developments for Intrastate Crowdfunding and Social Media Use*, SMITH ANDERSON (June 2, 2014), <http://www.smithlaw.com/newsletter-68.html>.

<sup>113</sup> Andrew Stephenson, *Intrastate Crowdfunding Offerings May Not Exceed 500 Investors—Unless You Want to Be an SEC Reporting Company*, CROWDCHECK (Mar. 19, 2014), <http://www.crowdcheck.com/blog/intrastate-crowdfunding-offerings-may-not-exceed-500-investors-%E2%80%94-unless-you-want-be-sec>.

<sup>114</sup> Joe Wallin, *Intrastate Crowdfunding and the 499 Shareholder Problem*, STARTUP L. BLOG (Aug.

*C. The New Legal Landscape for Crowdfunding*

In conclusion, the passage of the JOBS Act has resulted in a scattershot collection of new exemptions. Grouping all of these exemptions from registration under the umbrella term “crowdfunding” suggests a coherence and common philosophy among the exemptions that does not exist. If one common theme does emerge from these disparate exemptions, it is the erosion of the principle that unregistered shares should not be generally advertised and marketed to unsophisticated investors. In particular, state laws creating an intrastate crowdfunding exemption can be viewed as an effort to combine offerings over the internet with the one statutory exemption from registration that has traditionally allowed the sale of unregistered shares to unsophisticated investors—the intrastate offering.<sup>115</sup> The SEC went down this road once before, when the ban on general solicitation was lifted for Rule 504<sup>116</sup> offerings in 1992, and the result was an embarrassing re-instatement of the prohibition on general solicitation in 1999<sup>117</sup> after organized crime became involved in pushing worthless stock to the unsuspecting public.<sup>118</sup>

Will the result be different this time? State intrastate crowdfunding laws can include provisions that limit the risk of harm to investors from fraud. Limits on the amount that individuals can invest annually will help to reduce the risk of harm. In addition, the solicitation of the general public to buy shares in an unregistered offering presents less risk when the purchase is funneled through a licensed intermediary such as an internet portal. The portal acts as a third party that can verify the legitimacy of the issuer and that has every economic incentive to refuse to do business with shadowy entities or “bad actors.” The portal could not collect fees from issuers, or stay in business, if it did not serve as a watchdog over those who use its services.

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16, 2014), <http://www.startuplawblog.com/2014/08/16/intrastate-crowdfunding-and-the-499-shareholder-problem/>.

<sup>115</sup> See Bill Meagher, *States Make Own Crowdfunding Rules, Rather Than Wait for SEC*, DEAL PIPELINE (May 5, 2014), <http://www.thedeal.com/content/regulatory/states-make-own-crowdfunding-rules-rather-than-wait-for-sec.php#ixzz3A1IJ0gQt>.

<sup>116</sup> Rule 504 allows offerings of up to \$1 million each year by non-reporting companies without any income qualifications on the persons who purchase in the offering.

<sup>117</sup> C. Steven Bradford, *Securities Regulation and Small Business: Rule 504 and the Case for an Unconditional Exemption*, 5 J. SMALL & EMERGING BUS. L. 1, 14 (2001).

<sup>118</sup> See generally Richard H. Walker, *Testimony Concerning the Involvement of Organized Crime on Wall Street*, U.S. SEC. & EXCH. COMM’N. (Sept. 13, 2000), <http://www.sec.gov/news/testimony/ts142000.htm>.

#### IV. CROWDFUNDING AND THE PUBLIC OWNERSHIP OF PROFESSIONAL SPORTS TEAMS

Given the current legal environment for equity crowdfunding, is it realistic to expect the number of publicly owned professional sports teams to increase in the future? For teams in the four major leagues, the answer remains “no.” Valuations of major league football, basketball, hockey, and baseball teams run in the hundreds of millions and even in excess of \$1 billion.<sup>119</sup> Crowdfunding has never been envisioned as a vehicle that could be used to raise sums at that level. At these stratospheric valuations, even conducting a stock sale intended to create a minority owned block of shares becomes unlikely using small individual contribution limits. In addition, the private owners who have the resources to buy these teams will be hesitant to share any future appreciation in the value of their investment with the public. The Green Bay Packers seem destined to remain the only publicly owned team in major league sports.

