


To Fund or Not to Fund: Deficiencies in the Wisconsin Crowdfunding Act that Hamper the Viability of Intrastate Crowdfunding

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TO FUND OR NOT TO FUND: DEFICIENCIES IN THE WISCONSIN CROWDFUNDING ACT THAT HAMPER THE VIABILITY OF INTRASTATE CROWDFUNDING

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I. INTRODUCTION

“Crowdfunding,” which is defined as “the practice of . . . solicit-

ing [financial] contributions from a large number of people especially from the online community,"¹ has recently taken the financial world by storm through the advent of websites like "Kickstarter," "Fundable," "IndieGogo," "Razoo," and "Appbackr."² Such websites provide a marketplace whereby companies, small businesses, and entrepreneurs looking for startup capital can solicit funding from individual investors.³ The concept is relatively straightforward: project creators initiate a profile that includes informative bits like short videos, a brief synopsis of the project, and images to further showcase the project.⁴ Each project has a target amount of funding to be raised, and is active for a fixed time period, which is commonly displayed as a countdown with an ongoing tally of funds raised.⁵ Ultimately, the goal of crowdfunding is to create a highly specific and unique group of like-minded individuals from the general public, and in turn utilize that community to generate necessary capital to implement a project or even create a business.⁶

The rise of crowdfunding in recent years⁷ has drawn attention from the Securities and Exchange Commission ("SEC").⁸ On April 5, 2012, President Barack Obama signed the JOBS Act into law, hailing it as a "potential game changer" for small businesses and startups.⁹ The JOBS Act added section 4(a)(6) to the Securities Act of 1933, and in doing so provided securities regulation exemptions for crowdfunding sites meeting a number of basic criteria.¹⁰ Since its passing, the JOBS Act has come under significant scrutiny for failing to provide adequate

1. *Crowdfunding*, MERRIAM-WEBSTER'S DICTIONARY, <http://www.merriam-webster.com/dictionary/crowdfunding> [<https://perma.cc/GTB4-K75C>] (last visited Apr. 24, 2017).

2. DEBORAH GONZALEZ, *MANAGING ONLINE RISK: APPS, MOBILE, AND SOCIAL MEDIA SECURITY* 200 (2015).

3. See Tanya Prive, *What Is Crowdfunding and How Does It Benefit The Economy*, FORBES (Nov. 27, 2012), <http://www.forbes.com/sites/tanyaprive/2012/11/27/what-is-crowdfunding-and-how-does-it-benefit-the-economy/>.

4. *Id.*

5. *Id.*

6. *Id.*

7. See discussion *infra* Part II.

8. See discussion *infra* Part III.C.

9. *Remarks by the President at JOBS Act Bill Signing*, THE WHITE HOUSE OFFICE OF THE PRESS SECRETARY (Apr. 5, 2012), <http://www.whitehouse.gov/the-press-office/2012/04/05/remarks-president-jobs-act-bill-signing> [<https://perma.cc/6SP4-LNLX>].

10. 15 U.S.C. § 77d(a)(6) (2012 & Supp. 2015); GONZALEZ, *supra* note 2, at 201.

clarification on important considerations,¹¹ providing overly burdensome requirements and limits on crowdfunding sites,¹² and a number of other issues.¹³ Scrutiny of the JOBS Act has become so pronounced that some Republican lawmakers have led a movement for sweeping changes to the Act, known as the “JOBS Act 2.0.”¹⁴ As a result of the issues with the JOBS Act, coupled with a need to provide regulations on intrastate transactions that do not fall within the jurisdiction of federal securities regulation, individual states have begun implementing their own securities regulation exemptions for crowdfunding sites.¹⁵

Wisconsin became one of the first states to institute its own intrastate crowdfunding exemption statute,¹⁶ which passed into law as part of 2013 Wisconsin Act 52 and became effective on June 1, 2014.¹⁷ The Wisconsin crowdfunding exemption statute shares many common elements with the federal crowdfunding exemption,¹⁸ and runs somewhat parallel with similar exemption statutes in other states.¹⁹ How-

11. GONZALEZ, *supra* note 2, at 202.

12. See Ruth Simon & Angus Loten, *Frustration Rises Over Crowdfunding Rules*, WALL ST. J., Apr. 30, 2014, <http://online.wsj.com/articles/SB10001424052702304163604579532251627028512> [<https://perma.cc/TFW4-VYQL>].

13. See, e.g., Jason W. Parson, *Crowdfunding: The Real and the Illusory Exemption*, 4 HARV. BUS. L. REV. 281, 283 (2014); Tom Wentzell, Comment, *The JOBS Act: Effects on Capital Market Competition in Both Public and Private Markets*, 10 U. ST. THOMAS L.J. 892, 892 (2013); James J. Williamson, Comment, *The JOBS Act and Middle-Income Investors: Why It Doesn't Go Far Enough*, 122 YALE L.J. 2069, 2069 (2013).

14. Joseph Lawler, *House Republicans Aim for JOBS Act 2.0*, WASH. EXAM'R, Apr. 9, 2014, <http://www.washingtonexaminer.com/house-republicans-aim-for-jobs-act-2.0/article/2547013> [<https://perma.cc/4CMX-RC24>].

15. GONZALEZ, *supra* note 2, at 202.

16. See *Crowdfunding in Wisconsin*, WIS. DEP'T OF FIN. INSTS, <http://www.wdfi.org/fi/securities/crowdfunding/> [<https://perma.cc/A35E-U6TB>] (last visited Apr. 24, 2017).

17. *Id.* For further discussion on Wisconsin's crowdfunding exemption statute, see *infra* Part IV.

18. Compare WIS. STAT. § 551.202(26)-(27) (2015-2016), and WIS. STAT. § 551.205 (2015-2016), with 15 U.S.C. § 77d(a)(6) (2012).

19. Wisconsin imposes similar caps on amounts received to Idaho, Indiana, and Michigan. Compare WIS. STAT. § 551.202(26)-(27), and WIS. STAT. § 551.205, with IND. CODE § 23-19-2-2(27) (2015), and IDAHO CODE § 30-14-203 (2004), and *In Re Treasure Valley Angel Fund, LLC* (fka Meridian Angel Fund, LLC) Request for an Order Pursuant to Idaho Code § 30-14-203, BLUE SKY L. REP. 21729, 2014 WL 4063439 (2015), and MICH. COMP. LAWS. § 451.2202a(c)(i), (ii) (2013). Each state requires some level of registration with state regulatory bodies and notice and disclosure requirements, though the levels to which each are required differ. See Edward A. Fallone, *Crowdfunding and Sport: How Soon Until the Fans Own the Franchise?*, 25 MARQ. SPORTS L. REV. 7, 28-29 (2014).

ever, like corresponding exemptions provided by federal law and many state “blue sky” laws,²⁰ Wisconsin’s crowdfunding exemption falls short in key areas, including the definitions of certain classes of investors, investment receipt caps placed on individual crowdfunding projects, and contribution limitations placed on classes of individual investors. Such issues severely hamper the efficacy of the Wisconsin’s crowdfunding exemption provisions and potentially denigrate any long-term viability of crowdfunding as a primary method of capital generation for small businesses and startups.

This Article will explore these practical concerns and place them in the context of other intrastate crowdfunding exemptions. Part II will provide a brief history of crowdfunding and highlight its rise to prominence in recent years. Part III will further explain crowdfunding as a capital-generation medium. Part IV will briefly examine the general regulatory environment for crowdfunding, including an overview of both federal and state law. Part V will explore key issues with Wisconsin’s crowdfunding exemption laws and propose a modified framework of Wisconsin’s crowdfunding exemption with an eye towards the future of crowdfunding as a means of generating capital.

II. A BRIEF HISTORY OF CROWDFUNDING

The concept of crowdfunding is hardly a novel one. In 1713, Alexander Pope set out on a substantial project: translate the entirety of Homer’s *Iliad* from Greek to English.²¹ The project involved six volumes, more than 15,000 lines, and took five years to complete, but Pope was ultimately able to accomplish his goal.²² How? Pope crowd-funded the project.²³ To secure necessary funding, Pope offered name acknowledgement in the published work in exchange for a pledge of two gold guineas, resulting in 750 subscribers and enough money to print his translation.²⁴

Other major historical figures have similarly relied on crowdfunding.²⁵ World-renowned composer Wolfgang Amadeus Mozart once

20. Jonathan R. Macey & Geoffrey P. Miller, *Origin of the Blue Sky Laws*, 70 TEX. L. REV. 347, 348 (1991).

21. Justin Kazmark, *Kickstarter Before Kickstarter*, THE KICKSTARTER BLOG (July 18, 2013), <https://www.kickstarter.com/blog/kickstarter-before-kickstarter> [<https://perma.cc/3BW6-M6CK>].

