Putting North Carolina Through the PACES: Bringing Intrastate Crowdfunding to North Carolina Through the NC PACES Act

C. Marshall Horsman III
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ABSTRACT

The nationwide increase in the number of small businesses over the past several years has led to more small businesses, startups, and entrepreneurs seeking capital investments from the general public in order to build and grow their businesses. In an effort to attract investors, businesses have taken an interest in securities crowdfunding, a method for raising capital whereby businesses offer stock in their companies in exchange for capital from investors. While an offering of securities generally must be registered with the United States Securities and Exchange Commission, companies can circumvent the registration requirement by utilizing one of the available exemptions provided by federal statute. This Comment focuses primarily on the intrastate exemption, which allows businesses to sell securities if the offering is wholly contained within a single state, but only if that state has given businesses the option to use that exemption. Since 2011, over half of the states have passed legislation permitting businesses within those states to take advantage of the intrastate exemption. North Carolina, through the NC PACES Act, is considering passing such legislation, yet that bill has been stalled in the North Carolina General Assembly since April of 2015. This Comment highlights the benefits that North Carolina can enjoy by allowing intrastate securities crowdfunding and ultimately calls for the General Assembly to pass the NC PACES Act.

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INTRODUCTION

In late 2009, a small rural town nestled in the southwestern corner of Kansas found itself with a serious problem few Americans have ever fathomed: the residents of Minneola, Kansas had nowhere to buy groceries.\(^1\) When the town’s only grocery store unexpectedly shut down, the community of around 800 residents\(^2\) felt compelled to take action.\(^3\) A group of community leaders began exploring the town’s options to bring a grocery store back to Minneola and eventually discovered the Invest Kansas Exemption (IKE).\(^4\) The Invest Kansas Exemption is a piece of legislation that, upon its passage in August 2011, became the first intrastate equity crowdfunding exemption to be adopted by any state.\(^5\) Through IKE, the residents of Minneola were able to form a corporation and begin selling shares of stock to members of the community.\(^6\) In all, 4,000 shares were sold, netting $200,000 to be used for the re-opening of the town’s grocery store.\(^7\) As the number of shares sold grew, so did Minneola’s sense of

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7. Id.
ownertship.8 A few months later, thanks to the capital raised and the volunteer labor of several dozen community members, Hometown Market opened its doors on March 7, 2012.9

Minneola’s Hometown Market is the story of one of the first successful utilizations of intrastate crowdfunding. As this small, rural grocery store continues to thrive, so does national interest in using crowdfunding to offer and sell equity securities. On April 5, 2012, the Jumpstart Our Business Startups (JOBS) Act10 became law.11 Despite having not yet gone fully into effect, this law has, over the past three years, slowly progressed toward its purpose of making several types of federal securities crowdfunding a reality. Along with this effort to introduce securities crowdfunding at the national level a reality, over two dozen different states have followed Kansas’s lead and enacted intrastate crowdfunding exemptions of their own.12 While states continue to adopt these exemptions, the debate over the benefits and risks associated with securities crowdfunding persists. As the North Carolina Providing Access to Capital for Entrepreneurs and Small Businesses (NC PACES) Act13 sits in the North Carolina General Assembly on the verge of passage, North Carolina finds itself in the middle of this debate.14

This Comment takes a detailed look at the legal and political landscape surrounding equity crowdfunding. Specifically, this Comment focuses on intrastate securities crowdfunding, the potential advantages and disadvantages associated with it, and North Carolina’s legislative efforts to bring the benefits of securities crowdfunding to the state while alleviating the concerns of those opposed to it.

Part I provides a general introduction to crowdfunding and explores the securities crowdfunding climate, specifically discussing the purpose of

8. Id.
9. Id.
I. UNDERSTANDING THE CURRENT SECURITIES CROWDFUNDING LANDSCAPE

A. Background and Definitions

Though crowdfunding is a relatively new and continuously developing concept, crowdfunding in its simplest form can generally be understood as a broad term referring to the general process of companies raising capital by using the internet or other media to reach out to a large number of investors who the investor did not know before the securities offering. Crowdfunding is based on the philosophy that members of the crowd will share their thoughts and opinions on potential investments, and through this open exchange of information, members of the crowd will protect one another. Typically, companies access the crowd by means of the internet, though this is not always the case. Nearly all crowdfunding campaigns are conducted through internet software platforms. While the exact role of platforms in the equity crowdfunding context is still developing, crowdfunding platforms generally provide a space where companies and


18. Id. at 684–86.

entrepreneurs seeking to raise capital can describe their businesses and offerings to potential investors looking for investment opportunities.\textsuperscript{20}

Crowdfunding can be separated into three basic categories from a legal standpoint: (1) rewards crowdfunding, (2) non-security loans crowdfunding, and (3) securities crowdfunding.

Under the rewards crowdfunding model, an investor will give a company or entrepreneur a certain amount of capital to be used for growing the company or achieving an objective.\textsuperscript{21} In exchange, the company gives the stakeholder some form of reward for their contribution, such as a product or something less tangible, like recognition for the contribution.\textsuperscript{22} Companies and entrepreneurs are projected to crowdfund approximately $34.4 billion in funds in 2015; $2.68 billion of which is expected to be raised under the rewards model.\textsuperscript{23}

Under the lending crowdfunding model, lenders will give money to individuals or companies with the expectation that the loan will be repaid, along with interest.\textsuperscript{24} For compliance purposes, crowdfunded loans under this category are not subject to federal securities laws.\textsuperscript{25} Of the $34.4 billion to be raised through crowdfunding this year, $25.1 billion is expected to come through loans crowdfunding; a significant amount of this will be non-security loans.\textsuperscript{26}

Securities crowdfunding is a term that encompasses all forms of crowdfunding subject to federal securities laws, and refers to both debt securities and equity securities. Debt securities are financial instruments that evidence a debt, and can take such forms as deposits, trade credits, and loans.\textsuperscript{27} Crowdfunding of equity securities, the focus of this Comment,

\begin{itemize}
  \item \textsuperscript{20} Carni, supra note 15, at 686–87.
  \item \textsuperscript{21} Id.
  \item \textsuperscript{22} Id.
  \item \textsuperscript{25} Whether a particular crowdfunded loan is subject to federal securities laws is beyond the scope of this Comment. For an analysis of federal court decisions that have considered this issue, see Kathy H. Rocklen & Benjamin Catalano, Syndicated Loans as Securities, PROSKAUER (Apr. 2011), http://www.proskauer.com/files/uploads/broker-dealer/Syndicated-Loans-as-Securities.pdf [http://perma.cc/CC5L-9K5A].
  \item \textsuperscript{26} See Barnett, supra note 23.
  \item \textsuperscript{27} BANK FOR INTL’L SETTLEMENTS ET AL., HANDBOOK ON SECURITIES STATISTICS 4 (May 2009), https://www.imf.org/external/np/sta/wgsd/pdf/051309.pdf [https://perma.cc/P4V6-KT2D].
\end{itemize}
allows investors the opportunity to invest their capital in a company in exchange for stock, or other equity securities, in the company. The JOBS Act created several exemptions from registration that compromise crowdfunding. To sell securities through crowdfunding, the issuer must either comply with one of these exemptions created in the JOBS Act or comply with a state crowdfunding law. Despite the restrictions on this model, an estimated $2.56 billion will be raised through equity crowdfunding in 2015.