However, for minor league and expansion teams, the outlook is more promising. For example, valuations for minor league baseball teams range from the tens of millions of dollars for AAA teams to less than \$10 million for a Class A team. In 2013, Forbes Magazine ranked the value of minor league AAA baseball teams from a high of \$38 million (the Sacramento River Cats) to a minimum of \$20 million.<sup>120</sup> But valuations are even lower for Class A teams. Baseball legend Cal Ripken, Jr. owns the Class A Aberdeen Ironbirds minor league team, valued by Forbes Magazine at \$15 million.<sup>121</sup> He also sold a Low A minor league franchise for \$7.5 million in December 2012.<sup>122</sup> While the valuations for Class A teams have been on the rise in recent years, they are still at levels where crowdfunding might provide a means for a minority or even majority group of public shareholders to buy a share of the team.

The situation is even more promising for the minor leagues in sports other than baseball, and for expansion teams. For example, a new minor league hockey franchise in the Central Hockey League costs a minimum of

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<sup>119</sup> See Bill Shea, *Detroit Native Ballmer's Expected \$2B Purchase of the Clippers May Lift Value for Other Pro Teams*, CRAIN'S DETROIT BUS. (May 30, 2014), <http://www.crainsdetroit.com/article/20140530/NEWS/140539982/detroit-native-ballmers-expected-2b-purchase-of-clippers-may-lift>. See generally W.R. HAMBRECHT & CO., THE U.S. PROFESSIONAL SPORTS MARKET & FRANCHISE VALUE REPORT (2012), available at [http://www.wrhambrecht.com/wp-content/uploads/2013/09/SportsMarketReport\\_2012.pdf](http://www.wrhambrecht.com/wp-content/uploads/2013/09/SportsMarketReport_2012.pdf).

<sup>120</sup> Chris Smith, *Minor League Baseball's Most Valuable Teams*, FORBES (July 17, 2013), <http://www.forbes.com/sites/chris-smith/2013/07/17/minor-league-baseballs-most-valuable-teams/>.

<sup>121</sup> Christina Settimi, *Cal Ripken's \$30 Million Baseball Brand*, FORBES (July 16, 2013), <http://www.forbes.com/sites/christinasettimi/2013/07/16/cal-ripkens-30-million-baseball-brand/2/>.

<sup>122</sup> *Id.*

\$500,000.<sup>123</sup> This is well within the range of amounts successfully raised on crowdfunding portals. Valuations are especially affordable for less well known professional sports leagues and for franchises in newly created leagues. The National Lacrosse League (NLL) is a professional indoor lacrosse league with nine teams, some of which draw in excess of 10,000 fans per game.<sup>124</sup> The asking price for an expansion franchise in the NLL is \$3 million.<sup>125</sup> And even though the A-11 Football League still exists only as a business plan, and may never play a game, the promoters of the league are asking for a \$5 million franchise fee to buy a team in the fledgling professional football league.<sup>126</sup>

At valuation levels below \$5 million, the strengths of crowdfunding as a means of raising capital seem particularly well-suited to professional sports teams. Sports teams are one of the primary beneficiaries of the way that the internet increases inter-connectivity between fans and content providers. More so than music fans or movie lovers, sports fans develop a passion for a team that is strong and often passed down through generations. If musicians and movie producers can successfully tap into fan loyalty via crowdfunding, sports teams can do so to an even greater extent.<sup>127</sup>

The federal exemptions from registration created by the JOBS Act improve the prospects for public ownership of sports teams via crowdfunding. The Rule 506(c) exemption will facilitate the use of internet portals to conduct exempt offerings, albeit only so long as all of the purchasers satisfy the definition of an accredited investor. Unfortunately, using crowdfunding in this way to sell shares to the public limits individual investors to the affluent. In contrast, the federal Section 4(a)(6) crowdfunding exemption allows widespread investor participation among all income groups, thus, promoting the democratization of investment opportunities in a way that seems desirable for a community-based sports team.