22. *Id.*; see generally HOMER, THE ILIAD (Alexander Pope trans., 1715).

23. GONZALEZ, *supra* note 2, at 199.

24. *Id.*

25. *Id.* at 199–200.

relied on crowdfunding in hopes of generating enough capital to perform publicly.²⁶ In 1783, Mozart offered copies of the manuscript for three piano concertos he composed so that he could raise the necessary financial support to play them in Vienna.²⁷ He did not succeed initially, but he tried again in 1784, received 176 pledges, and ultimately raised the funding to play the concertos.²⁸ One-hundred-and-one years later, *The New York World* publisher Joseph Pulitzer raised over \$100,000 in donations from readers to provide a pedestal to display the Statue of Liberty after the American Committee for the Statue of Liberty ran out of funding.²⁹ In exchange for one dollar of financial support, Pulitzer promised each donor a reward in the form of a six-inch statuette of Lady Liberty.³⁰

The modern movement in funding known as “crowdfunding” dates back as early as 1997, when British rock band Marillion raised \$60,000 to fund its reunion tour by soliciting online fan donations.³¹ Four years later, “ArtistShare” became the first official hub for online crowdfunding.³² The website still exists to this day and seeks to “connect artists with fans in order to share the . . . creative process and [fund] the creation of new artistic works.”³³ There was little further movement on the crowdfunding front until 2008, when IndieGogo launched, followed by Kickstarter in 2009.³⁴ More crowdfunding sites have jumped on the bandwagon in recent years, offering different types of services towards different target markets.³⁵ Since 2009, the crowdfunding industry as a whole has grown by one thousand percent and is now a multi-billion dollar industry with future growth likely on

26. *Id.* at 199.

27. *Id.*

28. *Id.*

29. *Id.* at 200.

30. Kazmark, *supra* note 21.

31. See *id.*; Mark Feinberg, *Why Donation-based Crowdfunding is Here to Stay (and Growing)*, THE CORP. SOC. RESP. NEWSWIRE (Oct. 8, 2013), <http://www.csrwire.com/blog/posts/1050-why-donation-based-crowdfunding-is-here-to-stay-and-growing> [https://perma.cc/9ZFY-9LB2].

32. GONZALEZ, *supra* note 2, at 200; Feinberg, *supra* note 31.

33. *What is ArtistShare?*, ARTISTSHARE, <http://www.artistshare.com/v4/> [https://perma.cc/7V8U-CHAS] (last visited Apr. 24, 2017).

34. GONZALEZ, *supra* note 2, at 200.

35. See Sandeep Sood: *The Rise of Crowdfunding*, WALL ST. J.: THE ACCELERATORS, Sept. 30, 2014, <http://blogs.wsj.com/accelerators/2014/09/30/sandeep-sood-the-rise-of-crowdfunding/> [https://perma.cc/4SBR-6LZE].

the horizon.³⁶ The takeaway is this: crowdfunding is not a new or novel concept, but its recent explosion cannot be ignored, nor passed off as a mere fad that will be completely extinguished in the near future.

III. CROWDFUNDING EXPLAINED

As discussed previously, crowdfunding in its most basic conceptual form is the soliciting of funding from individual donors, generally utilizing the Internet as the means of transaction.³⁷ However, the mechanics of crowdfunding are more nuanced, as crowdfunding exists in multiple forms that function in different ways, in turn creating different relationships between businesses and financial contributors.³⁸ In all, there are three distinct types of crowdfunding: (1) donation crowdfunding; (2) reward and pre-purchase crowdfunding; and (3) debt or equity crowdfunding.³⁹

A. Donation Crowdfunding

Donation crowdfunding sites, as the name suggests, offer nothing to the donor in return for financial contributions besides a warm, fuzzy feeling or, in some cases, a tax write-off.⁴⁰ One such example is “GoFundMe,” a crowdfunding site that allows individuals to seek funding for various causes under a plethora of categories, including “Medical,” “Volunteer,” “Emergencies,” “Education,” and “Memorials.”⁴¹ While donation crowdfunding sites are the simplest in nature, they are not particularly useful for entrepreneurial efforts.⁴² Not many purely donation-based crowdfunding sites exist, and though donations may fund for-profit projects, most donation crowdfunders focus on funding requests from non-profit organizations, social causes, and political

36. *Id.*

37. *See supra* note 1 and accompanying text.

38. *See C. Steven Bradford, Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 14–27 (2012).

39. *Id.* at 14–15. Bradford splits “reward” and “pre-purchase” crowdfunding into two separate categories initially, but then combines them into one. *Id.* at 16.

40. *Id.* at 15; Sally Outlaw, *Which Type of Crowdfunding is Best for You?*, ENTREPRENEUR (Oct. 3, 2013), <http://www.entrepreneur.com/article/228524> [<https://perma.cc/D34Q-7D4R>].

41. GOFUNDME, <http://www.gofundme.com/> [<https://perma.cc/A5XX-9WKQ>] (last visited Apr. 24, 2017).

42. *See* Outlaw, *supra* note 40.

campaigns.⁴³

B. Reward and Pre-Purchase Crowdfunding

Reward and pre-purchase crowdfunding are very similar in nature, and usually appear concurrently on crowdfunding sites.⁴⁴ Under the reward model (which was classically exhibited by Pulitzer),⁴⁵ a business or startup soliciting funds offers contributors something in return for a financial contribution.⁴⁶ Similarly, the pre-purchase approach allows financial contributors to purchase the product in advance of the general public, sometimes at a discounted rate.⁴⁷ Usually, the reward model will consist of at least three levels of contributions, with higher financial input resulting in greater rewards.⁴⁸ Kickstarter and Indiegogo are two prime examples of rewards-based crowdfunding sites.⁴⁹

C. Securities-Based Crowdfunding: Debt and Equity

The third major form of crowdfunding differs distinctly from donation or reward/pre-purchase crowdfunding, and creates the need for both federal and state governments to step in and impose securities regulations.⁵⁰ In essence, equity and debt-based crowdfunding act as if a company were offering stocks or bonds to potential investors on an open market in connection with an ongoing business enterprise.⁵¹ In general, such offerings are squarely within the definition of a “security” under section 2(a)(1) of the Securities Act of 1933, which includes in its definition of security any “note” or “stock.”⁵² As a result, federal

43. Bradford, *supra* note 38, at 15.

44. *Id.* at 16.

45. See discussion *supra* notes 29–30 and accompanying text.

46. Bradford, *supra* note 38, at 16.

47. *Id.*

48. *Types of Crowdfunding*, FUNDABLE,

<http://www.fundable.com/crowdfunding101/types-of-crowdfunding>

[<https://perma.cc/49PF-NBBN>] (last visited Apr. 24, 2017).

49. See generally KICKSTARTER, <https://www.kickstarter.com/> [<https://perma.cc/L7LU-DQKN>] (last visited Apr. 24, 2017); INDIEGOGO, <https://www.indiegogo.com/> [<https://perma.cc/FS8U-33MA>] (last visited Apr. 24, 2017).

50. Fallone, *supra* note 19, at 18.

51. See Bradford, *supra* note 38, at 24.

52. Fallone, *supra* note 19, at 18; see also 15 U.S.C. § 77b(a)(1) (2012). Two different cases lay out the Supreme Court’s tests for what qualifies as a “stock” and what qualifies as a “note” within the meaning of section 2(a)(1). In *Landreth Timber Co. v. Landreth*, 471 U.S. 681 (1985), the Supreme Court defined what a “common stock” is, relying on the prominent characteristics security instruments commonly classified as “common stocks” all possess. The Court focused on five main traits: (1) the right of shareholders to receive dividends; (2)

securities regulation is required for interstate transactions, and state securities regulation is required for intrastate transactions.⁵³ Though security-based crowdfunding offerings seem inexorably similar to general offers and sales of securities via traditional mediums, they differ significantly enough to be addressed distinctly due to three main characteristics: (1) crowdfunding offers and sales generally rely on the use of Internet portals to promote the offers and effectuate the transactions; (2) crowdfunding offers are generally made by small, relatively unsophisticated issuers in small monetary volumes; and (3) the level of connection that an investor may have to the issuer, based on familial relationships, friendships, or other interpersonal means, may be increased when compared with securities transactions performed on a larger scale and in a more open and public context.⁵⁴

1. Debt-Based Crowdfunding

In lending, or debt crowdfunding, individual crowdfunders lend money to businesses and startups via an Internet portal set up for crowdfunding activity.⁵⁵ The business or startup then repays the amount over time, either with interest or merely a return of the principal.⁵⁶ Lending crowdfunding usually targets a different kind of consumer than donation or reward crowdfunding platforms.⁵⁷ Crowdfunding Internet portals that are looking for businesses to use their service to engage in debt-based offerings often target “restaurants, retailers, salons, gyms . . . that already have customers, already have

negotiability; (3) the ability to pledge the instrument as collateral; (4) the conferring of voting rights to shareholders; and (5) appreciability. *Id.* at 686. The Supreme Court adopted a different definition for “notes” in *Reves v. Ernst & Young*, 494 U.S. 56 (1990), known as the “family resemblance” test. Under the family resemblance test, any debt instrument that has a maturity date of greater than nine months is presumed to be a security within the meaning of section 2(a)(1). *Id.* at 63–67. However, the presumption is rebuttable, and only holds up if the instrument bears a family resemblance to instruments that are commonly considered notes based on a four-factor test. If the motives of purchaser, the plan of distribution, and the public’s reasonable expectations are in line with those commonly associated with a note, and no alternative regulatory schemes exist, then the short-term debt instrument will almost certainly be considered a note. *Id.* at 66–67.

