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A Comparative Analysis of Crowdfunding Rules in the EU and U.S.

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Abstract

The development of modern economies critically depends on the existence and smooth functioning of credit markets. Access to credit and funding sources in reasonable conditions determine survival possibilities of projects, initiatives, and businesses and delimit their growth opportunities. Recent periods of crisis and economic turmoil have appreciably debilitated financing muscle in our economies. Accordingly, credit facilities have been dramatically limited. In such a context, the search for alternative-financing sources has become a priority for social, business, research, or cultural projects. Crowdfunding emerges as an encouraging alternative to traditional funding sources able to promote, boost, and support a variety of projects. Crowdfunding is not a new phenomenon, but due to the conjunction of the economic climate, technological progress, and social trends, it has gained momentum in present times with a unique profile. It cannot be entirely explained as a mere emulation of existing financing models. As crowdfunding has spread (mainly, in America and Europe), and the number of funded projects, financing platforms and prospective contributors has rocketed, close attention has been paid by legislators, supervisors and regulators. The increasing volume and scope of the phenomenon has increased legal concerns. Not surprisingly, initiatives to regulate and/or supervise activity and participants in the crowdfunding sector have been undertaken in jurisdictions with the most active crowdfunding markets.

Whereas in 2012 the United States adopted the Crowdfunding Act, Title III "Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012" of Jumpstart Our Business Startups Act (JOBS Act), the European Union is still working on a regulatory model for crowdfunding in Europe. Some EU Member States have already enacted or are in process of adopting rules on crowdfunding. Nevertheless, full harmonization on crowdfunding rules is still in progress. Within such a context, the aim of this Paper is two-fold. First, to outline crowdfunding from a legal perspective, to identify operating business models and legal variants, and, finally, to sketch the contours of possible regulations. Second, to provide a framework for the comparative analysis of rules on crowdfunding in the European Union and the United States, to identify similarities and differences, and to develop qualitative conclusions. A comparative approach to U.S./EU regulatory processes may reveal differing views both in legal solutions and in procedural decisions. Such a comparative analysis might provide some helpful insights to the process in the EU.

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I.- Access to finance challenges and the search for alternative sources

Credit availability and access to financing on reasonable conditions are considered to be the most pressing factors in the launching and development of business projects[1]. Particularly, entrepreneurs and small-and-medium sized enterprises (SMEs) face financing problems at the start-up stage. Financial crises have visibly aggravated this situation with a serious funds shortage, higher credit costs (including direct costs such as interest rates, as well as indirect costs, such the increasingly common request for additional suretyships and security interests), and a generalized reluctance to rely on innovative, creative, or emerging projects with higher levels of risks (See Figure 1, Annex). Even if, due to the current economic situation, access to finance is progressively a less concerning issue for most businesses, it still represents a substantially more pressing factor for SMEs and micro-enterprises than for big companies[2] (See Figure 2, Annex).

Financing strategies can be fueled by internal or external funding sources, and essentially are based on equity or on debt. Nonetheless, start-ups and entrepreneurs tend to prefer to rely on external financing (See Figure 3 and Figure 4, Annex).[3] Limited retained earnings at the start-up period and a lack of personal financial sources usually force start-ups and entrepreneurs to look for external funding sources in multiple forms: bank loans, credit lines, public grants, borrowing funds from family and friends, investments from angel investors, and venture capitalists. Each type of external financing presents benefits and risks, advantages and drawbacks. Likewise, no one external funding model is suitable for all business projects. The economic sector, the growth potential, and the development

[1] *2013 SMEs' Access to Finance Survey,* Analytical report by European Commission and European Central Bank, conducted by Ipsos Moris, 14 November 2013, available at http://ec.europa.eu/enterprise/policies/finance/files/2013-safe-analytical-report_en.pdf (last visit 17/05/2015).

[2] As the European Central Bank *2016 Survey on the Access to Finance of Enterprises in the euro area* clearly shows, available at https://www.ecb.europa.eu/pub/pdf/other/accesstofinancesmallmediumsizedenterprises201606.en.pdf?c96d449e601cbe6c87d2e67d54e68c70 (last visit 22/2/2017).

[3] *2013 SMEs' Access to Finance Survey,* p. 20.

phase are important factors in determining the most suitable (or simply the available) external funding method for each business project.

In that regard, there has been a progressive shift of venture capital and bank finance towards later phases of the business finance curve. Venture capitalists and banks are continuously displacing their targets to projects of bigger size, higher financial needs, and, as a consequence, lower risk. Below the high quantitative thresholds set by banks and venture capitalists, the finance gap is growing. This results in an appreciable abandonment of start-up initiatives, innovative projects, and emerging business.

The perverse combination of the contraction of traditional financing sources and the increasing finance gap is devastating for the start-up business market. Hence, entrepreneurs and start-ups are pressed to explore alternative financing sources beyond the traditional framework of equity- and debt-based funding options. Likewise, the need to develop stronger, bigger, and better capital markets to provide the economy with diversified sources of funding is critical to break the traditional bank lending dependence and the external-finance inertia.[4] Diversification of financing sources, along with the needed recovery of the credit market, has become a crucial strategy in economic stimulus policies. In this context, crowdfunding has burst in as a means of filling the gap[5].

Certainly, crowdfunding is not a new phenomenon. The possibility of funding a project by raising small (albeit, the amount is continuously increasing) contributions from a large number of users (investors, lenders, donors, users) instead of relying on a few investors for the whole amount has made feasible many projects feasible through history. Notwithstanding, the extraordinary vigor, exponential growth, and increasing popularity

[4] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *Action Plan on Building a Capital Markets Union,* COM/2015/0468 final; European Commission, Capital Markets Union, *Consultation Document. Capital Markets Union Mid-Term Review 2017,* 10 January 2017.

[5] COLLINS, Liam; PIERRAKIS, Yannis, *The Venture Crowd. Crowdfunding Equity. Investment into Business,* Julio 2012, www.nesta.org.uk;

of crowdfunding now marks a clear inflexion point. More than a simple emulation of a public funds collection in digital form, crowdfunding has gained a unique profile and become a genuine alternative model for financing. Recent studies provide data endorsing the revolutionary potential of crowdfunding for the future of the business finance market[6]. Three concurrent factors explain crowdfunding's emergence and increasing popularity.[7] Although the retraction of traditional financing sources and the narrowing of available credit have triggered the need to search alternative funding, the social factor and technological enabling have been decisive in forming the current shape of crowdfunding. On the one hand, a social movement towards empowering communities has encouraged the design of bottom-up processes and decentralized structures. Crowdfunding takes advantage of crowd-based decision-making, collective creation and innovation, and virality of digital activities, and applies them to the funding of projects or businesses[8]. As a matter of fact, crowdfunding seems to be inspired by and to share the philosophy of the growing 'Sharing Economy'. The so-called 'Sharing Economy' describes an economic model that is fueled by trust,[9] is built of communities,[10] and evolves through interaction, collaboration, and co-participation relationships.[11]

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[6] As per *Crowdfunding's Potential for the Developing World,* InfoDev/The World Bank, 2013, the total market potential by 2025 is estimated to be up to US$90-96 billion per year -1.8 times today's global venture capital industry (http://www.infodev.org/infodev-files/infodev_crowdfunding_study_0.pdf, last visit 20/2/2017).