B. Intrastate Crowdfunding

The intrastate offering exemption afforded by section 3(a)(11) of the Securities Act of 1933 and related SEC Rule 147 is a federal exemption from registration that predates the JOBS Act. Section 3(a)(11) was incorporated into the Securities Act of 1933 because the United States Constitution expressly grants Congress authority to regulate interstate commerce, but not intrastate commerce. The section 3(a)(11) exemption reads:

Any 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 person resident and doing business within or, if a corporation, incorporated by and doing business within, such State or Territory.

If the conditions of the section 3(a)(11) exemption are met, the issuer of the security is not required to register the offering under section 5 of the Securities Act.

Issuers have been reluctant to utilize the section 3(a)(11) intrastate exemption in the past due to its ambiguous language requiring some degree of statutory interpretation. The intrastate offering exemption’s requirement that the issuer be “doing business” in the state where the offering is being conducted has been open to many different interpretations.

31. See Barnett, supra note 23.
33. U.S. CONST. art. I, § 8, cl. 3.
interpretations. In an effort to give issuers a clear, objective means to qualify for the intrastate exemption, the SEC issued Rule 147 in 1974. Rule 147 was designed to provide issuers with a "safe harbor" from the ambiguities of section 3(a)(11). If an issuer satisfies all requirements of the rule, the offering is guaranteed to qualify for the intrastate exemption. However, a securities offering in accordance with Rule 147 is not the exclusive method of satisfying 3(a)(11). Offerings that do not comply with the rule may nonetheless qualify for the 3(a)(11) intrastate exemption if they meet the guidelines that have materialized through judicial interpretations and SEC commentary.

Though Rule 147 imposes several requirements on issuers wishing to qualify for exemption under the rule, one of its key components is the 80-80-80 test. This test requires that, for an offering to qualify for the intrastate crowdfunding exemption, the securities issuer must derive 80% of its revenue from the state, 80% of the issuer's assets must be located within the state, and 80% of the capital raised through the offering must go toward operations occurring in the state.

As an alternative to the section 3(a)(11) and Rule 147 intrastate crowdfunding exemption, some states have begun enacting legislation that allows issuers to conduct offerings in compliance with SEC Rule 504. Originally enacted in 1992, Rule 504 permits issuers to generally solicit investors (regardless of the investor's state of residence) when making offerings of no more than $1,000,000. Rule 504 exempts the offering from federal registration, and insists only that the offering is registered at the state level. While Rule 504 does not make use of the intrastate exemption relied on by 3(a)(11) and Rule 147, Rule 504 is similar in that, just like the intrastate exemptions, it provides issuers with a way to avoid federal registration of the offering.

As of August 1, 2015, twenty-eight states have enacted legislation allowing businesses and entrepreneurs within their state to take advantage

37. Id.
38. Id. at 199.
39. Id.
40. See id. at 199.
41. Id. at 200.
42. See id.
44. See id.
45. 17 C.F.R. § 230.504 (last amended Mar. 8, 1999).
46. Id. For an example of state legislation relying on the Rule 504 exemption, see 32 ME. REV. STAT. tit. 32, § 16304 (2015).
47. See 17 C.F.R. § 230.504.
of these intrastate or Rule 504 exemptions, and another eight states have such legislation pending.48

C. Role of the Securities and Exchange Commission

Prior to the creation of the SEC and the Securities Act of 1933, federal regulation of securities and the exchange of stock was extremely limited.49 Because securities regulation was primarily handled by the states, regulation was uneven, and in some instances, states were failing to protect investors from fraudulent securities offerings that originated outside state boundaries.50 These practices continued and increased throughout the 1920’s until the stock market crashed in 1929.51 The stock market crash, along with the Great Depression that quickly followed, severely weakened public confidence in securities markets.52 Congress, through the Securities Exchange Act of 1934, created the SEC in 1934 to restore the public’s faith in the stock market.53 Since its creation, the SEC has operated with a focus on protecting investors while simultaneously facilitating companies’ efforts to form capital.54 These two interests, however, frequently conflict with one another, as illustrated by the equity crowdfunding debate.55

D. The Jumpstart Our Business Startups (JOBS) Act

On April 5, 2012, the JOBS Act56 was signed into law.57 The JOBS Act’s primary purpose is to increase economic growth and job creation by making it easier for small businesses and entrepreneurs to raise capital.58

50. See id.
51. Id.
52. See id.
54. The Investor’s Advocate, supra note 49.
57. Armstrong Teasdale LLP, supra note 11.
58. Id.
In an effort to achieve this goal, part of the JOBS Act attempts to grant these startups and small, growth-seeking businesses access to potential investors by means of federal securities crowdfunding.\textsuperscript{59} Essentially, once the framework for federal securities crowdfunding is completed by the SEC, these companies will be able to offer and sell securities to the general public through the use of intermediary platforms, or "portals."\textsuperscript{60} However, while the JOBS Act's purpose is clear, it does not provide all the necessary rules for establishing how this form of crowdfunding will be implemented.\textsuperscript{61} Instead, the JOBS Act tasked the SEC with drafting rules for capital formation and disclosure requirements within the federal crowdfunding mechanism.\textsuperscript{62}

Though the JOBS Act's goal of making the capital formation process for small, private companies has been partially realized through the implementation of Title II and Title IV of the Act, the crowdfunding rules under Title III of the JOBS Act have not yet been finalized by the SEC.\textsuperscript{63}

Title II of the JOBS Act commanded the SEC to rewrite Rule 506 to exempt offerings and sales of securities from the ban on general advertising and solicitation if all securities purchasers are accredited investors.\textsuperscript{64} This exemption has been codified in Rule 506(c).\textsuperscript{65} Under this rule, the responsibility to prevent non-accredited investors from purchasing the offered securities lies with the issuer, who must "take reasonable steps to verify that purchasers of securities... are accredited investors."\textsuperscript{66} However, the ban on general advertising and solicitation still applies if any of the securities purchasers are not accredited investors.\textsuperscript{67} Such offerings and sales of securities to both accredited and non-accredited investors have been permitted under Rule 506(b) for many years prior to the JOBS Act.\textsuperscript{68}
but these offerings have been hindered by the advertising and solicitation restriction.\textsuperscript{69} The 506(c) exemption allows issuers to advertise freely in hopes of expanding their investor base and completing larger, quicker fundraises.\textsuperscript{70} The SEC completed its revision of Rule 506 in accordance with Title II in September 2013.\textsuperscript{71}