53. See 15 U.S.C. § 77r (2012). Though the Securities Act of 1933 instituted sweeping securities regulation reforms, it also preserved the jurisdiction of state-level securities regulation bodies, meaning state “blue sky” laws remained in effect in certain situations where federal law did not apply. See *id.*; Macey & Miller, *supra* note 20, at 348.

54. See Fallone, *supra* note 19, at 17–18.

55. Outlaw, *supra* note 40.

56. Bradford, *supra* note 38, at 20.

57. Outlaw, *supra* note 40.

cash flow, and can service debt.”⁵⁸ Such crowdfunding platforms may also target companies that are “at least a year old and [have] at least a year’s worth of receipts.”⁵⁹ Thus, in lending or debt crowdfunding, which can also be properly described as “peer-to-peer lending,”⁶⁰ both a different type of business and consumer may be the focal point of lending-based crowdfunding platforms.

2. Equity-Based Crowdfunding

Equity crowdfunding acts just as any sale of stock, and allows businesses and startups to sell ownership stakes via crowdfunding sites, in turn allowing financial contributors to become investors, thus gaining shareholder status and potentially generating a return on investment.⁶¹ While debt-based crowdfunding may or may not involve any actual profit, depending on whether or not the debt instrument provides for any return of interest or merely principal,⁶² equity crowdfunding is based on an expectation of return on investment.⁶³ As a result, of the four types of crowdfunding, equity crowdfunding is the most obvious model that necessarily involves securities.⁶⁴ Crowdfunding sites active in the United States that offer equity-based models include AngelList and Fundable.⁶⁵ The development of equity crowdfunding in particular has led to the need for securities regulations and brought about the crowdfunding-specific sections of the JOBS Act, along with further state regulations.⁶⁶ Both debt and equity crowdfunding offerings and sales ultimately exhibit classic properties of transactions that are considered squarely within the realm of activity that must be regulated under federal and state law, even if they have unique characteristics relative to more traditional concepts of stock and debt offerings.⁶⁷

58. *Id.*

59. *Id.*

60. Bradford, *supra* note 38, at 20.

61. Outlaw, *supra* note 40.

62. *See supra* note 52 and accompanying text.

63. Outlaw, *supra* note 40.

64. Bradford, *supra* note 39, at 24 (“The equity model is the model that most clearly involves the sale of a security.”).

65. *See generally* ANGELLIST, <https://angel.co/> [<https://perma.cc/G7VS-W8WU>] (last visited Apr. 24, 2017); *Types of Crowdfunding*, FUNDABLE, <http://www.fundable.com/> [<https://perma.cc/2RTD-286N>] (last visited Apr. 24, 2017).

66. *See* Outlaw, *supra* note 40.

67. *See supra* Part II.

IV. CURRENT CROWDFUNDING EXEMPTIONS

To fully understand the benefit offered by Wisconsin's intrastate crowdfunding regulation exemption laws, it is first important to understand the overarching framework of securities regulation, including the interplay between federal and state requirements, and the benefits that exemption from registration provide. Securities regulation in its skeletal function works as follows: any entity making an offering that meets the definition of a "security" must ordinarily register that security with SEC.⁶⁸ However, there are exceptions from federal registration. For example, if the security in question is only offered, sold, and transferred to investors within a single state, then that offering may be considered "intrastate" and be eligible for federal exemption under section 3(a)(11) of the Securities Act of 1933.⁶⁹ However, exemption from federal registration does not preclude *all* potential registration requirements.⁷⁰ Where an issuer is exempt from registration with the SEC under federal law, it still must find a state exemption to be exempt from registration with the state regulatory bodies where securities are offered or sold.⁷¹ Thus, where a Wisconsin issuer is able to rely

68. See 15 U.S.C. § 77b(a)(1) (2012) (providing a number of interests and instruments that qualify as securities under federal law); see also 15 U.S.C. § 77f (2012).

69. 15 U.S.C. § 77c(a)(11) (2012 & Supp. 2015) ("Any security which is part of an issue offered and sold to only persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory."). It should be noted that a section 3(a)(11) exemption can be destroyed even after the issuer's offering and sale is complete. Bryn Vaaler, *Financing a Small Business In Mississippi: A Practitioner's Guide to Federal and State Securities Exemptions Part II*, 63 MISS. L.J. 267, 306-22 (1994). For example, where a purchaser of an intrastate issuer's security resells the security to an out-of-state purchaser, and the security has not "come to rest," that resale may be integrated with the original issuing, meaning that the section 3(a)(11) exemption would be destroyed. *Id.* at 321-22; 17 C.F.R. § 230.147(e) (2013) (providing that the section 3(a)(11) exemption does not apply where any resale of a security as part of a 3(a)(11) offering is made to an out-of-state resident within a nine month period from the date of the last sale of securities as part of the offering); *Busch v. Carpenter*, 827 F.2d 653, 656-57 (10th Cir. 1987) (holding that a resale of securities to an out-of-state resident within seven months after the last security as part of an intrastate issuing may not destroy the section 3(a)(11) exemption where the initial sales were "bona fide").

70. See *Small Business and the SEC*, SEC. AND EXCH. COMM'N, <http://www.sec.gov/info/smallbus/qasbsec.htm> [<https://perma.cc/97QT-S775>] (last visited Jan. 7, 2016) ("If your company is selling securities, it must comply with both federal regulations and state securities laws and regulations in the states where securities are offered and sold . . . A particular offering exempt under the federal securities laws is not necessarily exempt from any state laws.").

71. For an extended discussion of the interplay between federal and state crowdfunding exemptions, see Fallone, *supra* note 19, at 22-31.

on the intrastate exemption to avoid federal registration, it still must find an exemption under Wisconsin state law to be fully exempt from all securities registration requirements under both federal and state law.⁷²

The primary advantage of exemption from registration can be substantial, especially for small business owners who lack the funds and resources of a large corporation.⁷³ Absent an exemption, issuers must create and submit extensive disclosures containing highly-detailed information about the issuer's financials, operations, products, and business activities.⁷⁴ The disclosures must be both accurate and complete, and producing the necessary registration and disclosure materials requires a significant amount of due diligence efforts by specialized lawyers and investment bankers.⁷⁵ The fees associated with employing a law firm and an investment banking firm will undoubtedly be high, and would naturally serve to prevent many potential small issuers from making any sort of offering due to a lack of resources.⁷⁶ Additionally, registration and other filing fees can be a major problem for potential crowdfunding issuers.⁷⁷ Without an exemption, issuers must file both with the SEC and state regulatory bodies in each state where securities are offered or sold.⁷⁸ Since crowdfunding issuers primarily use Internet portals to offer and sell the securities, the offering will very likely be construed as an offer or sale to each and every state, thus requiring registration in all fifty states.⁷⁹ As a result, many businesses who would consider using crowdfunding as a means to generate capital not only would prefer an exemption, but absolutely must have one to be able to raise funds via crowdfunding.

A. *Federal v. State Crowdfunding Exemptions in General*

Before tackling Wisconsin's crowdfunding exemption specifically, a brief look at federal and state crowdfunding regulations is useful to provide context on the overarching body of crowdfunding regulations

72. See, e.g., WIS. STAT. § 551.202(26)(b) (2015–2016) (expressly requiring an issuer to be exempt under section 3(a)(11) of the Securities Act of 1933 in order to qualify for the Wisconsin crowdfunding exemption).