[7] A further analysis of these three factors as enablers of the current expansion of crowdfunding, RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, "El Crowdfunding como mecanismo alternativo de financiación de proyectos", Revista de Derecho Empresarial (REDEM), San José, Costa Rica, No.1 – February 2014, pp. 121-140; at http://www.redemcr.org/; RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, "Modelos jurídicos para el *Crowdfunding.* Nuevas formas de financiación colectiva de proyectos", *La Ley,* 2013-C, 28 de mayo de 2013, Argentina, pp. 1-4.

[8] *Crowdfunding's Potential for the Developing World,* p. 8.

[9] LUHMAN, Niklas, "Familiarity, confidence, trust: problems and alternatives", GAMBETTA, D.G. (Ed.), *Trust*, New York: Basil Blackwell, 1988, pp. 94–107; FUKUYAMA Francis, *Trust: the social virtues and the creation of prosperity*, New York: The Free Press, 1995; LEWIS, J David, WEIGERT, Andrew, "Trust as a social reality", *Social Forces*, num. 63(4), pp. 967-985, 1985.

[10] About the building of communities in the digital economy through electronic platforms, RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, "Refusal to Deal, Abuse of Rights and Competition Law in Electronic Markets and Digital Communities", *European Review of Private Law,* vol. 22, 5-2014, pp. 685-702.

[11] BENKLER, Yochai, *The Wealth of Networks: How Social Production Transforms Market and Freedom,* New Haven-CT, Yale University Press, 2006.

On the other hand, the advent of electronic platforms[12] has created the ideal structural conditions for realizing an authentic crowd-based financing alternative. Digital technology has been a powerful enabler for the creation of multilateral environments based on a centralized management, a peer-to-peer interaction scheme, and a contract-based operation.

II.- The framework of the comparative analysis

The aim of this paper is two-fold. First, to outline crowdfunding from a legal perspective, to identify operating business models and legal variants, and finally to sketch the contours of possible regulations. Second, to provide a framework for the comparative analysis of rules on crowdfunding in the European Union and United States.

Such a comparative analysis of regulations is determined by three factors: time, scope, and approach.

First, the comparison is unavoidably conducted in relation to rules that are in force or available drafts in the process of adoption. As the phenomenon evolves, new rules are adopted and current legal provisions may require reform or subsequent modifications.[13] In that regard, the analysis is inherently limited as it depicts a static moment in a dynamic,

[12] A comprehensive legal analysis of electronic B2B platforms (trading systems, electronic platforms, e-marketplaces), its creation, functioning and implications, in RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *El régimen jurídico de los Mercados Electrónicos Cerrados,* Madrid: Marcial Pons, 2006.

[13] The regulatory panorama is immersed in a permanent adaptation. On the one hand, in the US, the regulatory framework was not completed and fully operational until the adoption and entering into force of the SEC Regulations, several years after the enactment of the Crowdfunding Act. On the other hand, within the EU, in absence of a common single framework, Member States has designed their own schedules to adopt and modify their domestic rules. The timeline of crowdfunding rules in the EU is long, changing, and still opened to new domestic initiatives. Only in 2016, two new Member States have introduced on investment-based and lending-based crowdfunding: Lithuania on 1 December 2016 and Finland on 1 September 2016. Likewise, other EU jurisdictions have proceeded to amend their legislation to establish a legislative framework for crowdfunding. To that end, Greece has modified, in September 2016, its legislation on the issuance of prospectuses and on provision of financial services. Concurrently, other Member States that had adopted early crowdfunding regulations are currently also reviewing their existing regimes and implementing (or are in the process of introducing) amendments (France in October 2016 and United Kingdom in July 2016).

unfinished process. Hence, the general principles and rules underlying specific legal provisions will be sought and stressed.

Second, unlike US legislative action, the EU is still working on a possible regulation on crowdfunding for the common market.[14] As a result, there is not presently a single text regulating crowdfunding in Europe on a comprehensive basis that is comparable to US legislation and related regulations. Thus, for the purposes of forming the European approach, a combination of reports, consultations, documents, and other relevant texts produced by EU bodies, and a variety of domestic legal actions must be compiled, analyzed, and presented. Not surprisingly, the resulting effects of such fragmented regulation of crowdfunding on the consolidation of a single market will be discussed in this Paper, along with the issue of whether a EU-wide action on crowdfunding is needed.

Third, as further explained below, current regulations of crowdfunding do not cover all modalities, nor do they regulate the phenomenon as a whole and in all its aspects. On the contrary, legislative initiatives are partial both in scope and in approach. Crowdfunding laws do not, for the most part, govern all crowdfunding variants, but exclusively (or mainly) focus on financial modalities – namely, debt-based crowdfunding and equity-based crowdfunding. Such a selective approach is based on diverse grounds that will be further explored. Besides, crowdfunding laws do not aim to provide for a complete legal regime for crowdfunding. As explained below, my thesis is that legislators and regulators have mainly, if not solely, addressed the *outside effect* of certain variants of crowdfunding

[14] The most recent milestones in the progress of the EU's work on crowdfunding regulation are the following: an Expert Group of the European Securities Committee is working on crowdfunding; the European Crowdfunding Stakeholder Forum (ECSF) held its last meeting on 17 February 2016; within the Capital Markets Union (CMU) Action Plan, the Commission Services published a report on the EU crowdfunding sector in May 2016 - Commission Staff Working Document on Crowdfunding in the EU Capital Markets Union, SWD(2016) 154 final, 3.5.2016, available at: http://ec.europa.eu/finance/general-policy/docs/crowdfunding/160428-crowdfunding-study_en.pdf - ; the Commission set up an internal Task Force on Financial Technology (Fintech); DG FISMA launched a study to identify market and regulatory barriers to the development of cross-border crowdfunding activity in the EU; on 20 January the Commission Services launched a public consultation on the 2017 mid-term review of the CMU Action Plan.

on financial markets through classic regulated-market legal solutions that seek to control market access, monitor conduct and practices in the market, minimize risk, and protect parties' interests, market stability, and transparency. Except for a few legal provisions dealing with non-regulatory issues, corporate matters (described as the *inside effect* in my thesis), contractual issues, liability rules of platform operators, IP rights or other private-law matters are not fully addressed by crowdfunding rules or simply not mentioned at all. In practice, crowdfunding laws must be complemented by other rules regulating the different aspects of the entire process of the financing operation – applicable rules on loan agreements, corporate law, electronic contracting, privacy policies, competition law, and IP rights.

Moreover, as discussed below, there is a preliminary debate about the need to adopt specific rules to regulate crowdfunding, or, contrarily, to apply existing rules by subsuming crowdfunding operators and crowdfunding-related transactions in other legal institutions (payment service providers, investment services entity, multilateral trading facility, so on) without the formulation of new rules.