Title IV, commonly referred to as Regulation A+, was finalized by the SEC on March 25, 2015.\textsuperscript{72} One purpose of Regulation A+ is to facilitate private companies’ transition from being a private company to being a public company.\textsuperscript{73} Essentially, Regulation A+ created an intermediary stage that allows companies to file fewer reports with the SEC, which would reduce the expenses a traditional public company typically faces.\textsuperscript{74} Under Regulation A+, private companies can publicly offer and sell up to $50 million in unrestricted securities.\textsuperscript{75} Though these securities are not restricted, the SEC requires the issuer to file audited financial statements annually, and may subject the issuer to other terms or conditions in order to protect investors and the public in general.\textsuperscript{76} While Regulation A+ does provide a cheaper way for companies to sell securities than registering as a traditional public company, utilizing Regulation A+ is still likely to be cost-prohibitive\textsuperscript{77} for many smaller companies that do not intend to raise

\begin{itemize}
    \item There are no more than or the issuer reasonably believes that there are no more than 35 purchasers of securities from an issuer in any offering under [506(b)] . . . [and e]ach purchaser who is not an accredited investor . . . has such knowledge and experience in financial and business matters that he is capable of evaluating the merits of risks of the prospective investment, or the issuer reasonably believes immediately prior to making any sale that such purchaser comes within this description.
\end{itemize}


\textsuperscript{70} Id.

\textsuperscript{71} Barnett, supra note 62.


\textsuperscript{73} Id.

\textsuperscript{74} Id.


\textsuperscript{76} Id.

\textsuperscript{77} The cost of doing a traditional initial public offering (IPO) is estimated to be around $500,000. Express IPO Capital Frequently Asked Questions, EXPRESS IPO CAP., http://www.expressipo.com/faqs.html [http://perma.cc/NDW7-XVHW] (last visited May 18,
large amounts. Regulation A+’s filing, reporting, and preparation requirements, while manageable for established companies in a later stage of growth, will put too much of a financial burden on many small companies that are trying to raise capital in the first place.

Title III of the JOBS Act, referred to as the “Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012,” or the “CROWDFUND Act,” has yet to be implemented. The SEC has proposed, but has not finished Title III rules. Title III and the proposed SEC rules will allow companies using this exemption to offer and sell up to $1,000,000 in unregistered securities. The transactions between the company and investor cannot exceed the greater of $2,000 or 5% of an individual’s income if that individual’s net worth or annual income is less than $100,000. If the investor’s net worth is at least $100,000, the transaction cannot exceed 10% of the investor’s net worth or individual income, subject to a maximum amount sold, which is capped at $100,000. These transactions must occur through an intermediary, such as a broker or funding portal. These intermediaries must register with the SEC. The intermediaries must also make certain required disclosures, and they have a duty to educate investors about the issuers and the risks associated with this form of investing. The specifics of these requirements and duties have not yet been finalized by the SEC. The securities issuers likewise have assigned duties under Title III, including an obligation to make a disclosure

2016). By contrast, using Regulation A+ is estimated to cost roughly $100,000. Carni, supra note 15.

78. Raneri, supra note 72.
79. Id.
84. Id.
85. Id.
86. Id.
87. Id.
88. Id.
to the SEC, to the intermediary, and to the investors, consisting of at least nine different pieces of information.\textsuperscript{90}

More than three years after the JOBS Act was signed, the SEC continues to work toward drafting a workable set of rules that comport with the text of the Act.\textsuperscript{91} As the SEC addresses the intricacies of Title III and the complex body of law it affects, the Commission finds itself struggling to create rules that effectively balance the seemingly competing concerns of both investors and private companies.\textsuperscript{92} These concerns from investors and issuers are further compounded by the apprehension of intermediaries and portal operators, fear that the rules eventually put in place by the SEC might hold intermediaries liable for the wrongs of issuers using them to reach investors.\textsuperscript{93}

Further, Congress itself has expressed trepidation over some of the SEC's proposed rules. United States Congressman Patrick McHenry, the drafter of Title III of the JOBS Act, has voiced concern over some aspects of the SEC's propositions thus far.\textsuperscript{94} Congressman McHenry has said that if the SEC attempts to put into place regulations and requirements that are inconsistent with Congress' intent with the JOBS Act, Congress will write new legislation to effectively void the SEC's rules.\textsuperscript{95} In fact, Congressman McHenry did exactly that when he drafted a new piece of legislation on April 23, 2014, in an effort to rework Title III and fix the issues plaguing it.\textsuperscript{96} However, it does not appear much progress has been made on making Title III a reality or introducing new substitute legislation, as experts have, as recently as March 2015, declared Title III to be effectively "dead."\textsuperscript{97}

\begin{itemize}
\item \textsuperscript{90} See Jumpstart Our Business Startups (JOBS) Act § 302.
\item \textsuperscript{91} See The Ultimate Crowdfunding Guide, supra note 24.
\item \textsuperscript{93} See id. at 330.
\item \textsuperscript{94} See id. at 329.
\item \textsuperscript{95} See Congressman Patrick McHenry, Deputy Republican Whip (NC-10), Opening Remarks at the Fordham Journal of Corporate and Financial Law Symposium: JOBS Act: The Terrible Twos (Mar. 24, 2014), in 20 FORDHAM J. CORP. & FIN. L. 293, 299 (2015). On March 24, 2014, Congressman McHenry stated that, regarding the SEC's attempts to finalize the rules for Title III he thought "[the SEC] missed the mark, and ... it will take Congress to address it legislatively to fix it." \textit{Id.} at 301.
\item \textsuperscript{97} See Samuel Guzik, JOBS Act State of the Union: What's Become of Regulation A+ and Crowdfunding?, CROWDFUND INSIDER (Mar. 11, 2015, 7:00 AM), http://www.crowd
\end{itemize}
II. THE DEBATE OVER SECURITIES CROWDFUNDING

A. Tensions Within Securities Crowdfunding

Securities crowdfunding, in the form that the JOBS Act and many state legislatures have attempted to employ it, involves two main actors: the securities issuer and the investor. Just as in the JOBS Act, many of the more recent intrastate crowdfunding exemption statutes include a third actor: the intermediary. These three actors have individual interests in the equity crowdfunding context, and frequently these interests conflict with one another.

Securities issuers are primarily interested in raising capital from investors in order to meet their goals of growth. However, this option for raising capital must be cost-effective for businesses, or else they will be dissuaded from utilizing securities crowdfunding exemptions. The JOBS Act and intrastate crowdfunding legislation subject businesses attempting to offer and sell securities to several filing, reporting, and disclosure requirements, which can place a heavy financial burden on startups without much capital.

These very requirements that legislation places on issuers exist in order to serve the interests of the investors. Investors want the freedom to invest in companies and startups in hopes of getting a return on that investment, while still being protected from risky and potentially fraudulent companies. The SEC exists, in part, for this very purpose.

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102. See id.