73. Fallone, *supra* note 19, at 19.

74. *Id.*

75. *Id.*

76. *Id.*

77. *Id.*

78. *Id.*

79. *Id.*

in the United States broadly. Section 4(a)(6) of the Securities Act of 1933 provides the federal exemption from registration with the SEC in qualifying crowdfunding offerings.⁸⁰ In addition to the federal exemption, thirty-four states and the District of Columbia have passed crowdfunding exemptions relating to specifically intrastate transactions.⁸¹ Seven more states have crowdfunding exemption legislation pending, and four states have rejected proposed crowdfunding exemptions.⁸²

Though the specifics vary to some degree, the essence of the crowdfunding exemptions across state and federal law are very similar. Most states follow Congress's lead, and have instituted a flat, \$1,000,000 cap on amounts received via crowdfunding in any twelve-month period.⁸³ Others, including Wisconsin, allow for up to \$2,000,000 under certain conditions.⁸⁴ In addition, federal law and many state laws limit the amounts that an individual investor may contribute to a crowdfunding offering in any twelve-month period.⁸⁵ Further, similar to federal law, each state requires issuers to register with the state regulatory authority before making any offers or sales to the public and make certain disclosures available to potential investors.⁸⁶ Some states go so far as to require the dissemination of quarterly reports to investors regarding the company and its financial performance.⁸⁷ However, many other states' crowdfunding exemptions

80. 15 U.S.C. § 77d(a)(6) (2012 & Supp. 2015).

81. Anthony J. Zeoli, *State of the States – List of Current Active and Proposed Intrastate Crowdfunding Exemptions*, CROWDFUNDING LEGAL HUB COM, <http://crowdfundinglegalhub.com/2015/01/16/state-of-the-states-list-of-current-active-and-proposed-intrastate-exemptions/> [https://perma.cc/T6XU-G2WK] (last updated Oct. 2016).

82. *Id.*

83. Fallone, *supra* note 19, at 29. Compare WIS. STAT. § 551.202(26)–(27) (2015–2016), and WIS. STAT. § 551.205 (2015–2016), with IND. CODE § 23-19-2-2(27) (2016); IDAHO CODE § 30-14-203 (2014), and *In Re* Treasure Valley Angel Fund, LLC (fka Meridian Angel Fund, LLC) Request for an Order Pursuant to Idaho Code § 30-14-203, BLUE SKY L. REP. 21729 (C.C.H.), 2014 WL 4063439 (2015), and MICH. COMP. LAWS. § 451.2202a(c)(i), (ii) (2016).

84. See WIS. STAT. § 551.202(26)–(27) (2015–2016); IND. CODE § 23-19-2-2(27) (2016).

85. See, e.g., WIS. STAT. § 551.202(26)–(27) (2015–2016); IND. CODE § 23-19-2-2 (2016); MICH. COMP. LAWS. § 451.2202 (2016).

86. Fallone, *supra* note 19, at 29.

87. Indiana, Michigan, Washington, and Wisconsin are among the states that require the dissemination of quarterly reports for issuers utilizing a crowdfunding exemption. Fallone, *supra* note 19, at 29; IND. CODE § 23-19-2-2(27)(P) (2016); MICH. COMP. LAWS § 451.2022(b)(iv); WASH. REV. CODE. § 21.20.880(3) (2014); WIS. STAT. § 551.205(2) (2015–2016).

are silent regarding any ongoing disclosure requirements.⁸⁸ While the most basic tenants of the crowdfunding exemptions instituted across state laws and federal law are very similar, Wisconsin's crowdfunding exemption is somewhat unique in its overall requirements.⁸⁹ Nevertheless, the Wisconsin crowdfunding exemption is burdened by many of the same deficiencies present in the broad body of crowdfunding regulation in the broad body of United States law at both the federal and state levels.

B. Wisconsin's Intrastate Crowdfunding Exemption

Wisconsin's intrastate crowdfunding exemption lessens the burden on businesses seeking to offer a securities-based crowdfunding model to consumers, but nevertheless imposes limitations on amounts received and filing requirements to provide sufficient notice to investors and the state in the hopes of protecting potentially unsophisticated investors from making poor investment decisions or from being victims of fraudulent sales of securities.⁹⁰ Under Wisconsin law, "[a]n offer or sale of a security by an issuer" is exempted from regulation under the Wisconsin Uniform Securities Act if: (1) "[t]he issuer of the security is a business entity organized under [Wisconsin law] and authorized to do business in [Wisconsin]";⁹¹ (2) the transaction is an intrastate offering within the federal exemption for intrastate offerings;⁹² and (3) the offering of securities "is made exclusively through one or more Internet sites and each Internet site is registered with the division under § 551.205(1)(b)."⁹³

88. Fallone, *supra* note 19, at 29.

89. *See supra* notes 83 and 84.

90. *See* Stephen Choi, *Regulating Investors Not Issuers: A Market-Based Proposal*, 88 CAL. L. REV. 279, 280 (2000) (noting the general goal of protecting investors in creating regulatory schemes governing the securities markets).

91. WIS. STAT. § 551.202(26)(a).

92. WIS. STAT. § 551.202(26)(b); *see also* 15 U.S.C. § 77c(a)(11) (2012); 17 C.F.R. § 230.147 (2013).

93. WIS. STAT. § 551.202(26)(e). In addition to Wisconsin, Indiana, Iowa, Kentucky, Minnesota, Mississippi, Nebraska, New Jersey, and Texas all maintain an Internet-only requirement in their respective crowdfunding exemptions. *Id.*; IND. CODE § 23-19-2-2(27)(O) (2014); IOWA CODE § 502.202(24)(a)(1), (e) (2016); KY. REV. STAT. ANN. § 292.411(1)(r) (LexisNexis 2015); MINN. STAT. §§ 80A.461(1)(b), (3)(3) (2015); MISS. CODE ANN. § 1-14-2.04(C) (2015); NEB. REV. STAT. § 8-1111(24)(a)(xii) (2015); N.J. STAT. ANN. 49:3-50(b)(14)(v) (2015); 7 TEX. ADMIN. CODE § 139.25(d) (2015). The District of Columbia has additional provisions in its crowdfunding exemption dealing with Internet broker-dealers, but does not place a flat requirement that all issuers using its crowdfunding exemption must offer and sell through an Internet portal. *See* D.C. Mun. Regs. tit. 26-B, §§ 250.1, 250.2, 256.1 (2014). Likewise, Illi-

In addition to those basic requirements, the Wisconsin crowdfunding exemption scheme has two key components: (1) a hard cap on amounts received in a twelve-month period and limits on amounts that particular investors can contribute in a twelve-month period;⁹⁴ and (2) notice filed with the Wisconsin Department of Financial Institutions (“WDFI”).⁹⁵

1. Cap on Amounts Received

Like under federal law⁹⁶ and other states’ regulations,⁹⁷ Wisconsin limits the amount of contribution an exclusively intrastate crowdfunding platform can receive in a twelve-month period.⁹⁸ Under Wisconsin law, a business may only receive up to either \$1,000,000 or \$2,000,000 via crowdfunding offerings and sales in a twelve-month period.⁹⁹ Whether the cap is \$1,000,000 or \$2,000,000 depends on whether the issuer has undergone a financial audit of its most recently completed fiscal year and made the audit available to each prospective investor and the administrator of the division of securities in the WDFI.¹⁰⁰ If the issuer has undergone a financial audit of its most recently completed fiscal year and provided proper disclosure to prospective investors and the WDFI, the stepped-up \$2,000,000 cap will be imposed.¹⁰¹ If the issuer has failed to fulfill either of the two requirements, the baseline \$1,000,000 cap will be imposed.¹⁰²

Two important caveats apply to the cap regardless of whether it is

nois, Massachusetts, and Oregon contemplate that Internet portals may be used to facilitate crowdfunding offerings, but stop short of imposing the same requirement that Indiana and Wisconsin do. See 815 ILL. COMP. STAT. 5/4(T) (2016); 950 MASS. CODE REGS. 14.402(B)(13)(o) (2014); OR. ADMIN. R. 441-035-0080(7), 441-035-0090(3)(b) (2015).

94. See WIS. STAT. §§ 551.202(26)(c)(1)(a)–(b).

95. See *id.* §§ 551.202(26)(f)–(n).

96. The SEC’s crowdfunding regulation was adopted on October 30, 2015. *SEC Adopts Rules to Permit Crowdfunding; Proposes Amendments to Existing Rules to Facilitate Intrastate and Regional Securities Offerings.* SEC. AND EXCH. COMM’N (Oct. 30, 2015), <https://www.sec.gov/news/pressrelease/2015-249.html> [<https://perma.cc/G6FU-M9AP>] [hereinafter *Proposed SEC Amendments to Existing Crowdfunding Rules*]. Further changes have been proposed to raise the overall cap on amounts received from \$1,000,000 to \$5,000,000. *Id.*

97. See discussion *supra* Part IV.A.

98. WIS. STAT. § 551.202(26)(c)(1)(a)–(b) (2015–2016).

99. *Id.*

100. *Id.*; see also WIS. STAT. § 551.102(1m) (2015–2016) (“‘Administrator’ means the administrator of the division of securities in the department of financial institutions.”).