III.- Crowdfunding: concept, variations, and regulations

According to the description formulated by the World Bank[15], "Crowdfunding is an Internet-enabled way for businesses or other organizations to raise money in the form of either donations or investments from multiple individuals". Certainly, at its infancy, crowdfunding appeared on the market simply as a crowd-based funding method. Nonetheless, it promptly evolved into towards a comprehensive model that assists entrepreneurs and SMEs, especially, in developing their business strategy. Today, crowdfunding provides more than funding. Crowdfunding permeates the whole business

[15] *Crowdfunding's Potential for the Developing World,* p. 8.

model and allows project promoters to launch marketing campaigns, test the market, interact with clients, and validate products or process feedback. At present, crowdfunding is a complex phenomenon with varied implications.

It is common to classify crowdfunding models by several categories, [16] depending on the nature of the relationship between the contributor and the promoter. Beyond mere classification purposes, this interest in utilizing distinct categories is multifold. First, through the spectrum of crowdfunding variations, one can trace and cover the evolution of crowdfunding. Second, the scope of regulations can be more easily visualized and better understood through categorization, since the regulatory strategies relating to financial modalities of crowdfunding clearly differ from the non-regulation approach in respect of non-financial categories. In that regard, a comparison of different crowdfunding models reveals the variety of different interest protection mechanisms available. Third, as the market moves towards financial crowdfunding models (namely, equity-based and debt-based crowdfunding), the impact on corporate governance requirements and business strategy needs appreciably intensifies.

Within this context, the following variations are already familiar in the US and Europe. In donation-based crowdfunding, donors contribute to the project without expecting any monetary (or financial) compensation. In reward-based crowdfunding, there are several subvariations. In pure reward models, funders receive a token gift of appreciation in return for the contribution. Under pre-sale models, however, the amount contributed by the funder represent the advance payment of the price for a (future) provision of services or delivery of goods. Unlike in the pure rewards model where the value of the gift is symbolic, in pre-sale crowdfunding the contribution may equal the price of the product. If the crowdfunding model is based on debt, funders contribute an amount of money that

[16] DE BUYSERE, Kristof, GAJDA, Oliver, KLEVERLAAN, Ronald, MAROM, Dan, *A Framework For European Crowdfunding,* 2012, www.crowdfundingframework.eu.

equivalent to a loan. Accordingly, funders will receive in return a debt instrument entitling them to receive interest and the principal of the loan at a stipulated date. In social lending models, no interest is expected. Equity-based models are more sophisticated. Two variations may occur.[17] In the securities model, investors receive equity instruments in return for their investment and become partners/shareholders of the promoting company accordingly. In contrast, in the collective investment scheme (CIS) model, funders' contributions are not treated as equity. Funders are solely entitled to participate in profits under profit-sharing arrangements, without exercising partners' rights.

All above-mentioned crowdfunding variations coexist in the market, although with different levels of popularity depending on the sector. Nonetheless, a perceptible trend can be traced from non-financial models (donation and reward) to financial ones (lending and equity) in recent times (See Figure 5 in market share and Figure 6 in volume, Annex).[18] Such a trend towards financial modalities has clearly contributed to establishing crowdfunding as a real alternative for traditional financing techniques. However, this progressive shift has attracted regulators' attention and increasingly aroused legal concerns. Of the existing regulations, regulatory and supervisory energy has focused on financial models: equity-based crowdfunding and lending crowdfunding (repaid with interests). Whereas funders in donation-based and reward-based crowdfunding models would arguably be protected by general contract rules and

[17] *UKIE Crowd Funding Report: A Proposal to Facilitate Crowd Funding in the UK,* February 2012, p. 2 (available at http://ukie.org.uk, last visit 20/2/2017).

[18] According to the *2nd European Alternative Finance Industry Report* prepared by the Cambridge Center for Alternative Finance, September 2016 (available at https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2016-european-alternative-finance-report-sustaining-momentum.pdf): "Peer-to-peer consumer lending is the largest market segment of alternative finance, with €366m recorded for 2015 in Europe. Peer-to-peer business lending is the second largest segment with €212m, with equity-based crowdfunding in third with €159m and reward-based crowdfunding, fourth, with €139m in 2015. However, invoice trading is the fastest-growing alternative finance model in Europe registering €81m in 2015, up significantly from the low base of just €7m in 2014" (p. 20). Even if in global terms, donation- and reward-based crowdfunding is still ranking second in amount ($5.5B) as per *Massolution Crowdfunding Industry 2015 Report* (available at http://crowdexpert.com/crowdfunding-industry-statistics/ (last visit 21/2/2017).

consumer protection legislation, lending and equity-based variations invaded the realm of financial regulation, interweaving multiple public and private interests. Although specific risks have also arisen in non-financial crowdfunding, past legislation and regulatory efforts shows that most concern centers around financial models (equity crowdfunding, and crowdlending, primarily).

From the perspectives of corporate governance and business strategy, crowdfunding affects various layers. Donation-based crowdfunding and, above all, reward crowdfunding in the pre-sale model exert a visible influence on the design and the deployment of business strategies. As opposed to traditional financing context in which entrepreneurs first seek funds in order to subsequently run the project and attract clients, crowdfunding encourages entrepreneurs to restructure the stages of business strategy process. Hence, promoters first publish their project, test the market, attract clients/users, and, subsequently, with a critical mass of clients and a tested idea, they appeal to prospective investors for fundraising. Donation and reward crowdfunding infuse business models with the opportunity to exploit different priorities and competitive advantages.

Lending and, primarily, equity-based crowdfunding more intensively influence promoters' corporate governance requirements and corporate structure. Certainly, as further discussed below, the crowd of investors/lenders creates a corporate structure suitable for managing numerous, scattered capitalist partners. Likewise, the funding campaign requires increasingly sophisticated and complex disclosure duties similar to the standards that underpin the transparency paradigm in financial markets (based on disclosure). However, these crowdfunded projects lack a genuine trading market to provide liquidity. As a consequence, promoters have to deal with entry and exit requests from existing and prospective investors with company-law tools. This inside effect has been, nevertheless, mostly disregarded by recent regulations on crowdfunding. Specific

solutions provided by funding platforms, creative responses formulated by promoters or general rules of company laws are the main boundary stones for exploring issues and proposing groups of possible solutions.

IV. Emerging trends in crowdfunding sectors and new challenges

The number of crowdfunding platforms and funded projects has rocketed in last two years, and the average amount of funds raised has similarly significantly increased.[19] Interestingly, an expansion of crowdfunding beyond microcredit and micro-investments is increasingly visible. Some expansion trends clearly reveal an ambitious enlargement of the scope of crowdfunding.

First, the participation of accredited investors or the running of funding platforms where solely accredited investors are eligible entails an increase in investments, funds raised, and number of projects.[20]

Second, angel investors, pension and mutual funds, family offices, and venture capitalists are increasingly acknowledging the added value contributed by funding platforms to the financing process, such as: reduction of transaction costs, transparency, centralization of resources, economies of scale, rating services, provision of searchers, comparators or aggregators. Accordingly, these professional and institutional investors are willing to participate as users (prospective investors) in crowdfunding platforms (See Figure 8,

[19] According to the data provided by the *Massolution Crowdfunding Industry 2015 Report* (available at http://crowdexpert.com/crowdfunding-industry-statistics/ (last visit 21/2/2017), fundraising volume in 2015 for the global industry is estimated in $34 Billion representing P2P Lending $25B; Reward and Donation Crowdfunding: $5.5B; and Equity Crowdfunding $2.5B. See previous data and statistics in *Crowdfunding Industry Report. Market Trends, Composition and Crowdfunding platforms,* Massolution, May 2012, www.crowdsourcing.org. Growth by region prediction for 2015 was estimated of 82% for North America and 98.6% for Europe. In predicted funding volume, however, North American region leads the industry with $17.2B whereas Europe ranks at a third position with $6.48B – Asian region is second with $10.54B -.