104. See id.

securities crowdfunding to the general public means that unaccredited investors, who likely have had little to no experience with purchasing securities, will be making their own decisions on which securities to purchase. Requiring securities issuers to disclose and report certain information to potential investors gives these investors the ability to make more informed decisions on which companies they choose to invest with.

Intermediaries also have an interest in the equity crowdfunding discussion—avoiding liability for the actions of issuers operating through the intermediary. These intermediaries, typically taking the form of portal websites, see themselves as platforms through which investors and companies can connect. Portals do not intend to take on the role of providing investors with advice on which companies are worthwhile investments, but, due to Title III's definition of an issuer, portals may come close to falling within the definition of an issuer. Because issuers are held liable for their omissions, misstatements, and fraudulent activities, portals are concerned with avoiding classification as issuers.

B. Securities Crowdfunding Benefits and Risks in the Equity Context

The federal and state legislatures have begun focusing their efforts on equity securities crowdfunding in an attempt to grow the economy by giving startups and small businesses greater access to capital. The idea is that by allowing these small businesses to raise capital in a new, practical way, more small businesses will have the opportunity to succeed and grow. In turn, the hope is that as more businesses succeed and expand, these businesses will create new jobs and improve overall economic health.

106. The Investor's Advocate, supra note 49.
108. See The Promise and Perils of Equity Crowdfunding, supra note 103.
110. Id. at 327.
111. See id. at 330.
112. Id. at 334.
113. The Promise and Perils of Equity Crowdfunding, supra note 103.
114. Id.
115. Id.
Startups have historically had limited options for raising capital.\textsuperscript{116} Donations or loans from friends and family are an option, but those resources may be too limited to meet the needs of certain businesses in some instances.\textsuperscript{117} Banks and institutional lenders, another potential source of capital, often refuse to make loans to startups due to the risky, unpredictable future of these companies.\textsuperscript{118} If these traditional lenders are willing to loan capital to a startup, they might go so far as to require collateral for the loan, which could be problematic for some new entrepreneurs.\textsuperscript{119} Equity securities crowdfunding is an alternative method for small businesses to raise capital that incentivizes investors to get involved through contributing capital.\textsuperscript{120}

An added benefit of equity securities crowdfunding is its dispersal of risk among a larger pool of investors.\textsuperscript{121} Because investors can only purchase a limited amount of equity, the number of investors in the small business will be greater than if only a few were buying stock.\textsuperscript{122} Thus, each investor's risk is limited, and the investor faces a less significant loss if the startup fails.

Intrastate crowdfunding in particular has the potential to serve the needs of individual states in a way the federal crowdfunding mechanism cannot.\textsuperscript{123} States have the ability to craft intrastate crowdfunding rules tailored to the state's unique needs not addressed by the federal model created through Title III of the JOBS Act.\textsuperscript{124} States might be able to use crowdfunding on a state level in ways that get more investors and companies involved than if the parties were left with only the federal model.\textsuperscript{125}

With the benefits of equity securities crowdfunding come potential risks. One of the most commonly voiced concerns surrounding equity

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\item \textsuperscript{116} Carni, \textit{supra} note 15.
\item \textsuperscript{117} \textit{The Promise and Perils of Equity Crowdfunding}, \textit{supra} note 103.
\item \textsuperscript{118} Carni, \textit{supra} note 15.
\item \textsuperscript{119} \textit{The Promise and Perils of Equity Crowdfunding}, \textit{supra} note 103.
\item \textsuperscript{120} \textit{See id.}
\item \textsuperscript{121} Carni, \textit{supra} note 15.
\item \textsuperscript{122} \textit{Id.}
\item \textsuperscript{125} McGlade, \textit{supra} note 123.
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\end{footnotesize}
securities crowdfunding is the potential for fraud.\textsuperscript{126} The worry is that allowing these startups to ask the general public for money will give fraudsters the opportunity to solicit money from unaccredited, unsuspecting investors without actually intending to give these investors a return on their investments.\textsuperscript{127} While fraud may take the form of a criminal soliciting funds and then disappearing, the fraudulent activity could be more subtle.\textsuperscript{128} For instance, a company giving performance statements that, while true, are designed to purposefully mislead investors, would be considered fraud.\textsuperscript{129} Whatever the form fraud takes, some experts are confident that it will occur to some extent.\textsuperscript{130}

While fraud is frequently cited as a detractor to equity securities crowdfunding, there is little concrete evidence to support this concern. For instance, Australia, which has allowed equity crowdfunding since 2007, did not have a single registered complaint of fraud as of March 24, 2014.\textsuperscript{131} Similarly, England did not have any reported instances of equity crowdfunding fraud between the country’s first implementation of securities crowdfunding in 2012 and March 24, 2014.\textsuperscript{132}

Along with fraud concerns, securities crowdfunding exemptions can potentially expose the public to businesses purporting to conduct sales of securities under a crowdfunding exemption, despite not actually meeting the exemption requirements. An example of such conduct occurred in Massachusetts in 2012.\textsuperscript{133} According to a complaint from the Massachusetts Secretary of State, an individual violated Massachusetts securities laws by making general solicitations over social media, and claiming that such offerings were being made through a crowdfunding exemption.\textsuperscript{134} In reality, these offered securities were not registered, and

\begin{itemize}
  \item \textsuperscript{126} The Promise and Perils of Equity Crowdfunding, supra note 103.
  \item \textsuperscript{127} Id.
  \item \textsuperscript{129} Id.
  \item \textsuperscript{130} See, e.g., id.; Isenberg, supra note 107.
  \item \textsuperscript{132} Id.
\end{itemize}
did not qualify for exemption from Massachusetts securities laws.\textsuperscript{135} The individual attempted to offer $250,000 in securities for his company, Tabletop Arena LLC, which sold gambling products and services.\textsuperscript{136} The individual managed to collect over $153,000 in cash through transactions with at least twenty investors over a span of nearly two years.\textsuperscript{137} This incident occurred before the JOBS Act was signed or any state had adopted intrastate crowdfunding legislation.\textsuperscript{138}

The Tabletop Arena example illustrates a concern brought on by equity securities exemptions that may prove troublesome for both securities issuers and investors: these securities crowdfunding exemptions, might be inviting unnecessary risk and confusion surrounding the offer and sale of securities, a sector of the law that is already foreign to many businesses and individuals.