One potential limitation on the practical utility of the Section 4(a)(6) exemption is the annual cap on the amount raised under the Section 4(a)(6) ex-

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<sup>123</sup> Mike Sunnucks, *What Can \$500,000 Buy You? How About a Minor League Hockey Franchise*, PH. BUS. J., <http://www.bizjournals.com/phoenix/news/2014/07/24/what-can-500-000-buy-you-how-about-a-minor-league.html?page=all> (last updated July 25, 2014).

<sup>124</sup> See *2013 NLL Regular Season Attendance Numbers, Colora*, INSIDE LACROSSE, <http://www.insidelacrosse.com/wire.php?id=8185> (last visited Dec. 2, 2014).

<sup>125</sup> *\$3 Million for NLL Expansion Franchise*, INSIDE LACROSSE, <http://www.insidelacrosse.com/wire.php?id=7777> (last visited Nov. 20, 2014).

<sup>126</sup> Peter J. Jessen, *Purchasing a Franchise in a New, NFL-Quality Football League in 2014 for 2015*, BEACON ON THE HILL SPORTS MKTG., [http://www.beacononthehillssportsmarketing.com/pages/leaguesfranchises\\_purchasingfranchise.htm](http://www.beacononthehillssportsmarketing.com/pages/leaguesfranchises_purchasingfranchise.htm) (last updated Feb. 25, 2014).

<sup>127</sup> See Titilayo Tinubu, *Fan Finance: Alternatives to Securities Restrictions on Social Media-Based Fundraising*, 30 ENT. & SPORTS L. 3, 3-4 (2013).

emption. A majority stake or a wholly public team might be achievable in instances where the valuation of the team is in the \$1 million to \$2 million range, which is an amount that could be raised over a two year period under the exemption. However, the prospect of public ownership rises substantially if, as some have advocated, the maximum amount that can be raised annually under Section 4(a)(6) is raised to \$5 million.<sup>128</sup>

The rapid proliferation of state intrastate crowdfunding laws may be the most promising step towards facilitating the possible public ownership of sports teams. Unlike the federal Section 4(a)(6) exemption, in which an offering is open to investors nationwide, these state laws require that all of the investors who purchase in the offering must be residents of the same state where the team is incorporated and resident. This geographic limitation on the investor universe is not a significant disadvantage in selling ownership interests in a sports team. In most instances the state where investors are permitted to purchase shares will correspond with the state that has the majority of the team's fan base.

However, to utilize the full potential of state intrastate crowdfunding laws and to increase the likelihood that sports teams could successfully sell ownership stakes to the general public under the law, four changes to the current mix of federal and state exemptions would be advisable.

First, state legislatures should consider amending their state intrastate crowdfunding statutes to increase the amount that can be raised under the exemption to a maximum of \$5 million for issuers that make audited financial statements available to investors. Many professional sports teams trade at values that are just out of reach of the current \$1 million and \$2 million maximums permitted under state statutes. Raising the maximum limit under the statutes would not risk losing the federal exemption that corresponds to the state exemption. Twelve of the thirteen state intrastate crowdfunding laws rely upon Section 3(a)(11) of the Securities Act to exempt the securities at the federal level, which does not cap the amount that can be raised under its provisions.<sup>129</sup>

Second, state intrastate crowdfunding laws that do not already require the use of an internet portal or broker-dealer as an intermediary in the solicitation of the public should be amended to add this requirement. Requiring the use of

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<sup>128</sup> John R. Hemphill & Lauren Lewis, *Crowdfunding 2.0: Proposed Equity Crowdfunding Improvement Act of 2014*, NAT'L L. REV. (June 25, 2014), <http://www.natlawreview.com/article/crowdfunding-20-proposed-equity-crowdfunding-improvement-act-2014>; Alexander J. Davie, *Is It Time for the JOBS Act, Part Two?*, STRICTLY BUS. (June 30, 2014), <http://www.strictlybusinesslawblog.com/2014/06/30/time-jobs-act-part-two/>.