[20] "Online platforms for accredited investors are fueling the continued growth in angel investing", according to the Angel Capital Association, *2015 PENSCO Crowdfunding Report,* March 20, 2015, available at http://info.pensco.com/2015-crowdfunding-report.

Annex).[21] Wisely, funding platforms are not only filling the gap left by the shift of banks and investors towards later stages of the finance curve, but they also serve as enablers and intermediaries at the very core of professional investment.

Both elements reveal a progressive and continuous institutionalization of crowdfunding with increasing institutional investor participation (See Figure 9, Annex).

Third, as an example of how average project budgets (See Figure 10, Annex, representing average amount of funds raised per crowdfunding model in Europe in 2015) are increasing and the crowdfunding model is migrating to other, more traditional sectors, real estate platforms are making their debut.[22]

These trends increase the impact of crowdfunding on the finance industry, accelerate its penetration of financial markets, and certainly consolidate its role as an organizational model transforming financial structures, beyond its initial perception as a mere alternative financing source. My thesis is that the transformative power of crowdfunding essentially derives from its operation on electronic platforms. The digital economy has indeed transformed into a genuine platform economy.[23] Platforms have become a highly

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[21] HAAHR, Jon K.; LEE, Robert E.; HAAHR, Jon K. Jr., "The Institutional Crowd", in *2015 PENSCO Crowdfunding Report,* March 20, 2015, pp. 38-40; available at http://info.pensco.com/2015-crowdfunding-report, do vehemently endorse this tendency: "The continuing evolution of the industry can be expected to result in a number of related trends, including a growing interest among traditionally institutional sponsors, (…), to use crowdfunding platforms for larger, higher profile investments. (…) We also believe that the type of opportunities sponsors allocate to crowdfunding platforms will broaden – from basic debt and equity offerings to preferred and mezzanine capital. Finally, larger funds, private REITs and other national operators will be attracted to the lower cost of raising capital and streamlined investor relations that web portals provide, as well as the expanded access to private accredited investors and family offices". See also WealthInsight Report (http://www.wealthinsight.com/IndexReports) estimating the growth prediction of high net worth individuals.

[22] As per *2015CF-RE. Crowdfunding for Real Estate,* Report prepared by Crowdsourcing, available at http://reports.crowdsourcing.org/?route=product/product&product_id=52 (last visit 21/2/2017), Real Estate Crowdfunding has emerged as one of the most attractive crowdfunding categories with significant growth rates and appreciable higher average amounts per campaign. According to these data, real estate crowdfunding grew 156 percent in 2014, breaking the $1 billion mark, with campaigns ranging in size from less than $100,000 to over $25 million. In global terms, real estate crowdfunding is expected to increase by 150 percent, equaling $2.57 billion in 2015, making it one of the fastest-growing industry segments of crowd capitalism.

[23] I have elaborated further this thesis in previous publications: RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, "Legal Aspects of Recommender Systems in the Web 2.0: Trust, Liability and Social Networking", in PAZOS ARIAS, Jose; FERNÁNDEZ VILAS, Ana; DÍAZ REDONDO, Rebeca P. (Eds.), *Recommender Systems for the Social Web,* Series "Intelligent Systems Reference Library" vol. 32, New York (etc):

disruptive organizational model that have the ability to deeply reshape economies and modern markets.

V. Comparative study of Crowdfunding Rules in the EU and US: An Initial Assessment

The regulatory challenges posed by crowdfunding have been addressed at different pace in the EU and the US. As a consequence, both the adopted approach and the resulting regulatory outcomes differ appreciably. Whereas in the US, the early adoption of the Crowdfunding Act as Title III of the JOBS Act in 2012 represented an early attempt to lead the regulation of crowdfunding on the international scene, the EU has clearly delayed its response and opted for a cautious wait-and-see strategy. Even though the comprehensive legal regime for funding platforms in the US was not completed until the adoption of the SEC regulations—which occurred several years after the enactment of the Crowdfunding Act-- the US model nonetheless represents a leader-based strategy and a unified approach. In contrast, the EU has postponed harmonized regulatory action for the Community and adopted a prudent follower-like approach that has resulted in the production of studies, working documents, and consultation without creating specific regulatory actions.

A first comparison between the EU and the US models should then focus on their different macro-approaches to crowdfunding challenges. In comparing the leader-follower approach, some preliminary implications arise easily. The leader strategy carries with it

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Springer-Verlag, 2012, pp. 43-62; "Mercados virtuales y comercio en red. Análisis jurídico de los E-Marketplaces y otras plataformas electrónica de contratación: constitución, estructura y funcionamiento", *Investigaciones. Investigación de Derecho Comparado. Revista de la Corte Suprema de la Nación de la República Argentina,* núm. 1-2, 2007, pp. 1-33; "E-marketplaces: la competencia entre mercados", *Gaceta Jurídica de la Unión Europea y de la Competencia*, núm. 228, nov/dic 2003, pp. 53-64; "Refusal to Deal, Abuse of Rights and Competition Law in Electronic Markets and Digital Communities", *op.cit., Régimen jurídico de los Mercados Electrónicos Cerrados (eMarketplaces), op.cit.*

all the risks of pioneering law in an unknown field. As the phenomenon to be regulated is still developing, the understanding thereof and the solutions to be devised must incorporate a degree of uncertainty and dynamism. Nevertheless, an early regulation in an emerging sector can provide needed predictability, and, if it succeeds in establishing a trustworthy playing field for businesses, may help the US to become the leading market in that emerging sector, both domestically and internationally. On the other hand, a wait-and-see strategy in principle allows the EU to learn from the leader's experience, select market-tested solutions, and avoid mistakes. Nonetheless, such advantages might be neutralized by a secondary position in the international scene and a potential drain of business opportunities as businesses opt for the leader's jurisdiction.

Thus, regulatory competition between US and EU has been primarily determined by this difference in timing.

Industry statistics[24] endorse the assessment that a leader strategy gives an advantage in an emerging sector, as the US (as North America in many studies) stands as the largest region by funding volume, retains the lead in the market, and maintains high expected growth rates. Certainly, the EU market is growing at a fast rate, even at a higher annual rate, but the funding volume is still slightly lower. Recent market studies in the EU[25] conclude that, as a general rule, data reveal that a favorable governmental stance and progressive regulation (along with tax benefits, in many cases) positively correlate with high volumes in the industry. According to most recent reports, low volumes in crowdfunding industry are typically related to regulatory issues, and only rarely correlate to lower penetration of online payments, business culture, uses, and practices. Therefore, the current diversity of regulations within the EU constitutes a second-level testing

[24] http://crowdexpert.com/crowdfunding-industry-statistics/. And all previously-cited statistics and reports.
[25] *Current State of Crowdfunding in Europe 2016*, conducted by CrowdfundingHub and available at www.crowdfundingineurope.eu (last visit 9/11/2016).

ground for the regulatory strategy. Although volume data are not always totally decisive, as in some cases crowdfunding platforms proliferate precisely because of the lack of regulation or in anticipation of announced legislation, it can be argued that the adoption of specific rules, and more clearly, the consideration of regulatory issues,[26] tends to encourage the establishment of platforms and to increase the level of crowdfunding activity.