Another concern raised by equity crowdfunding skeptics is the worry that inexperienced investors will not appreciate the risky nature of these stocks.\textsuperscript{139} Because the level of success of any given startup is often unpredictable, investors could easily find themselves making poor investments.\textsuperscript{140} Some experts warn that the average person does not have the knowledge, skills, or resources to properly examine an investment opportunity and accurately evaluate that company's prospects of success.\textsuperscript{141}

In response to the concerns over fraud and the inherent risk associated with the practice of equity crowdfunding, some have pointed out that the "crowd" aspect of equity crowdfunding will serve to allay these concerns.\textsuperscript{142} One side argues that the wisdom of the crowd will allow investors to determine whether a capital raising campaign shows signs of fraud, or is just a poor investment in general.\textsuperscript{143} With larger groups of investors analyzing business plans and financial statements, the chances of someone discovering potential problems or suspicious activity is greater.

\begin{thebibliography}{99}
\bibitem{135} Id. at 1.
\bibitem{136} Id.
\bibitem{137} Id.
\bibitem{139} See Isenberg, supra note 107.
\bibitem{140} \textit{The Promise and Perils of Equity Crowdfunding}, supra note 103.
\bibitem{141} See id.
\bibitem{142} See, e.g., id.
\end{thebibliography}
than if a small pool of investors were involved.\textsuperscript{144} The idea is that once an alarming discovery is made, news will spread throughout the crowd, and investors will avoid the risky or potentially fraudulent company.\textsuperscript{145}

However, some believe that the crowd will not be able to differentiate between good and bad investments as one might think.\textsuperscript{146} As a group of investors gets larger, more prospective investors fall into the logic that such a large group of individuals cannot all be making a bad investment. In reality, the “crowd” may not be as wise as investors believe.\textsuperscript{147} This argument is based on the social phenomenon of “pluralistic ignorance,”\textsuperscript{148} the concept that an individual will follow the behavior of others even though that behavior is contrary to the individual’s beliefs.\textsuperscript{149} Applying pluralistic ignorance to the equity crowdfunding model, individuals will be susceptible to following others into poor investments, thinking that these early investors have diligently vetted the company and made a sound investment, even if the individual investor has not researched the company or has done so and believes it to be a bad investment.\textsuperscript{150}

The risks of securities crowdfunding are not confined solely to investors. Businesses choosing to offer securities under the federal or intrastate crowdfunding exemptions may find themselves liable for failing to adhere to federal or state statutes. Title III of the JOBS Act imposes a number of disclosures companies engaging in an exempted offering must make to its investors.\textsuperscript{151} Likewise, many in-state exemption statutes have adopted similar lists of required disclosures.\textsuperscript{152} Businesses that try to navigate these securities exemptions without legal assistance risk unintentionally omitting material information or making misstatements to

\textsuperscript{144.} The Promise and Perils of Equity Crowdfunding, supra note 103.
\textsuperscript{145.} Id.
\textsuperscript{146.} See id.
\textsuperscript{147.} Id.
\textsuperscript{148.} Isenberg, supra note 107.
\textsuperscript{150.} Isenberg, supra note 107.
\textsuperscript{152.} See, e.g., North Carolina Providing Access to Capital for Entrepreneurs and Small Businesses (NC PACES) Act, ch. 78A, sec. 78A-49, 2015 N.C. Sess. Laws 481. This proposed statute, including its list of required disclosures, will be further examined in Part III infra.
investors. Under the JOBS Act, a business making such material omissions or misstatements would be subject to liability for violating the statute.\textsuperscript{153}

C. History of Intrastate Securities Crowdfunding Exemptions

States have only recently begun to utilize the intrastate crowdfunding exemption to federal securities regulations authorized by the Securities Act of 1933. In March 2011, Kansas became the first state to allow its intrastate businesses to use this exemption by passing the Invest Kansas Exemption (IKE).\textsuperscript{154} This first-of-its-kind piece of legislation created an avenue for Kansas companies to raise up to $1,000,000 from non-accredited investors residing within the state.\textsuperscript{155} IKE includes limitations on how much money each non-accredited investor can contribute and how the funds can be transferred to the offering issuer.\textsuperscript{156} In November 2011, Georgia followed Kansas’s example by becoming the second state to bring intrastate equity crowdfunding to its businesses and residents.\textsuperscript{157}

In these two states, this pioneer legislation was slow to attract businesses. In Kansas, only six companies took advantage of IKE during its first two years.\textsuperscript{158} Similarly, Georgia companies were slow to utilize the intrastate exemption. Georgia officials reported that only six businesses used the Invest Georgia Exemption in 2013.\textsuperscript{159} Part of this underutilization of equity crowdfunding during the early years stemmed from a lack of businesses understanding just how the exemption was supposed to work.\textsuperscript{160} A more recent hindrance has been a lack of awareness on the part of investors.\textsuperscript{161} While businesses have been prepared to conduct raises through intrastate crowdfunding, investors in some markets have not yet appeared.\textsuperscript{162}

Although intrastate crowdfunding was not a popular capital formation option during its beginning, the current outlook seems more positive. Since

\begin{itemize}
  \item \textsuperscript{153} Jumpstart Our Business Startups (JOBS) Act § 302.
  \item \textsuperscript{154} Clark, supra note 124.
  \item \textsuperscript{155} KAN. ADMIN. REGS. § 81-5-21 (2011).
  \item \textsuperscript{156} See id.
  \item \textsuperscript{157} Clark, supra note 124.
  \item \textsuperscript{158} Id.
  \item \textsuperscript{159} Id.
  \item \textsuperscript{160} Id.
  \item \textsuperscript{162} See id.
\end{itemize}
2011, the number of states enacting intrastate exemptions has increased. As more states adopt these exemptions, more startups and small businesses will have the option to participate in equity crowdfunding. Further, most of these intrastate exemptions share many qualities, including having similar maximum capital raise amounts for issuers, maximum contribution amounts for individual investors, and disclosure requirements. This may allow businesses and investors from states with well-established and utilized intrastate exemptions to share their knowledge and expertise on these exemptions with states that have only recently enacted them. The number of businesses taking advantage of intrastate exemptions has increased significantly since the first two years of intrastate crowdfunding; as of August 1, 2015, 118 businesses and startups had filed offerings under the exemption, with 102 of those filings being approved.

D. North Carolina and Intrastate Crowdfunding

North Carolina’s first venture into intrastate crowdfunding came on April 9, 2013, when House Bill 680, referred to as the NC JOBS Act, was filed in the North Carolina General Assembly. That original bill did not pass, so in 2014 the House attached the text of the JOBS Act to a Senate bill that is before the House waiting on approval. When the bill stalled in the General Assembly, the Senate added the NC JOBS Act to House Bill 1224, along with a number of other unrelated provisions. These other, more controversial pieces of legislature attached to House Bill 1224 prevented the House from approving the changed bill. House Bill 1224, including the NC JOBS Act, was defeated on August 19, 2014, by a vote of


164. See Summary of ENACTED Intrastate Crowdfunding Exemptions, supra note 163.

165. Coverman, supra note 48.


167. Id.

168. Id.

Mark Easley, one of the organizers of the NC JOBS Act, said in an email to JOBS Act supporters that the bill simply “fell victim to political gamesmanship,” indicating the JOBS Act’s failure to pass was the result of procedural difficulties, not substantive problems.171

The North Carolina legislature has since presented four bills in either house of the General Assembly that would allow for some form of intrastate crowdfunding.172 All of those bills passed their first readings and were being examined by various committees within the Senate and the House in the 2015 Session.173 The leading bill, Senate Bill 481, referred to as the North Carolina Providing Access to Capital for Entrepreneurs and Small Businesses (NC PACES) Act, closely resembles the NC JOBS Act.174 The bill was sent to the Senate Committee on Finance in April 2015 where it remained until the close of the 2015 Session in October.175