101. WIS. STAT. § 551.202(26)(c)(1)(b) (2015–2016).

102. *Id.* § 551.202(26)(c)(1)(a).

\$1,000,000 or \$2,000,000 for any issuer. First, the current cap is subject to adjustment under Wis. Stat. § 551.206.¹⁰³ As a result, the WDFI will adjust the monetary amounts specified in both caps “to reflect changes since January 1, 2014, in the consumer price index for all urban consumers, Milwaukee-Racine area average, as determined by the U.S. department of labor,” round the caps to the nearest multiple of \$50,000, and provide notice on the WDFI website.¹⁰⁴ Thus, the caps could either increase or decrease depending on the consumer price index at five-year intervals.

Second and more importantly, the cap could shrink for an issuer if the issuer has sold securities within twelve months before the first offer or sale made in reliance on the crowdfunding exemption.¹⁰⁵ In essence, the provision is backward-looking and lowers the cap on an issuer by the sum of all securities sold in reliance on the crowdfunding exemption before the point at which the issuer made the current sale relying on the exemption.¹⁰⁶ This limitation is potentially significant, as an issuer that wants to make a successive offering utilizing the crowdfunding exemption within a twelve-month period will have an even lower cap due to the integration imposed by Wis. Stat. §§ 551.202(c)(1)(a) or (b).¹⁰⁷ Thus, depending on which cap applies, if an issuer sold \$1,000,000 or \$2,000,000 worth securities as part of a crowdfunding offering in the twelve-month window before a subsequent offering purporting to fall within the crowdfunding exemption, it will be prohibited from utilizing the crowdfunding exemption until the twelve-month look-back period has passed.

2. Limitations on Individual Investors

In addition to limiting total amounts issuers can receive in a twelve-month period, Wisconsin imposes strict limitations on investors, subject to an important potential exemption. There is no limit on the number of investors an issuer can take in, but there are limitations on individual investors.¹⁰⁸ Ordinarily under Wisconsin law, any single

103. *Id.* §§ 551.202(26)(c)(1)(a)–(b) (explaining that the amount of either cap is “subject to adjustment under § 551.206”).

104. WIS. STAT. § 551.206 (2015–2016).

105. WIS. STAT. § 551.202(26)(c)(1)(a)–(b) (2015–2016).

106. *See id.*

107. *Id.*

108. *See Crowdfunding in Wisconsin, Frequently Asked Questions*, WIS. DEPT. OF FIN. INSTS., <http://www.wdfi.org/fi/securities/faqCrowdfunding.htm> [<https://perma.cc/VH5L-7AQH>] (last visited Apr. 24, 2017).

investor is not allowed to contribute more than \$10,000 to any issuer.¹⁰⁹ However, the \$10,000 limit is removed if the investor is considered an “accredited investor” or a “certified investor.”¹¹⁰

In Wisconsin, a “certified investor” must be a resident of the state of Wisconsin, and at the time of an offer or sale of securities, must have either: (1) “an individual net worth, or joint net worth with the individual’s spouse, of at least \$750,000”; or (2) “an individual income in excess of \$100,000 in each of the two most recent years or joint income with the individual’s spouse in excess of \$150,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year.”¹¹¹ “Accredited investors” are defined in Wisconsin as they are in Rule 501(a) of the Securities Act of 1933.¹¹² Under Rule 501(a), accredited investors include the following: banks; savings and loan institutions; brokers and dealers of securities; private business development companies; retirement or employee benefit plans with assets in excess of \$5,000,000; trusts with assets in excess of \$5,000,000; “[a]ny director, executive officer, or general partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer”; and natural persons with an individual or joint net worth greater than \$1,000,000.¹¹³ On top of having no per-investor limitation on contributions to any single offering, funds raised via certified and accredited investors and any contributions from such investors do not count against the overall cap on issuers’ receipts in a twelve-month period.¹¹⁴

In addition, funds received from “institutional investors” do not count against the aggregate cap.¹¹⁵ “Institutional investors” involve a wide array of finance and banking institutions, along with other finan-

109. WIS. STAT. § 551.202(26)(d) (2015–2016).

110. *Id.*

111. WIS. STAT. § 551.102(4m) (2015–2016).

112. *See* WIS. STAT. § 551.202(13)(am) (2015–2016).

113. 17 C.F.R. § 230.501(a) (2013). For a full list of what qualifies as an “accredited investor” under federal law, see Rule 501(a). It should be noted that a person’s primary residence is generally not included in the net worth calculation, subject to the exception provided in 17 C.F.R. § 230.501(a)(5)(ii). 17 C.F.R. § 230.501(a)(5)(i).

114. *See* WIS. STAT. § 551.202(26)(a)–(b) (2015–2016).

115. *Id.* § 551.202(26)(c). Interestingly, Wisconsin does not expressly provide that institutional investors are exempt from the \$10,000 per-investor limit, as accredited and certified investors are. Since all three are expressly accounted for in § 551.202(26)(c)(1), and yet institutional investors are not referred to directly below in § 551.262(26)(d), it is reasonable to presume that an institutional investor would have to qualify as an accredited investor to be exempt from the \$10,000 per-investor limit.

cial and banking professionals and advisers.¹¹⁶ In essence, Wisconsin imposes a hard aggregate cap on amounts received from “ordinary” investors, but removes any limitations on amounts received from investors attaining a certain status.¹¹⁷ Thus, issuers relying on the Wisconsin crowdfunding exemption have a potentially unlimited aggregate cap, depending on whether or not accredited or certified investors decide to purchase securities through the offering.¹¹⁸

3. Notice Requirements under the Crowdfunding Exemption

In addition to strict caps on amounts received through crowdfunding involving the offer or sale of securities, Wisconsin provides additional requirements that must be fulfilled before any offer or sale occurs if issuers want to claim the Wisconsin crowdfunding exemption.¹¹⁹ First, the issuer must provide evidence that it is organized under Wisconsin law and authorized to do business in Wisconsin to the operator of the Internet portal the issuer will use to conduct the crowdfunding offer or sale.¹²⁰ Second, the Internet site operator of the portal used to offer or sell the securities must file a registration statement with the WDFI that includes the following: that the operator is a business entity organized under Wisconsin law and authorized to do business in Wisconsin; that the site is being used to offer and sell securities under the Wisconsin crowdfunding exemption; the identity of, location of, and contact information for the operator; and potentially, that the operator is registered as a broker-dealer under Wis. Stat. § 551.401.¹²¹

Generally, the Internet site operator will have to state that it is registered as a broker-dealer under Wis. Stat. § 551.401.¹²² However, there are two exceptions to this general rule.¹²³ First, the exception under § 551.205(1)(b)(2) provides an operator will not have to register where

116. For a complete definition of what comprises an “institutional investor,” see WIS. STAT. § 551.102(11) (2015–2016). Wisconsin also exempts from the aggregate cap any sales to officers, directors, partners, trustees, or individuals “occupying similar status or performing similar functions with respect to the issuer or to a person owning [ten] percent or more of the outstanding shares of any class or classes of securities of the issuer.” WIS. STAT. § 551.202(26)(c)(2) (2015–2016).

117. WIS. STAT. § 551.202(26) (2015–2016).

118. See WIS. STAT. § 551.202(26)(c)(1) (2015–2016).

119. WIS. STAT. § 551.205 (2014–2015).

120. *Id.* § 551.205(1)(a).

121. *Id.* § 551.205(1)(b)(1).