The suggested impact of the leader-follower strategy on the size and the growth of the market is particularly conditioned by a regulatory factor. As further discussed in the comparative analysis, the territorial scope of crowdfunding rules will determine the real level of mobility of platforms, promoters, and users among jurisdictions. Should the territorial scope of regulation restrict effective mobility or hamper cross-border activities, the actual regulatory competition would be substantially limited. Connecting factors and criteria in applying regulations will be studied in more detail below. Notably, financial models of crowdfunding (debt-based and equity-based crowdfunding), which affect regulated markets, tend to be more acutely affected by geographical limitations for the provision of crowdfunding services or requirements likely to limit cross-border operations in some jurisdictions. This effect was shown in a study commissioned by the European Commission collecting and analyzing data from crowdfunding platforms across the EU for the time period under consideration (2013-14), 510 live platforms were active in the EU as at 31 December 2014 (See Figure 11, Annex).[27] Of these platforms operating in Europe, 502 platforms were located in 22 Member States, while 8 platforms were located in other countries (Australia, Canada, China, New Zealand, and the United States). The majority of platforms were involved in reward-based crowdfunding (30%),

[26] The Alternative Finance Maturity Index, created in the report *Current State of Crowdfunding in Europe 2016,* is based on 15 research areas, 8 of those factors refer to regulatory issues (see pp. 9 and 12-14).
[27] *Crowdfunding: Mapping EU markets and Event Study,* 30 September 2015, commissioned by the European Commission and prepared by Ernst & Young and Crowdsurfer.

followed by platforms involved in equity crowdfunding (23%) and loan-based crowdfunding (21%). Although data on volume and number of projects would be needed to produce more accurate conclusions, the number of active platforms depict low transatlantic mobility of crowdfunding platforms.

Interestingly, the available data[28] suggest that the crowdfunding industry within the EU remains largely national. Cross-border activity is still infrequent (See Figure 7, Annex).[29] Such a fragmentation of the common market seems to be a reflection of domestic regulations, among other factors, in those countries where crowdfunding specific regimes have been adopted, designed, and tailored to meet local needs and domestic market conditions. Although most national regimes are overall consistent in their approach, the diversity in requirements and regulatory conditions is likely to discourage effective and systematic cross-border activity within the EU, with the undesirable effect of hampering the consolidation of a common crowdfunding market, penalizing small platforms unable to afford the cost of operating across borders, and exacerbating the fragmentation of the market. Likewise, in the absence of EU legislation, some crowdfunding-related activities, such as crowd-lending or credit intermediation, do not enjoy EU-passport rights. Therefore, the need to apply for local authorizations and to comply with national regulations may increase costs and prevent platforms, promoters, and investors from getting involved in cross-border operations.

As further discussed below, market fragmentation, both at a regional and a global level, has a perturbing impact on the rationale behind crowdfunding. On the one hand, the

[28] CMU Green Paper consultation and discussions held at the meetings of the ECESG and the ECSF of 10 February and 17 February, respectively.

[29] According to the *2nd European Alternative Finance Industry Report* prepared by the Cambridge Center for Alternative Finance, September 2016 (available at https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2016-european-alternative-finance-report-sustaining-momentum.pdf), data reveal that market activity in the crowdfunding sector remains mostly domestic. Their findings show that foreign inflows (none in 46% of the operating platforms) and foreign outflows (none in 76% of the platforms) represent very limited percentages in the whole activity.

popularity of crowdfunding is mainly driven by expected scale benefits, lack of jurisdictional connection, and even 'disintermediation' trend facilitated by digital technology and electronic platforms, insofar as the completion of the investment transactions is not conducted through traditional financial intermediaries.[30] Market fragmentation ignores such promising possibilities and discounts such expected benefits. On the other hand, effective competition is limited and distorted, the ability of platforms to gain scale is hindered, and opportunities deriving from global exposure for promoters and investors is unavoidably restricted.

As a consequence of the disharmonized EU regulatory response, the regulatory processes and their characteristics also differ. The prompt US reaction outlined a legal framework for funding platforms (initially pending the subsequent SEC regulations). Nevertheless, the EU's wait-and-see strategy has led to at least two issues. On the one hand, due to the lack of specific regulations, it has been lively debated whether existing rules on contracts, financial services, financial intermediaries, bank activities, are suitable for governing crowdfunding transactions and platforms. On the other hand, some EU Member States, in view of EU inaction, have decided to act and adopt specific rules on crowdfunding. Despite the fact that most of the domestic regimes share common principles and rules, national models are not identical, and they differ in scope, approach, and specific conditions. Hence, the EU is today fragmented, plural, and diverse. European countries show significantly different levels of industry maturity, volumes, crowdfunding activity and regulatory responses to alternative finance.

[30] I elaborate my thesis on the "electronic intermediation layers" as a manifestation of the cycle of "disintermediation-reintermedaition" in the digital market in the following publications: RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, "Intermediación electrónica y generación de confianza en la Red: escenarios de riesgos y responsabilidad", *Revista Española de Seguros,* num. 153-154, 2013, pp. 43-68; "Intermediación en la Red y responsabilidad civil. Sobre la aplicación de las reglas generales de la responsabilidad a las actividades de intermediación en la Red", *Revista Española de Seguros,* núm. 142, 2010, pp. 217-259; "La responsabilidad de los prestadores de servicios de intermediación y los estratos de la intermediación en la Red", *Revista Derecho y Tecnología,* núm. 11, 2010, pp. 69-96.

The comparative study of crowdfunding rules in the EU and the US is conducted against this backdrop. To the extent that EU rules (Regulations and Directives) apply to crowdfunding platforms, a pure block comparison (US-EU) is possible and will be developed. However, in many issues, the comparative analysis will have to be carried out on a one-to-many approach, as US rules are compared to a selection of domestic rules of European countries. For the purposes of comparability, where it is convenient, common principles or shared rules will be extracted from the diversity of domestic regulations to build a consistent and reasonably unified set of rules for comparison.

VI.- Regulatory layers: the levels of the comparative analysis

Crowdfunding regulation do not represent a uniform body of rules aiming to govern all the angles of this alternative finance mechanism. On the contrary, with the regulation of crowdfunding, diverse disciplines converge, a variety of rules overlap, and regulatory attention has been paid to different dimensions of the problem. Therefore, in order to conduct the proposed comparative analysis, we must first identify the possible regulatory layers and determine at which levels the study will be carried out.

The regulatory layers are categorized in accordance to three criteria:

VI.1. Crowdfunding models.

The regulatory reply to crowdfunding has not attempted, in most jurisdictions and, certainly, both in US and in the EU, to devise an all-encompassing single legal regime for all crowdfunding variants. Far from such an overarching approach, regulators have focused on those modalities likely to arouse more visible legal concerns and those that threaten systemic risks. As a result, regulations and, in general, regulatory attention are

concentrated on financial modalities of crowdfunding including debt-based and equity-based variants.