III. ANALYZING THE NC PACES ACT

The vast majority of the NC PACES Act consists of the Invest North Carolina Exemption, a proposed statute that will be created upon passage and enactment of Senate Bill 481.176 The statute will exempt issuers from section 78A-24, which prevents the offer and sale of unregistered securities in North Carolina if such an offer and sale are not conducted under an exemption.177 The Invest NC Exemption contains maximums for the amount of capital that can be raised by companies and the amount of capital unaccredited investors can contribute.178 In an effort to protect

170. Id.
171. Id.
173. Id.
176. Id.
177. Id.
178. Id.
investors from harmful investments, the exemption also includes many provisions creating requirements that businesses must meet in order to qualify for the exemption and maintain that qualification.\footnote{Id.} Overall, the Invest NC Exemption, as created by the NC PACES Act, will be an effective tool for allowing new and growing businesses to raise capital, while still providing the necessary safeguards to protect investors from the perils of equity crowdfunding.

\textbf{A. Complying with Federal Securities Laws}

When deciding to make securities crowdfunding available to businesses, state legislators have options for which federal registration exemption those securities offerings will be utilizing. As discussed above, a state might choose the section 3(a)(11) intrastate crowdfunding exemption, the Rule 504 federal registration exemption, or it might make both options available.

If the state chooses the intrastate exemption model, it must decide whether to require issuers to adhere to the Rule 147 safe harbor requirements. If the state requires issuers to follow Rule 147, the state and the issuers will be afforded certainty that all security offerings are protected by the 3(a)(11) intrastate exemption. If the state does not force issuers to follow Rule 147, the state gives up that certainty. In exchange, the state affords issuers flexibility in choosing how to conduct securities offerings. Under this model, issuers need only satisfy the 3(a)(11) requirements to qualify for the intrastate exemption.\footnote{See North Carolina Providing Access to Capital for Entrepreneurs and Small Businesses (NC PACES) Act, ch. 78A, sec. 78A-49, 2015 N.C. Sess. Laws 481.} However, by choosing not to utilize the Rule 147 safe harbor, and instead navigating the ambiguities of 3(a)(11), issuers run the risk of failing to satisfy the statutory requirements and would thus not qualify for the exemption.

The NC PACES Act, if passed, will require issuers to follow Rule 147.\footnote{17 C.F.R. § 230.147 (1974).} This is the most restrictive option for issuer compliance with federal securities laws. With Rule 147 comes the 80-80-80 test used to determine if an issuer is “doing business” in the state for the purposes of section 3(a)(11).\footnote{Id.} This test may be problematic for companies that generate large portions of revenue through online sales to out-of-state customers. Additionally, businesses located in cities close to state borders risk not satisfying the 80\% requirement if those businesses have a large

\footnote{179. Id.}
\footnote{180. Even, if the statute does not require the issuer to follow Rule 147, issuers nonetheless remain free to utilize that safe harbor.}
\footnote{182. 17 C.F.R. § 230.147 (1974).}
client base from the neighboring state. Charlotte, North Carolina’s largest city, is situated very close to the South Carolina border. Thus, many Charlotte businesses may not qualify for the Invest NC Exemption if a significant number of their customers are from South Carolina.

Another serious restriction imposed by Rule 147 is the prohibition on making an offering to out-of-state residents. This necessarily implicates any advertising that could reach residents outside of the state in any medium. Given society’s ever-increasing reliance on the internet, this restriction is especially problematic. An online mention of an equity raise, or an advertisement that could be interpreted as such, would likely run afoul of Rule 147 and cause the issuer to lose its exemption. The rule would prohibit issuers from advertising offerings over social media due to its transcendence of physical state borders. Simply put, Rule 147 imposes significant restrictions on businesses. By forcing businesses to adhere to it, North Carolina may find its businesses hesitant to make offerings under the intrastate exemption.

Fortunately, the SEC has recognized the anachronisms of Rule 147 in the modern economic landscape. The rule was drafted over forty years ago when social media and online consumer transactions were unheard of. In an effort to modernize Rule 147, the SEC’s Advisory Committee on Small and Emerging Companies has reviewed the rule and is recommending the SEC make significant changes. In a letter dated September 23, 2015, the Advisory Committee recommended that the SEC make three changes designed to alleviate the most restrictive aspects of the rule.

The Advisory Committee has proposed eliminating the 80-80-80 test used for determining whether the issuer is “doing business” within the state. The Committee has acknowledged that this test is difficult to satisfy for many businesses, and has suggested the SEC consider alternative tests for determining whether an issuer has the necessary connection to the state in which it conducts the offering. Eliminating the 80-80-80 test

183. Id.
185. Id.
187. Id.
188. Id.
would be a major step in reducing Rule 147’s restrictiveness. Without the test, many businesses that do a significant amount of business online, or have many out-of-state customers, are more likely to qualify for exemption under the modernized rule.  

The Advisory Committee has also recommended that the rule be changed to “allow[] offers made in reliance on Rule 147 to be viewed by out-of-state residents, but require that all sales be made only to residents of the state in which the issuer has its main offices . . . .” This change would allow issues to advertise and solicit investors without concern for who actually views the advertisement. The issuer would have the responsibility of preventing any securities from being sold to out-of-state residents. If this change is adopted, the advertising difficulties issuers face under Rule 147’s current format will be eliminated. Issuers could use online advertisements and social media to reach investors without fear of losing the intrastate exemption.

The Advisory Committee’s last recommended rule change is elimination of the requirement that the issuer be incorporated or organized in the same state where the sales occur. Without this restriction, businesses will not be restrained by their state of incorporation or organization when making an intrastate offering. More businesses would be able to qualify for the exemption through the rule’s safe harbor.

Should the SEC adopt the Advisory Committee’s recommended Rule 147 changes, the rule would become much less restrictive for small businesses. Modernization of the rule would allow more North Carolina businesses to qualify for the intrastate exemption without having to sacrifice the certainty that comes within meeting the requirements of the Rule 147 safe harbor. Simply put, an improved Rule 147 would allow North Carolina businesses to enjoy the benefits of intrastate crowdfunding more so than they would under the current Rule 147. North Carolina legislators should pay close attention to how the SEC incorporates the recommendations from the Advisory Committee in the coming months because any changes will directly impact the effectiveness of the Invest NC Exemption.

189. While the Advisory Committee has recommended removing the 80-80-80 test, it is unclear what new test would take its place. The Advisory Committee has not proposed any specific alternatives. Just how beneficial a change to the rule would be for small businesses depends on the restrictiveness of the alternative adopted.