<sup>129</sup> The only exception is the Maine statute, which is tied to Rule 504 under Regulation D. For this reason, the maximum amount that can be raised under the Maine intrastate crowdfunding law cannot be raised above \$1 million without losing the federal exemption of Rule 504 (which permits offerings up to a maximum of \$1 million).

an intermediary for internet-based offerings would increase the likelihood that the SEC will recognize the applicability of the Section 3(a)(11) exemption to the transaction. Even if these state laws exempt issuers from state registration requirements, the offering must still be conducted in a manner designed to qualify for a federal exemption from registration. The SEC has signaled that it will consider offerings conducted via social media or via an issuer's company website to be solicitations of the public that cross state boundaries in a way that is not permitted under Section 3(a)(11). However, it appears that solicitations conducted solely through an internet portal that takes steps to verify the residence of persons visiting the site will be considered by the Commission as offers conducted in-state. The use of such an internet portal should be required as a condition of qualifying for the exemption created by state law.

Third, internet portals should receive an across-the-board exemption from the requirement to register as a broker-dealer. The JOBS Act created two exemptions from broker-dealer registration requirements for internet portals that facilitate crowdfunding offerings.<sup>130</sup> One is an exemption for intermediaries in a Rule 506 offering. The second is an exemption for funding portals in connection with an offering under Section 4(a)(6). Internet portals that participate in Regulation A+ offerings and in offerings under state intrastate crowdfunding laws are not relieved of the obligation to register as broker-dealers.<sup>131</sup> There is no reason to subject internet portals to treatment as a broker-dealer under the securities laws on a selective basis. The result would be to discourage crowdfunding under those exemptions where internet portals receive less favorable treatment. In particular, Congress or the SEC could encourage the use of state intrastate crowdfunding laws by extending the exemption from federal broker-dealer registration to internet portals that facilitate offerings under these state laws.

Finally, Congress or the SEC should move at the federal level to prevent the owners of securities sold via an intrastate crowdfunding exemption from being counted against the 500 unaccredited shareholders permitted before the issuer becomes a reporting company under Section 12(g) of the 1934 Securities Exchange Act. The SEC's proposed rules for the Section 4(a)(6) exemption provide that shareholders who purchase in an offering under the federal crowdfunding exemption do not count against the number of official shareholders of record. A similar provision should be created which prevents shareholders who purchase in a state intrastate crowdfunding offering from being counted as

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<sup>130</sup> SHEARMAN & STERLING LLP, *supra* note 79.

<sup>131</sup> See Bradford, *supra* note 18, at 53 (noting "strong possibility" that websites serving as crowdfunding portals would be subject to the broker-dealer registration requirements of the securities laws in the absence of the JOBS Act exemption).

shareholders of record for this same purpose.<sup>132</sup>

## V. CONCLUSION

Although a relatively recent phenomenon, crowdfunding has already proved itself to be a useful fundraising tool to raise donations and membership fees in support of athletes and sports teams. This article has examined the legal issues surrounding crowdfunding's potential use in pursuit of a more ambitious goal: sales to the public of ownership shares in a professional sports team. In many respects, the strengths of crowdfunding as a fundraising tool are especially well adapted to the situation where sports teams sell shares of stock to the public. Recent legislative action intended to harness the potential of crowdfunding, and to exempt crowdfunding from the registration requirements of state and federal securities laws, has increased the possibility that more professional sports teams will pursue public ownership in the future, especially in the minor leagues and in newly formed sports leagues. However, additional reform to the existing federal and state laws regulating crowdfunding would substantially increase the attractiveness of crowdfunding as a means of creating publicly owned sports teams.

It is likely that the majority of professional sports teams in the United States will continue to be owned by corporations and wealthy private investors. The emergence of crowdfunding as a fundraising vehicle will not change this situation any time soon. However, the passage of the JOBS Act and the proliferation of intrastate crowdfunding laws at the state level eventually may force privately owned teams to share the field with more publicly owned sports teams. Such a result would be a victory for sports fans everywhere.

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<sup>132</sup> Wallin, *supra* note 114.