Donation-based crowdfunding as well as reward-based modalities have generally not been subject to specific regulatory actions. Lack of specific regulation, however, has not left those crowdfunding modalities in an unregulated state nor resulted in an immediate acknowledgement of illegality of such activities. As a general rule, donation-based and reward–based crowdfunding operations, both at the level of the platform operator and of the parties involved in transactions, remain subject to existing applicable rules on contracts, liability, consumer protection, and competition. In sum, with no need for newly formulated rules, legal systems are prepared to accommodate the creation and the functioning of the platforms, and the transactions concluded within it between the parties. Such crowdfunding models smoothly settle into the existing legal systems through subsuming, in which the new activity (crowdfunding) is treated as equivalent to another, already regulated activity. As a result, the new activity is subject to existing rules. For instance, donation-based crowdfunding is simply subject to existing rules regulating traditional donations. If regulatory issues do not immediately arise, and supervision is not needed in relation to the foundation and the operation of funding platforms to facilitate transactions under the said modalities, then crowdfunding activity is regulated by the parties' agreement. Thus, platforms are designed and operated by the private contract, only limited by the general limits of the law, good morals and public order, and some specific limitations, such as consumer protection, standard term contracts, and ecommerce-related duties. Thus, platform operators run their business in compliance with electronic commerce rules as an internet service provider (ISP, intermediary service

provider as per EU E-Commerce Directive)[31] and in accordance with general rules applicable to any market player. Likewise, transactions between parties – promoters and donors/contributors/purchasers – would be subject to relevant rules on donation agreements, reward contracts (or unilateral promises), and sale agreements with advance payment.

Certainly, the strategy of applying existing legal forms to new realities is not simple or direct. On the contrary, such application face distinct challenges and must overcome certain difficulties. Along with issues related to conflict-of-laws rules, which frequently arise with electronic activities, there are fascinating new conceptual problems. For instance, peer-to-peer relationships, which are the foundation for many sharing-economy models, challenge well-established notions forming legal schemes for business transactions and social relationships such as consumer and trader, regular business activity and occasional activity, and for-profit and not-for-profit situations. Interestingly, sharing-economy platforms create new scenarios for testing classical ideas, including: whether occasional transactions amount to business activity; whether consumer protection can be applied in reward-based crowdfunding relationships; whether cost-covering goals may be deemed a for-profit aim; whether labor law is directly applicable to activities on sharing-economy platforms; and how to define personal, family, or household use. From this perspective, non-financial crowdfunding models might be more disruptive than expected, although they have not attracted as much regulatory attention.

Nonetheless, save certain exceptions further discussed below – i.e. the case of Portuguese legislation that covers donation- and reward-based models -, as a general rule, no

[31] Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the Internal Market (*Directive on electronic commerce*), Official Journal L 178, 17/07/2000, p. 1-16.

specialized legal framework has been developed in the relevant jurisdictions for non-financial crowdfunding versions.

Therefore, for the comparative analysis, comparing rules governing non-financial modalities of crowdfunding would entail comparing and contrasting private law systems as a whole. Since such a general systemic comparison is not the aim of this analysis, references to rules on non-financial crowdfunding models will be only included to the extent that they help to assess whether the poorly-adapted rules in some jurisdictions may hamper or even totally prohibit non-financial crowdfunding models or their progression in the market. Apart from those references, where pertinent, the comparative analysis will focus on financial variants of crowdfunding.

VI.2. Parties involved in crowdfunding.

As previously explained, crowdfunding has become popular and gained critical mass as a real alternative finance method due to technological changes and platform-based organizational models. In sum, platform-operated crowdfunding models have become a genuine alternative to traditional finance structures. As a consequence, regulatory attention and supervision has been mainly focused on platform-based crowdfunding models.

Such an organizational factor explains why regulatory actions adopted in different jurisdictions address, in fact, two layers. As explained above, some regulations are clearly focused on the intermediary layer, whereas other rules impact the transaction layer. Under the former regulations, platform operations are subject to registration requirements, regulatory conditions, duties, and prohibitions. Under the transaction layer regulations, specific duties and limitations are imposed on the promoters' crowdfunding campaigns and some limits may restrict investors' decisions thereon.

On the first level (intermediary layer), rules on crowdfunding platform operators aim to regulate how new intermediaries access financial markets and provide services. On the second level (transaction layer), regulations provide the conditions for crowdfunding offerings as securities offerings through electronic means or, more specifically, within electronic platforms. Likewise, on the side of investors, regulations frequently implement protective measures to mitigate risks, enhance transparency, provide compensation schemes, and, in most cases, even limit investors' ability to use alternative finance methods. To that end, investors are classified as accredited or non-accredited investors, under different and specific thresholds, and a set of protective measures, such as warnings, informational rights, or investments caps, are made available.

The comparative analysis will be conducted following this two-layer structure underlying the development of crowdfunding activity in the market. On the one hand, there are rules aimed to regulate the platform operator as an intermediary. On the other hand, there are rules that intend to impact any contractual aspects of the crowdfunding transaction.

VI.3. Regulatory strategy: application of existing general rules or adoption of bespoken regimes.

As a corollary to the two above-analyzed criteria, regulatory strategies in different jurisdictions, and in particular in the EU and the US, reflect the proposed multi-layer approach – combining rules governing the intermediary layer and rules belonging to the transaction layer – and the discrimination between financial variants and non-financial models of crowdfunding.

Against this backdrop, once a need to regulate has been affirmed, two main paths have been explored: either to use existing legal models or to adopt particularized regimes.

The comparative analysis of the EU and the US reveals that, in most cases, both strategies have been implemented on a multi-layer basis. So, whereas non-financial crowdfunding models and most aspects of crowdfunding transactions – in both financial and non-financial variants – have been regulated with a subsuming strategy; financial modes of crowdfunding and a few aspects of transactions in specifically debt-based and equity-based crowdfunding variants have been regulated with tailored rules that adjust existing models to new realities.

As further detailed below, the analysis of the final crowdfunding rules reveal that the regulatory strategy is indeed devised from this combination of criteria. Thus, for instance, the SEC final rules on Regulation Crowdfunding (2016) implement the regulatory option (Title III JOBS Act) for a crowdfunding exemption from the registration requirements of Securities Act, provided that certain conditions are met. Such requirements relate to the maximum limits on the amount of funding raised by promoters, limits on the amount invested by investors, and a requirement that the transaction go through a SEC-registered intermediary, either a broker or a new funding platform. Then, the final exemption-based regulatory framework (so as VI.3.) relies on a scheme of requirements applicable to promoters' offerings and investors' contributions, the participation of a regulated intermediary (so as VI.2.), and the limitation of scope to specific financial modalities of crowdfunding (so as VI.1.).

The comparative analysis will focus on regulatory strategies developed in the US and in the EU, both at a Community and at a domestic level.

US Rules on Crowdfunding are essentially comprised of the legal provisions of Title III "Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012" of *Jumpstart Our Business Startups Act*[32]*, JOBS Act* (hereinafter, Crowdfunding

[32] H.R. 3606, of 5 of April of 2012.