122. *Id.*

123. *Id.* § 551.205(1)(b)(2), (4).

it meets all of a series of eight prerequisites: (1) it does not offer investment advice or recommendations; (2) it does not solicit any purchases, sales, or offers to buy the securities available on its portal; (3) it does not compensate any employees, agents, or others for solicitation or based on sales of securities on its portal; (4) it is not compensated based on securities sold, and it does not hold, manage, or possess investor funds or securities; (5) its fee charged to issuers is fixed, variable based on how long the securities are offered, or some combination therein; (6) it does not engage in advertising that specifically identifies, promotes, or otherwise refers to any individual securities offered; (7) it does not engage in any other activity that the WDFI determines is prohibited; and (8) neither it, nor any party with management authority, is subject to any action specified in Rule 506(d)(1) of the Securities Act of 1933 that would disqualify an issuer from the broker-dealer exemption.¹²⁴ Second, the exception under § 551.205(1)(b)(4) provides that where a Wisconsin Internet site operator is registered federally as a broker-dealer, it will not have to in Wisconsin as well.¹²⁵

In addition to pre-offer or sale requirements, issuers and Internet site operators have duties that apply following the commencement of the offering.¹²⁶ First, both the issuer and the Internet site operator must “maintain records of all offers and sales of securities effected” done through the Internet site and must provide “ready access” to the WDFI upon request.¹²⁷ Second, issuers must provide free, quarterly reports to their investors until no securities issued under the crowd-

124. *Id.* Rule 506(d)(1) actions involve the “‘Bad Actor’ disqualification,” which disqualifies an issuer from making an offering under Rules 506(b) and (c) of Regulation D “if the issuer or any other person covered by Rule 506(d) has a relevant criminal conviction, regulatory or court order or other disqualifying event” that happened on or after September 23, 2013—the effective date of the most recent amendments to Rule 506. 17 C.F.R. § 230.506(d)(1), (2) (2013); *Disqualification of Felons and Other “Bad Actors” from Rule 506 Offerings and Related Disclosure Requirements: A Small Entity Compliance Guide*, SEC. AND EXCH. COMM’N (Sept. 19, 2013), <https://www.sec.gov/info/smallbus/secg/bad-actor-small-entity-compliance-guide.htm> [<https://perma.cc/6LC6-VQQC>]. Rule 506(d) extends to all “covered persons,” which includes the issuer and any predecessors and affiliates; the issuer’s executive officers, directors, general partners, and managing members; twenty-percent beneficial owners of the issuer by total voting power; promoters connected to the issuer; fund investment managers if the issuer is a pooled investment fund; and all persons compensated for soliciting investors. 17 C.F.R. § 230.506(d)(1); *Disqualification of Felons and Other “Bad Actors”*, *supra*.

125. WIS. STAT. § 551.205(1)(b)(4) (2015–2016).

126. *See generally id.* § 551.205.

127. *Id.* § 551.205(1)(c).

funding exemption are outstanding.¹²⁸ The issuer may satisfy the quarterly reporting requirement by making the information available on an Internet site so long as “the information is made available within [forty-five] days after the end of each fiscal quarter and remains available until the succeeding quarterly report is issued.”¹²⁹ In addition, the issuer must file each quarterly report with the WDFI and provide a written copy of any report made available online to any investor upon the WDFI’s request.¹³⁰

Wisconsin also imposes content requirements on each quarterly report.¹³¹ Each report must set forth the cash compensation each director and executive officer received since the previous quarterly report, along with any “bonuses, stock options, other rights to receive securities of the issuer or any affiliate of the issuer, or other compensation received” on an annual basis.¹³² Further, the issuer’s management must provide analysis of the issuer’s business operations, along with its financial condition.¹³³ As reflected by Wis. Stat. § 551.205, exemption from having to go through the full securities registration process does not preclude *all* disclosure requirements.¹³⁴ Issuers that seek the crowdfunding exemption and the operators of the sites they use as portals to conduct the offerings and sales nevertheless have burdens to provide certain, albeit limited, levels of documentation, notice, and information to the WDFI, each other, and investors.¹³⁵

V. FUNDAMENTAL ISSUES WITH THE WISCONSIN CROWDFUNDING EXEMPTION AND POTENTIAL REMEDIES

Despite the buzz that the crowdfunding movement has generated nationwide, it has not caught on in Wisconsin when it comes to specifically intrastate offerings.¹³⁶ As of April 2017, only five Internet crowdfunding portals have registered with the WDFI, and none have since

128. *Id.* § 551.205(2).

129. *Id.*

130. *Id.*

131. *Id.* § 551.205(2)(a)-(b).

132. *Id.* § 551.205(2)(a).

133. *Id.* § 551.205(2)(b).

134. *Id.* § 551.205(2).

135. *Id.*

136. See Anthony Zeoli, *State of the States: An Update on Intrastate Crowdfunding*, CROWDFUND INSIDER (Sept. 30, 2014), <http://www.crowdfundinsider.com/2014/09/51187-state-states-update-intrastate-crowdfunding/> [<https://perma.cc/B3SR-6T5U>].

February 5, 2015.¹³⁷ Further, only ten issuers have filed for the Wisconsin crowdfunding exemption under Wis. Stat. § 551.205(26).¹³⁸ Such a lack of activity begs the question: why are more Internet portals and issuers not utilizing the Wisconsin crowdfunding exemption? Perhaps a lack of general public awareness of both the exemption itself and the potential for capital generation via crowdfunding is the cause,¹³⁹ or perhaps some other extrinsic factors are present that are hampering the development of crowdfunding on an intrastate level.¹⁴⁰

Regardless of any extrinsic factors, latent deficiencies in the regulatory scheme itself at minimum serve to create barriers to entry into the market that may deter Wisconsin businesses from attempting to utilize the exemption and make a crowdfunding offering. In response, Wisconsin should modify its crowdfunding exemption in a manner that would make crowdfunding a more attractive capital generation medium while maintaining investor protections that are at the heart of securities regulation. First, it should rework its current two-tier system of investor classes into a three-tiered system with revised definitions applying to each class in a manner that more narrowly and accurately protects certain types of investors.¹⁴¹ Second, it should apply a different cap to each respective tier in a manner that increases the overall amount of potential capital available to crowdfunding issuers while maintaining adequate protections for investors that lack sophistication and/or wealth.¹⁴² Third, it should maintain its current notice and disclosure requirements, as they become even more essential with the increased stakes for investors brought about by the cap increases.¹⁴³

A. *Rethinking Wisconsin's Investor Classes*

In attempting to distinguish between investors who require more

137. *Internet Site Operator Registration Statements*, WIS. DEPT. OF FIN. INSTS., <https://www.wdfi.org/apps/Crowdfunding/ISO> [<https://perma.cc/BV3Q-G5EV>] (last visited Apr. 24, 2017).

138. *DFI Crowdfunding Exempt Offerings*, WIS. DEPT. OF FIN. INSTS., <https://www.wdfi.org/apps/Crowdfunding/Exemption> [<https://perma.cc/L6AP-XBC4>] (last visited Apr. 24, 2017).

139. See Zeoli, *supra* note 136 (suggesting one of the causes of the general lack of intrastate crowdfunding activity nationwide is the general public's lack of awareness and understanding of crowdfunding, along with an overall skepticism of the medium).

140. *Id.* (suggesting some intrastate funding legislation has not passed due to outside factors such as misunderstanding of the bill itself, or attempts to bundle the proposals).

141. See *infra* Part V.A.

142. See *infra* Part V.B.

143. See *infra* Part V.C.

protection and those who do not, Wisconsin incorporates the federal definition of “accredited investor” under Rule 501(a) of the Securities Act of 1933, and exempts any funds received from such investors from applying against the aggregate cap on amounts received in a twelve-month period under the exemption.¹⁴⁴ In addition, Wisconsin defines and incorporates “institutional investors” and “certified investors” into the exemption against the cap along with accredited investors.¹⁴⁵ Further, Wisconsin’s crowdfunding exemption applies no per-investor limit regarding accredited and certified investors.¹⁴⁶

The fundamental problem with Wisconsin’s creation of a separate range of investors to whom no limits apply is similar to the issues present in the comparable class of investors under federal law.¹⁴⁷ Wisconsin ties its elevated class of investors in large part to net worth or yearly income,¹⁴⁸ which is problematic because individuals with a large net worth or high yearly income level may still be novice investors who lack the sophistication to make intelligent, fully informed investment decisions.¹⁴⁹ In fact, it is entirely possible that an individual with a relatively low net worth or income level who would not qualify as part of the elevated class may possess significantly more sophistication regarding investments than an individual who qualifies as an accredited or certified investor.¹⁵⁰ In other words, just because a particular investor has the funds to qualify as an “accredited” or “certified” investor, it does not necessarily follow that they should escape per-investor limitations under a regulatory scheme.¹⁵¹

Rather, Wisconsin should rework its definition of certain types of investors under its crowdfunding exemption, and create three tiers of investors. Under a revised framework, Wisconsin would first create a new class of investors, known as “qualified investors.” The definition of a qualified investor would include three classes of investors: (1) institutional investors,¹⁵² (2) “any director, executive officer, or general

144. WIS. STAT. § 551.202(26)(c) (2015–2016); *see also* discussion *supra* Part IV.B.2.

145. WIS. STAT. § 551.202(26)(c) (2015–2016); WIS. STAT. § 551.102(4m), (11) (2015–2016).

146. WIS. STAT. § 551.202(26)(d) (2015–2016).

147. *See generally* Wallis K. Finger, *Unsophisticated Wealth: Reconsidering the SEC’s “Accredited Investor” Definition Under the 1933 Act*, 86 WASH. U. L. REV. 733 (2009).

148. *See* WIS. STAT. § 551.102(4m) (2015–2016) (defining “certified investors”); 17 C.F.R. § 230.501(a) (2013) (defining “accredited investors”).

149. *See* Finger, *supra* note 148, at 733–34.