190. Letter from Advisory Committee, supra note 186.

191. Id.
B. Granting North Carolina Businesses Access to Capital

In order for intrastate crowdfunding exemption to positively impact North Carolina, the State must pass legislation providing North Carolina businesses with an easily-accessible avenue for seeking investments. Despite the obstacles presented by contrary interests and federal securities laws, the NC PACES Act, if passed, will give businesses precisely this. The Invest NC Exemption includes a generous annual maximum for crowdfunding campaigns that will be more than adequate for the large majority of businesses. This is a useful method for raising the capital needed for these businesses to grow and will spur economic vitality in North Carolina.

As required by the federal intrastate exemption, the Invest NC Exemption applies only to businesses formed under North Carolina laws and registered with the North Carolina Secretary of State. If the business meets these criteria, it may use the exemption to raise up to $1,000,000 every twelve months, or up to $2,000,000 every twelve months if the business has undergone a financial audit for its most recent fiscal year, and made the information from that audit available to all prospective investors and the Administrator. These annual limits mirror those included in intrastate exemptions already adopted by other states, including Indiana, Michigan, and Wisconsin. Compared to states like Maryland and Oregon, which have limited annual intrastate crowdfunding campaigns to $100,000 and $250,000 respectively, the Invest NC Exemption purports to give businesses access to significantly more capital.

However, while these proposed limits may provide enough capital for the majority of businesses, others are pushing for higher maximums. Notably, some large software and biotech companies have expressed a need to raise more than $2,000,000 annually in order to achieve the growth they seek. Fearing the federal JOBS Act’s crowdfunding maximums will not

193. Id.
194. See Summary of ENACTED Intrastate Crowdfunding Exemptions, supra note 163.
196. See id.
197. See id. Given the size of these large biotech and software companies, along with the fact that a large amount of their products are probably being sold to citizens throughout the country, these companies are likely involved in significant amounts of interstate commerce. See generally id. If this is the case, the companies might not be deriving at least
meet their needs, these companies have pushed state legislatures to increase annual crowdfunding caps, or to not cap such fundraises at all. In the opinion of these companies, these annual limits are an unnecessary obstacle to growth.

In response to these companies’ push for higher limits, legislators and other entrepreneurs have pointed out that this exemption is intended for smaller companies in the early stages of growth. In other states, intrastate crowdfunding has been implemented by companies operating businesses in the restaurant, retail, and entertainment industries. To smaller companies like these, caps of $1,000,000 or $2,000,000 are usually sufficient to meet their needs. Additionally, these larger companies that have already gone through their initial stages of growth and now seek millions of dollars now have the new federal Regulation A+ crowdfunding option. These well-established companies dealing with large amounts of money are more likely able to bear the costs associated with this exemption. To the smaller startups that often have trouble with initial capital raises, the target businesses of the Invest NC Exemption, the $1,000,000 or $2,000,000 annual limit will be sufficient for raising funds to meet their needs in the vast majority of cases.

Though NC PACES does not restrict issuers’ advertising efforts beyond the Rule 147 restrictions, there are some proposed provisions that will affect how portals function in the offer and sale of securities. The Invest NC Exemption will allow issuers to offer and sell securities through online portals, though businesses are not required to use an online platform. In order to establish itself as a portal, a website must first register with the Administrator by filing a statement declaring it is a business entity organized under the laws of North Carolina, and that it will be used to offer and sell securities in accordance with the intrastate exemption. Further, the website will have to work with issuers utilizing

80% of their revenue from a single state, thus not satisfying Rule 147’s 80-80-80 test and failing to qualify for intrastate exemptions.

198. Id.
199. Id.
200. Id.
201. Coverman, supra note 48.
203. Id.
205. Id.
the site to keep and maintain records of offers and sales of securities that result from use of the site.\textsuperscript{206}

While alone these registration and record-keeping requirements may only be a minimal or modest burden on portals, these duties might be more problematic with the addition of the other portal restrictions. For instance, to prevent portals from slipping into the role of a broker-dealer,\textsuperscript{207} the Invest NC Exemption prevents portals from “offer[ing] investment advice or recommendations,” and from soliciting purchases, sales, and offers to buy the securities offered or displayed on the portal website.\textsuperscript{208}

Further, Invest NC places restrictions on compensation for these portals and portal employees or agents.\textsuperscript{209} Portals and their agents cannot be compensated based on securities transactions.\textsuperscript{210} However, portals are not prevented from charging issuers a subscription fee or a one-time flat fee for listing their offerings on the website. Additionally, intermediaries might discover other creative methods of generating revenue that avoid the transaction-based compensation restrictions imposed by the Invest NC Exemption. Because the exemption leaves individuals or businesses considering whether to operate as a portal with a substantial degree of flexibility for revenue generation, these potential portals should not be overly discouraged by the exemption’s prohibition on transaction-based compensation.

Overall, the Invest NC Exemption’s rules limit portals to a passive role. Because issuers will only be able to advertise crowdfunding raises in a limited capacity, portals can be a valuable tool for issuers seeking...
additional exposure and publicity for their fundraisers. But, if the portal is not well-known, its ability to attract prospective investors will be limited, thereby reducing the issuer’s chances of successfully raising funds. While portals may be able to appreciate how these rules are designed to protect them from the liability of posting a fraudulent offering, issuers would likely rather see rules that allow portals to take a more involved approach in promotion of raises.

On their face, these restrictions on portals might appear to be overly burdensome on portal operators. However, such restrictions serve a valuable purpose that actually benefits portals. By following these statutory requirements, portals are forced into an impartial, intermediary role in the issuer-investor relationship. This neutrality helps portal operators avoid liability for any securities violations that an offering posted on portal websites might trigger. Thus, these restrictions are a form of protection for portal operators. The protection the statute creates for portals is an overall positive in that it actually reduces uncertainty for operators in the context of liability for non-complying or fraudulent offerings conducted through their websites. Therefore, these provisions are beneficial to intermediaries and will likely encourage the formation of more portals, which in turn will create more options for issuers to choose from when deciding how to conduct their offerings.

C. Protecting North Carolina Investors

While the NC PACES Act attempts to give North Carolina businesses access to the crowd, it also includes several provisions designed to protect investors from the risky, perilous nature of the securities market. One of the most significant and useful investor safeguards in the Invest NC Exemption is the limit placed on the amount of money an unaccredited investor can annually contribute to a business. Unaccredited investors can invest no more than $5,000 with any single issuer per year.211 This prevents investors from losing more significant amounts of money to bad or fraudulent investments. A $5,000 maximum is similar to many of the other intrastate exemptions, which generally range from $2,000 to $10,000 for unaccredited investors.212

The Invest NC Exemption also imposes a number of requirements on issuers that are designed to protect investors.213 For instance, when an issuer makes an offer of securities to an investor, the issuer must provide