Act), which is implemented by the final rules adopted by the Securities Exchange Commission (SEC) under the Securities Act of 1933 and the Securities Exchange Act of 1934 (hereinafter, SEC Rules or SEC Regulation or Crowdfunding Regulation).[33] The final rules and forms went into effect May 16, 2016, except that instruction 3 adding part 227 and instruction 14 amending Form ID went into effect January 29, 2016.

The EU Rules on Crowdfunding are multiple and mainly domestic. The legal regime for crowdfunding within the EU is the (incomplete) outcome of a process of integrating EU-wide general rules on financial markets, domestic general rules, and national-wide crowdfunding-specific regimes. Therefore, the legal framework is multi-layered. In general terms, there are two regulatory approaches. First, there is the approach led by the attempt to subsume debt- and equity-crowdfunding in existing legal categories. In that regard, some EU Directives[34] tackle crowdfunding-related issues, although the directives were not originally envisioned to regulate crowdfunding. This approach achieves stability and provides a common playing field for all market players, both traditional and newcomers. Besides, since these rules are adopted at a European level, albeit under the form of Directive, harmonization across the EU is potentially higher. But this approach may to fail address the particularities of crowdfunding and, as a consequence, block the emergence of the new sector with unsuitable requirements. Second, some national jurisdictions have enacted, or are planning to adopt, specific legislation for crowdfunding— in most of the cases, for lending and equity crowdfunding. The EU is also working on a harmonization solution for crowdfunding. To that end, an Expert Group

[33] 17 CFR Parts 200, 227, 232, 239, 240, 249, 269, and 274 [Release Nos. 33-9974; 34-76324; File No. S7-09-13] RIN 3235-AL37.

[34] Directive 2003/71/EC as amended by Directive 2010/73/EC (Prospectus Directive) impacts how companies raise funds. Directive 2009/65/EC (Undertakings for Collective Investment in Transferable Securities Directive) impacts how investment companies can raise funds. Directive 2006/48/EC (Capital Requirements Directive) and Directive 2009/110/EC (E-Money Directive) impacts how crowdfunding platforms can hold funds. Directive 2011/61/EC (Alternative Investment Fund Manager Directive) can impact how crowdfunding platform function if they deal with investment companies. Directive 2004/39/EC (Market in Financial Instrument Directive) can impact how crowdfunding platform are regulated.

called the "European Crowdfunding Stakeholders Forum" (ECSF) was set up in June 2014 to assist the European Commission in exploring the potential and the risks of this growing form of finance, as well as the national legal frameworks applicable to it, in order to identify whether there should be a European level policy action in this field. Compared to the non-specific approach, this one is more likely to produce a consistent solution covering all legal issues related to crowdfunding. Nonetheless, there is a risk of treating market players providing competing financial services differently (traditional financial intermediaries and funding platforms)—which must be carefully managed.

In accordance with the latest overview of the crowdfunding regulatory frameworks (updated January 2017) provided by the Expert Group of the European Securities Committee, the following EU Member States have adopted bespoken regimes for investment-based crowdfunding: Austria (1 September 2015),[35] Belgium ('crowdfunding exception' in prospectus regime, 17 May 2014), Spain (29 April 2015),[36] France (1 October 2014),[37] United Kingdom (1 April 2014),[38] Italy (17 December 2012, Law, and

[35] Federal Act on alternative means of financing (Alternative Financing Act-*Alternativfinanzierungsgesetz, AltFG*) – Obligations for issuing bodies as well as operators of internet platforms ("crowdfunding") regarding the financing of terrorism (sec. 4, para. 5 and sec. 5 para. 1 (2)), Federal Law Gazette Vol. I No. 114/2015).

[36] Business Finance Promotion Act, number 5 of 2015 (hereinafter, LFFE2015), of 27 of April (*Ley 5/2015, de 27 de abril, de Fomento de la Financiación Empresarial*), as published in the Official Bulletin (BOE) num. 101, of 28 of April of 2015. Title V is entirely devoted to crowdfunding platforms legally named "Plataformas de Financiación Participativa".

[37] *Décret nº 2014-1053 du 16 septembre 2014 relatif au financement participatif / Ordonnance nº 2014-559 du 30 mai 2014. Ordonnance n° 2014-559 du 30 mai 2014 relative au financement participatif*, JORF n°0125 du 31 mai 2014 page 9075, texte n° 14, available at https://www.legifrance.gouv.fr/eli/ordonnance/2014/5/30/FCPX1406454R/jo/texte (*Ordonnance*).

[38] Policy statement 14/4, *The FCA's regulatory approach to crowdfunding over the internet, and the promotion of non-readily realisable securities by other media*, March 2014: http://www.fca.org.uk/static/documents/policy-statements/ps14-04.pdf (PS 14/4). FCA's February 2015 *Review of the regulatory regime for crowdfunding and the promotion of non-readily realizable securities by other media,* https://www.fca.org.uk/static/documents/crowdfunding-review.pdf (the *Review*). Financial Services and Markets Act 2000 (FSMA) - http://www.legislation.gov.uk/ukpga/2000/8/contents

26 June 2013, Regulation),[39] Germany (10 July 2015),[40] Portugal (24 August 2015 pending regulatory ruling to enter into force),[41] Finland (1 September 2016)[42] and Lithuania (1 December 2016).[43] With regard to lending-based crowdfunding, only a few countries have adopted specific rules: Spain (within the scope of the Crowdfunding legislation, 29 April 2015), France (within the scope of the Crowdfunding regulations, 1 October 2014), UK (within the scope, 1 April 2014), and Portugal (expected).

For the purposes of this comparative study, only selected domestic rules will be analyzed. The ultimate goal is to infer common rules, policy decisions, and conceptual elements from the multinational regulatory panorama, without aiming to produce a comprehensive comparative analysis among all the domestic regulatory actions in detail.

VII.- Comparative Analysis of the Scope of application

The comparative study between US and EU legal frameworks for crowdfunding activities must start by comparing the scope of the application of rules specifically adopted to regulate crowdfunding. In fact, the first key policy decision in the legislative process is to define the sphere of application on all the relevant bases: personal scope, material scope, and territorial scope. The scope definition is not only a natural prerequisite for the application of the law, and certainly relevant for practical matters, but also represents a

[39] *Legge 221/2012,* of 17 December 2012, *di conversione in legge, con modificazioni, del decreto-legge 18 ottobre 2012, n. 179, recante ulteriori misure urgenti per la crescita del Paese*. (12G0244), in forcé since 13th of January of 2014. Subsequently, CONSOB (*Commissione Nazionale per le Società e la Borsa*) adopted *Regolamento sulla raccolta di capitali di rischio da parte di start-up innovative tramite portali on-line*. *Delibera* num. 18592 and the attached Regulation of 26 of June of 2013 were published in *Gazzetta Ufficiale* num. 162 dated on 12 of July of 2013.

[40] Small Investor Protection Act, *Kleinanlegerschutzgesetz, Budesgesetzbakatt Teil I,* 2015, Nr. 28 vom 09.07.2015

[41] Lei n.º 102/2015 de 24 de agosto, *Regime jurídico do financiamento colaborativo*, *Diário da República*, 1.ª série — N.º 164 — 24 August 2015.