150. *Id.*

151. *Id.*

152. *See* WIS. STAT. § 551.102(11) (2015–2016) (providing Wisconsin’s definition of “in-

partner of the issuer of the securities being offered or sold, or any director, executive officer, or general partner of a general partner of that issuer,"¹⁵³ and (3) certain individual investors who are natural persons who possess sufficient "knowledge and experience in financial and business matters [to evaluate] the merits and risks of the prospective investment."¹⁵⁴ Such a definition would incorporate the federal definition of a "sophisticated" investor,¹⁵⁵ and will *not* be tied to net worth or yearly income levels, as it is presumable that neither institutional investors, nor individuals possessing the requisite sophistication to make sound, informed investment decisions will require the protections that common investors need.¹⁵⁶

Naturally, creating a tier based upon facially qualitative and potentially ambiguous criteria such as "sophistication" requires some level of assessment and verification to be practically feasible and capable of implementation.¹⁵⁷ Wallis K. Finger's "licensing scheme" provides an effective example of how to identify properly sophisticated versus unsophisticated investors.¹⁵⁸ Under a scheme similar to Finger's, Wisconsin would make a test available to investors seeking "qualified" status. Such a test would assess the investor's knowledge of basic business principles, private and public offerings, issuers and purchasers, practical considerations in making informed investment decisions, and ele-

stitutional investor").

153. See 17 C.F.R. § 230.501(a)(4) (2013). Incorporating this aspect of Rule 501(a) into the definition of "qualified investor" captures the other subset of natural persons that might be considered accredited investors. See *id.* § 230.501(a)(5) (providing for persons whose individual or joint net worth exceeds \$1,000,000 to be considered accredited investors); *id.* § 230.501(a)(6) (counting any natural person with "an individual income in excess of \$200,000 in each of the two most recent years or joint income with that person's spouse in excess of \$300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year" as an accredited investor). Including Rule 501(a)(5) and (6) into the definition of qualified investors is inadvisable, because the goal of the proposed framework is to only remove all limitations on investments based upon sophistication, as opposed to mere net worth or income levels.

154. 17 C.F.R. § 230.506(b)(2)(ii) (2013). Rule 506 provides for no aggregate investment cap where the purchasers are sophisticated, though it does limit the number of sophisticated purchasers in any offering to 35. *Id.* § 230.506(b)(2)(i), (ii); see also Finger, *supra* note 148, at 759-61 (proposing a licensing system for federal securities law whereby investors would have to pass one of two tests to show a sufficient level of knowledge and sophistication to be considered "licensed").

155. See 17 C.F.R. § 230.506(b)(2)(ii) (2013).

156. See generally Finger, *supra* note 148.

157. See *id.* at 759-60.

158. *Id.* at 759-66.

mentary principles of securities regulations.¹⁵⁹ To ensure that investors maintain the level of knowledge and sophistication necessary to be a qualified investor, either a new test should be periodically administered to each investor who holds qualified status (perhaps at five to ten year intervals), or maintaining qualified status should be conditioned on taking periodic educational courses to ensure the requisite level of knowledge and sophistication is maintained.¹⁶⁰

As Finger points out, one potential criticism for such a requirement is the administrative costs that would result, including expenses associated with designing the exam, creating testing centers, buying testing computers, and hiring individuals to proctor the exams.¹⁶¹ Additionally, there could be investor-side costs, including paying a testing fee, and paying to take preparatory classes.¹⁶² Moreover, an exam-based system would not be free from error, and may from time-to-time bar a truly sophisticated investor from attaining qualified status or allow an unsophisticated investor to attain qualified status.¹⁶³ Though a testing system would doubtlessly be imperfect and would require time and effort to iron out the initial problems that inevitably rise with such initiatives, it is nevertheless a more effective system than currently in place, and will serve to help better identify investors that truly are capable of making the kinds of informed investment decisions such that no investor protections in terms of aggregate caps on amounts received or per-investor caps on amounts invested need apply.¹⁶⁴

Below the tier of qualified investors would sit the second tier, which would contain “certified investors” and incorporate the definition of certified investors currently in place under Wisconsin law.¹⁶⁵ Certified investors would be natural persons who do not meet the definition of qualified investors, are Wisconsin residents, and have: (1) an individual or joint net worth exceeding \$750,000; (2) an individual yearly income exceeding \$100,000 in the two most recent years; or (3) a joint yearly income with his or her spouse exceeding \$150,000 in the

159. *See id.* at 762.

160. *See id.* at 763 (suggesting ongoing educational courses as a requirement to maintaining what he calls “licensed” investor status).

161. *Id.* at 765.

162. *Id.*

163. *Id.* at 763–64.

164. *See id.* at 765–66 (addressing potential issues that may arise under a testing system to evaluate investors’ knowledge and sophistication).

165. *See* WIS. STAT. § 551.102(4m) (2015–2016).

two most recent years.¹⁶⁶ Since Wisconsin's definition of "certified investor" looks at both individual or joint net worth and individual or joint income levels going back two years,¹⁶⁷ and has a lower threshold for both net worth and income when compared with the federal definition of "accredited investor,"¹⁶⁸ each and every individual that qualified as an accredited investor under Rule 501(a)(5) and (6) would qualify as a certified investor under Wisconsin law.¹⁶⁹ Thus, there is no need for a separate class of "individual accredited investors" under the proposed framework, and simply defining the entire second tier as "certified investors" will suffice. In essence, the second tier can be thought of as "non-qualified investors, plus." Individuals that are certified investors will not have the knowledge and sophistication required to be considered a qualified investor, but nevertheless possess a high level of net worth or income that allows them to fiscally handle a greater level of investment risk than common investors.

The third and final tier is already in place under the current regulatory framework, and works as a catchall that includes all persons who are not qualified investors or certified investors.¹⁷⁰ As a result, any individual investors that do not meet the sophistication requirements to be considered qualified investors, do not have a joint or individual net worth of \$750,000, do not have an individual yearly income in excess of \$100,000 in the past two years, and do not have a joint yearly income in excess of \$150,000 in the past two years necessarily will fall within the bottom tier.¹⁷¹

Creating a three-tier system for classifying investors under Wisconsin's crowdfunding exemption provides the foundation for increases

166. *Id.*

167. *Id.*

168. Compare 17 C.F.R. § 230.501(a)(5), (6) (2013), with WIS. STAT. § 551.102(4m) (2015-2016).

169. See discussion *supra* notes 153-56 and accompanying text. Wisconsin's monetary thresholds to be a "certified investor" are \$250,000 lower than the federal definition of "accredited investor" when it comes to individual or joint net worth, \$100,000 lower in terms of individual yearly income for the previous two years, and \$150,000 lower regarding joint yearly income for the previous two years. Compare 17 C.F.R. § 230.501(a)(5), (6) (2013), with WIS. STAT. § 551.102(4m) (2015-2016). As a result, every "certified investor" and "accredited investor" overlap, and the only part of the federal definition of accredited investor that needs to be included in the proposed definition of "qualified investor" is the provision found in Rule 501(a)(4). See 17 C.F.R. § 230.501(a)(4) (2013).

170. See WIS. STAT. § 551.202(26)(c)-(d) (2015-2016).

171. This operates the same as the current crowdfunding exemption, except for the addition of a third class of investors. See *id.*

in the aggregate cap on total amounts of capital raised in any given crowdfunding offering. In essence, providing for a tiered classification of investors that is significantly more focused than the current system allows for a more accurate advancement of the primary policy function served by investor protection under securities laws.¹⁷² By narrowing the class of investors whose contributions are excluded from the aggregate cap, Wisconsin will be able to eliminate limits on investors where they are truly warranted and apply limitations where they are legitimately required.

B. Raising the Cap on Amounts Received Under the Three-Tier System

Working in conjunction with a three-tiered classification of investors is a three-tiered cap system, premised first on raising the overall amount of capital that companies may raise through a crowdfunding offering in Wisconsin. Though the hard cap of \$1,000,000 or \$2,000,000 may seem like a relatively generous number that provides ample opportunity to raise a significant amount of money, the cap itself may not be high enough, which may serve to dissuade businesses from attempting to use crowdfunding.¹⁷³ Other exemptions, such as Rule 505 of Regulation D under federal securities law, allow for up to \$5,000,000 to be raised in a twelve-month period without significant disclosure requirements.¹⁷⁴ Even if an issuer is exempt under the Wisconsin crowdfunding exemption, it still must submit an initial disclosure to the Internet portal it uses, and more significantly, must issue quarterly reports to investors.¹⁷⁵ The costs associated with such submissions will undoubtedly be above the level of “negligible,” and could make crowdfunding a less attractive option than a private offering once costs are factored in in juxtaposition with the cap on funds raised imposed by Wisconsin law.¹⁷⁶

172. See Choi, *supra* note 90, at 280.

173. Anthony Zeoli, *The Illinois Intrastate Crowdfunding Exemption: The Reasoning Behind the Bill*, CROWDFUNDING LEGAL HUB (Nov. 8, 2014), <http://crowdfundinglegalhub.com/2014/11/08/the-illinois-intrastate-crowdfunding-exemption-the-reasoning-behind-the-bill/> [<https://perma.cc/JQE7-CCPE>].