211. Id.
212. See Summary of ENACTED Intrastate Crowdfunding Exemptions, supra 163.
the investor with a disclosure documenting several pieces of information.\textsuperscript{214} The disclosure must include the following: (1) a description of company; (2) the company’s address and principle office phone number; (3) a company history; (4) a business plan; (5) intended use of the profits from the raise (including amounts to be paid to company owners, executives, and directors); (6) the identity of anyone with more than a 10\% ownership interest in any class of the company’s securities; (7) the identity of all company directors, executives, managing members, and those fulfilling similar roles (including their titles and prior experience); (8) any of the company’s outstanding securities; (9) the minimum and maximum amount of securities being offered; (10) the identity of those that will be assisting the issuer in conducting the offering and sale of securities (including websites), as well as the consideration paid to them for this service; and (11) the names, addresses, and URL of any website used in connection with the offering.\textsuperscript{215} The disclosure must also include any additional information that is material to the offering, such as “a discussion of significant factors that make the offering speculative or risky,” as well as any litigation or legal proceedings surrounding the company.\textsuperscript{216}

Together, all of this information aids investors in two ways. First, it gives investors and the Administrator important details about the issuer and those responsible for the offering, which increases transparency and allows investors and the Secretary of State to hold the issuer liable for any fraudulent acts. Second, it provides important and useful information to help investors make more informed decisions when deciding whether to invest in a company thus reducing the riskiness of these investments, if only to a small degree.

The Invest NC Exemption also requires the issuer include a conspicuous all-capital letter statement on the cover page of the disclosure document that warns the investor that the securities in question are unregistered and are subject to limitations on resale, and that no government entity has verified the authenticity of the statements in the disclosure.\textsuperscript{217} This statement is designed to alert investors to the uncertainty and lack of government support surrounding these unregistered stocks. By educating investors on the risks of these investment opportunities, the hope is that these investors, who may be unfamiliar with the securities market, will be better suited to appreciate the potential for

\begin{itemize}
  \item \textsuperscript{214} \textit{Id.}
  \item \textsuperscript{215} \textit{Id.}
  \item \textsuperscript{216} \textit{Id.}
  \item \textsuperscript{217} See \textit{id.}
\end{itemize}
loss or other undesirable outcomes that may result from this form of investing.

This warning must be accompanied by a statement signed by all purchasers of the offering that acknowledges various risks of equity crowdfunding. This certification signifies that the security purchaser knows this form of investing is high-risk and that there is potential to lose the entire investment, as well as the fact that it may be difficult or impossible for the investor to resell or otherwise dispose of the investment, in which case the investor might have to hold the securities indefinitely. Like the warning, this certification serves to ensure the investor is educated on this form of investment, and understands the risks involved.

Under NC PACES, the responsibilities of the issuer would not end once an investor chose to invest in the company. The issuer must produce quarterly reports for its current investors, and must continue producing these reports until there are no remaining securities left to be sold. The report must contain figures for compensation given to the company’s executives and directors, as well as an analysis of the business operations and the issuer’s financial condition, as prepared by the issuer’s management.

While these required disclosures will provide investors with useful information when making investment decisions, some businesses may find these requirements burdensome to the point of choosing not to utilize the exemption. Some of those involved in the crowdfunding debate believe the Invest NC Exemption will be too restrictive to attract issuers. The balance between providing businesses with a viable avenue for raising capital while simultaneously protecting investors from bad actors and risky offerings is a challenge, and North Carolina may not be able to determine if the Invest NC Exemption adequately addresses both interests until the legislation is passed and put into practice. However, while finding an ideal balance between business capital-raising interests and investor-protection interests would be ideal, the Invest NC Exemption has wisely chosen to err on the side of caution.

Aside from these requirements placed on businesses, there are two other measures in the Invest NC Exemption designed to help protect investors from undesirable outcomes. First, all investor funds paid in

218. See id.
219. Id.
220. Id.
221. Id.
222. Id.
223. Cao, supra note 14.
exchange for the offered securities will be held in escrow at a bank or depository institution until the minimum target offering amount is raised.\textsuperscript{224} When the institution receives payments for securities, it must notify the Administrator of the investors' identities and residences.\textsuperscript{225} Once the target amount is reached, the proceeds will then be given to the issuer.\textsuperscript{226} However, if the target is not reached by the time specified in the disclosure document, investors who have already contributed may cancel their committed investments.\textsuperscript{227} This escrow agreement protects investors by preventing issuers from receiving funds immediately and then disappearing. Also, by forcing the issuer to wait until all the entire target amount of funds is reached, the issuer has a greater chance of achieving its objective. If issuers were allowed to begin utilizing the funds before the entire amount was raised, with the expectation that the needed remainder would soon be contributed, the issuer would have no guarantee the rest of the needed capital would come, and thus could potentially waste the collected investments before the raise was complete. Preventing the issuer from moving forward on the objective with incomplete funds improves the likelihood that the investor's contribution will be used appropriately and will yield a return.

The second additional provision in the Invest NC Exemption is the inclusion of a bad actor rule.\textsuperscript{228} The proposed statute disqualifies issuers from using the intrastate exemption if the issuer or someone affiliated with the issuer has been convicted of breaking specific state or federal securities laws.\textsuperscript{229} The purpose of this provision is to prevent individuals who have been involved in previous securities crimes or otherwise have demonstrated improper behavior in the context of the securities market from participating in the offer and sale of securities. By barring these individuals from the equity crowdfunding market, the Invest NC Exemption aims to protect investors from fraudulent or unscrupulous actors.

Overall, these measures in the Invest North Carolina Exemption, when taken together, will provide prospective investors with the materials and information they need to educate themselves on the perils associated with equity crowdfunding. The crowdfunding model these provisions create will also hinder any issuer's attempts to fraudulently sell securities and avoid liability. While the regulatory framework may prove to be

\textsuperscript{225} Id.
\textsuperscript{226} Id.
\textsuperscript{227} Id.
\textsuperscript{228} Id.
\textsuperscript{229} Id.
burdensome on businesses, and, to a lesser extent, portals, the Invest NC Exemption will provide these businesses access to unaccredited North Carolina investors' capital. At this point it is difficult to determine how many North Carolina small businesses will choose to shoulder the costs that will come with utilizing the Invest NC Exemption, and how successful those businesses will be in their attempts to raise capital through the exemption. Regardless, NC PACES will offer businesses a new, effective way to raise capital and benefit the state's economy with limited risk to citizens choosing to invest.

CONCLUSION

An analysis of equity crowdfunding demonstrates that, provided the appropriate regulations and safeguards to protect investors are put in place, equity crowdfunding can be a safe, successful method for small business startups and entrepreneurs to form capital. North Carolina, through proper legislation, can replicate the success of other states that already permit intrastate equity crowdfunding. The Invest North Carolina Exemption will grant numerous small businesses and entrepreneurs in North Carolina access to North Carolina investors, while still appropriately protecting investors against fraud and other potential hazards of equity crowdfunding. Therefore, the North Carolina General Assembly should move forward and bring intrastate crowdfunding to North Carolina by passing the NC PACES Act.

C. Marshall Horsman III*

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* J.D. Candidate 2017, Campbell University School of Law. The author thanks his family and friends for providing a network of constant encouragement and support throughout the writing of this Comment. Without their help, this Comment would not have been possible.