174. 17 C.F.R. § 230.505(b)(2)(i) (2015); see also 17 C.F.R. § 230.502 (2013) (imposing limited disclosure requirements on issuers making offerings qualifying under Regulation D).

175. See discussion *supra* Part IV.B.3; WIS. STAT. § 551.205(1), (2) (2015–2016).

176. See Steven Skolnick & Alan Wovsaniker, *The JOBS Act: Improving Access to Capital Markets for Smaller Businesses*, NEW DEVELOPMENTS IN SECURITIES LAW: LEADING LAWYERS ON UNDERSTANDING IMPORTANT LEGISLATION AND COMPLYING WITH SEC RULES AND REGULATIONS (INSIDE THE MINDS) 5 (2016 ed.) (noting the generally expensive nature of filing quarterly reports because of the due diligence efforts required to ensure the complete-

As part of the proposed framework, the top tier, containing qualified investors, would have no cap on aggregate amounts raised via a crowdfunding offering, no cap on amounts contributed by any one qualified investor, and no limitation on the number of qualified investors that would participate in any crowdfunding offering. In essence, the first tier is “wide open,” as investors that are institutional or individuals possessing a high level of business, financial, and investment sophistication should be able to invest as much as they want in an offering of securities without the need for regulatory protection.¹⁷⁷ Though doing so creates a potentially unlimited cap on funds that may be raised through a crowdfunding offering, it is no different than Wisconsin’s current regulatory scheme, besides applying a narrower definition of who qualifies as part of the unlimited class of investors.¹⁷⁸ Such a scheme echoes Rule 506 of Regulation D under the Securities Act of 1933,¹⁷⁹ but does so in a way that is a significant improvement over Wisconsin’s current crowdfunding exemption due to a narrower definition of who qualifies.

Unlike the first tier of qualified investors, both the middle tier and bottom tier will impose an aggregate cap on amounts received and a per-investor cap on amounts contributed to any crowdfunding offering, with the goal of increasing the overall cap crowdfunding offerings while maintaining sufficient investor protections. At the second tier applying to certified investors, Wisconsin should apply an \$8,000,000 or \$10,000,000 aggregate cap on total capital raised via investments made by certified investors, depending on whether the issuer has undergone and made available a financial audit to both investors and the WDFI.¹⁸⁰ In addition, each certified investor will have a \$50,000 cap on the amount of funding he or she may contribute to any single crowdfunding offering in exchange for securities within a twelve-month pe-

ness and accuracy of each quarterly report).

177. See Finger, *supra* note 148, at 733–34 (highlighting the incongruous result that occurs when the federal definition of accredited investor includes wealthy individuals with no sophistication and excludes people with substantial sophistication who fail to meet the net worth or income tests).

178. See WIS. STAT. § 551.202(26)(c)(1) (2015–2016).

179. Rule 506 of Regulation D under the Securities Act of 1933 provides for an unlimited cap on investments received as part of a Rule 506 offering, so long as two requirements are fulfilled: (1) there are no more than thirty-five unaccredited, but sophisticated investors in the offering; and (2) all other investors are accredited. 17 C.F.R. § 230.506(b)–(c) (2013).

180. See WIS. STAT. § 551.202(26)(c)(1)(a)–(b) (2015–2016) (imposing a split cap depending on whether or not the issuer has undergone a financial audit of its most recently completed fiscal year that meets general accounting standards).

riod. The third tier, which serves as a catchall for all investors not part of the top or middle tiers, will see its ceiling raised to \$4,000,000 or \$5,000,000, again depending on whether the audit requirement is fulfilled. Additionally, investors falling within the lower tier will have their individual cap on amounts invested to any single crowdfunding offering within a twelve-month period increased from \$10,000 to \$20,000.¹⁸¹ Like with qualified investors, there will be no limit on the number of investors in the middle or bottom tiers that may participate in any crowdfunding offering. Under such a regulatory scheme, the cap on amounts received would be theoretically unlimited as it currently is, but would raise the current cap on ordinary investors from \$1,000,000 or \$2,000,000¹⁸² to \$4,000,000 or \$5,000,000, with up to an additional \$8,000,000 or \$10,000,000 coming from certified investors. As a result, the aggregate cap on amounts received from investors not qualifying for exemption from the cap would increase from \$1,000,000 or \$2,000,000 to as much as \$12,000,000 or \$15,000,000, depending on the makeup of the overall investor pool.¹⁸³

Though the proposed regulatory framework is more complex in structure than Wisconsin's current crowdfunding exemption, it should be adopted for two primary reasons: (1) because investor protections need to be more accurate in terms of who is protected and the level to which they are protected; and (2) because caps on both aggregate amounts of capital raised and amounts contributed by individual investors as part of a crowdfunding offering need to be increased to stimulate more widespread use of crowdfunding in Wisconsin on an intrastate basis.

C. *Maintaining Current Notice and Disclosure Requirements*

Though Wisconsin's crowdfunding exemption requires a moderate overhaul of its structure, definitions, and limitations, its current notice and disclosure requirements should be maintained in the interest of investor protection.¹⁸⁴ As noted previously,¹⁸⁵ Wisconsin is one of only

181. *See id.* § 551.202(26)(d).

182. *See id.* § 551.202(26)(c).

183. Assuming that only third tier investors are involved, the cap would only increase from \$1,000,000 or \$2,000,000 to \$4,000,000 or \$5,000,000. However, if any second tier, certified investors are involved in the offering, their presence effectively increases the cap by \$8,000,000 or \$10,000,000, raising the overall cap to \$12,000,000 or \$15,000,000.

184. For a full discussion of Wisconsin's notice and disclosure requirements, *see* discussion *supra* Part IV.B.3.

185. *See* discussion *supra* note 87 and accompanying text.

a few states that requires quarterly financial reports in addition to incentivizing financial audits through a stepped-up cap¹⁸⁶ and imposing specific disclosure requirements to both investors and the state regulatory body.¹⁸⁷ Such requirements become even more essential with an increased aggregate cap and raised ceilings on individual investors, as more money is on the line and the stakes are significantly raised.¹⁸⁸ At the same time, the increased ability to raise funds brought about by increased financial caps provides the issuer with more capital to apply towards generating financial reports and making the requisite disclosures to investors and the WDFI. Doing so will allow for investors to make better initial decisions on whether to purchase a given security, and what to do after the initial offering and sale is completed, such as hold, sell, or purchase more in the secondary market. Wisconsin implements its notice and disclosure requirements as applied to crowdfunding issuers properly, and should continue to do so under a modified framework.

VI. CONCLUSION

As evidenced by its recent growth and development,¹⁸⁹ crowdfunding has potential to become a more widely-spread method of capital generation. However, in order to become a viable means of raising funds on an intrastate basis in Wisconsin, adjustments need to be made to the legislature's first attempt at instituting regulations on crowdfunding and providing an exemption for crowdfunding offerings. This article has examined the regulatory framework of the Wisconsin crowdfunding regulation in juxtaposition with basic tenants of corresponding regulations federally and in other states, highlighted the primary weaknesses in the current statutory schema, and provided for potential changes that may encourage greater levels of intrastate crowdfunding activity within Wisconsin while maintaining necessary investor protections. Similar adjustments could be made to both the federal crowdfunding exemption and such exemptions currently in place in other states, and could be initially enacted in the twenty-one states lacking a crowdfunding exemption.

It is inevitable that as time passes, technology advances, society

186. See WIS. STAT. § 551.202(26)(c)(1)(a)–(b) (2015–2016).

187. *Id.* § 551.205.

188. See Zeoli, *supra* note 173 (advocating for minimum disclosure and updating requirements imposed on issuers in the context of intrastate crowdfunding legislation).

189. See discussion *supra* notes 31–36 and accompanying text.

evolves, and global business practices adapt and modernize to meet the current sociocultural, technological, and economic environment. Due to the derivative challenges and concerns that naturally flow from such advancements, statutes must be rewritten and amended, and entirely new regulatory schema must be developed. The development of crowdfunding has created such a challenge, and the body of law relating to crowdfunding—both within and without Wisconsin—will need to continue to evolve to support a properly flexible regulatory scheme while protecting the interests of individual investors. Doing so could be a boon for small businesses and investors statewide, and may enhance the Wisconsin economy in a notoriously unstable economic era.

ANDREW S. HOVESTOL

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