[42] Press release on Finnish Crowdfunding Act at http://vm.fi/artikkeli/-/asset_publisher/joukkorahoituslaki-tuo-toimialalle-kevytta-saantelya?_101_INSTANCE_C91M3tdJeutx_languageId=en_US (last visit 22/2/2017).

[43] A brief note on the enactment of the legislation and an outline of the main points of the Lithuanian Crowdfunding Act accessible at https://www.crowdfundinsider.com/2016/11/92020-lithuania-approves-bespoke-crowdfunding-regulations-platforms-may-raise-e5-million/ (last visit 22/2/2016).

significant policy decision on the understanding and the legal apprehension of a socioeconomic reality. By demarcating the sphere of regulatory actions and supervisory powers, regulators make a decision about the need to protect certain interests, and the mechanisms for managing conflicts. Simultaneously, delimitating the scope of application entails drawing a line between activities that are covered by the specific legislation on crowdfunding and those that are covered by general rules. In most cases, activities that do not fall within the scope of application of the special legislation are not left unregulated, but simply subjected to existing rules. A perception of a total lack of regulation in such cases is incorrect. Likewise, unless expressly stated, uncovered activities are not forbidden. Simply, the aim of regulator is to ensure that activities falling within the sphere of application are carried out in conformity with the adopted rules.

In sum, the scope of application embodies and specifies a policy decision about which activities are likely to generate new risks and need, therefore, a specific regulatory action aimed to establish a scheme of incentives, allocate liabilities, protect interests, anticipate conflicts, and provide solutions.

In order to compare the scope of application, the following factors are relevant: the structural and operational factors that determines the personal scope (*infra* VII.1.); the financial factors that impact the material scope (*infra* VII.2.); and the territorial connecting factors that clearly defines the geographical scope (*infra* VII. 3.).

VII.1. Personal scope: platform-based models

From a structural and operational viewpoint, crowdfunding models can be divided into two main categories. First, there are direct crowdfunding models where the project promoter directly addresses the campaign to the prospective contributors, and, with no assistance from an intermediary, searches and finds contributors, interacts with them,

manages the campaign, provides the technical and legal infrastructure to complete contributions, and monitors the resulting relationships. Second, there are platform-based models which are characterized by the participation of an intermediary – the platform operator – that creates and manages an electronic environment where interaction among promoters and contributors takes place.

Both categories are strongly conditioned on the presence of digital technology. Digital technology has been one of most decisive enablers for all models of crowdfunding. Whereas digital technology as a powerful communication channel has notably amplified the reach of direct crowdfunding campaigns, it has also multiplied the structural options for efficiently allocating capital to investment through electronic platforms.

Platform-based businesses are one of the most fascinating and promising organizational models facilitated by digital technologies. Their value-creation potential results from a fruitful combination of a community-based environment suitable for self-regulation and an interactive environment managed by an operator exploiting economic efficiencies of intermediation. Not surprisingly, crowdfunding growth is almost fully triggered by platform-based crowdfunding models.

From a legal perspective, the dominance in the market of the platform-based models has a visible consequence on the regulatory and policy approach. The distinctive organizational features of platform-based models are a decisive factor: the participation of an intermediary (the crowdfunding platform operator). The participation of the platform operator not only entails the triangulating of relationships among parties (operator-promoter, operator-investor, promoter-investor); but also, and interestingly, brings to the fore a new actor who may perform an intermediary role in financial services. The penetration of crowdfunding activities in regulated markets has attracted supervisory attention and triggered regulatory actions.

The need to regulate the role of platform operators, their access to and participation in the market, largely explains the scope and aims of the adopted legislation on crowdfunding. The rules are mainly focused on providing a legal framework for crowdfunding platform operators and setting out requirements, obligations, and liabilities. In that regard, most legal texts are essentially operator-centered regimes.

First, most legislation in this area establishes a special legal regime or status for the crowdfunding platform operator, in line with traditional financial intermediaries, by way of subsuming crowdfunding into existing legal concepts, or, more frequently, adjusting existing legal regimes with more suitable requirements for crowdfunding. Should the latter option be chosen, a new legal concept of intermediary is created with a tailored legal regime and subject to specific requirements - i.e. *Plataformas de Financiación Participativa (PFP)* under Spanish law (LFFE2015), or Funding Platform under US Crowdfunding Act.

Second, crowdfunding regulations also indirectly refer to promoters and investors and partially govern transactions concluded between investors and promoters. Nonetheless, some of such provisions are drafted as an obligation of the platform to ensure, monitor, control, or verify compliance by promoters or investors. Although it could be alleged that some provisions are clearly addressed to promoters or investors and even seem to impose obligations on promoters, specific penalties or sanctions are not provided in case of infringement; whereas penalty rules instead sanction non-compliance or infringement of the monitoring obligation by platforms. In contrast, specific sanctions or legal consequences likely to derive from infringements committed by promoters as well as investors are not always expressly provided for. But a lack of express provisions does not imply that such infringements are unnoticed or indirectly tolerated. Parties should resort to general rules in contract law or tort law in order to prevent infringement and potential

liability. The rationale behind this legal policy decision seems self-explanatory. Crowdfunding rules devise a platform-centered legal regime subject to supervision and regulation by competent authorities. As a consequence, duties and obligations are imposed on platforms with the belief that in their role of gatekeeper,[44] they will efficiently supervise users' performance, adopt preventing measures, monitor compliance, and deter infringement.

The following examples under the Spanish Crowdfunding Act (as cited above, LFFE2015) help to illustrate this assertion. According to Spanish law, platforms have to ensure (Art. 71 LFFE2015) that promoters disclose all required information about the project, credit conditions and investment opportunities, and such information must be complete. Likewise, platforms must also publish all relevant information in their possession pertaining to both the project and the promoters. On the other hand, Article 73 LFFE2015 stipulates that promoters are liable to investors for providing to the platform the information to be published. As per Article 92.1.g) LFFE2015, the publication of misleading information likely to deceive an investor amounts to a serious infringement of the platform. Nevertheless, despite expressly contemplating that promoters are responsible for the information supplied, there is no sanction in case of infringement. In this context, liability risks are manifold.

- First, a sanction can be applied against the infringing platform. This sanction could take several forms: a fine, a temporary suspension of activities, the revocation of license/authorization to operate in the market, or the removal of directors or officers.

[44] KRAAKMAN, Reinier H., "Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy", 2 *J.L.Econ.&Org.,* nº 1, Spring 1986, pp. 53-104; CHOI, Stephen, "Market Lessons for Gatekeepers", 92 *Nw.U.L.Rev.* 916 (1998).

- Second, to the extent that the duty to provide accurate and complete information is included in terms of use and/or membership agreement with the investors, investors would be entitled to sue for breach of contract.
- Third, under general laws, promoters that give inaccurate or misleading information to prospective investors could incur in pre-contractual liability; or, more interestingly, those investors who rely on the false information provided by the promoter in deciding to invest in the project might consider alleging that the investment transaction is null or void by grounds of defects of consent or error. A more sophisticated approach might be that the disappointed investor could claim breach of contract due to the frustration of reasonable expectations and a lack of conformity between the promised and the actual performance.
- Finally, the position of gatekeeper exposes the platform to other potential risks. Investors, users, or third parties who relied on the accuracy of the information published by the platform and adopted a decision that resulted in economic losses might sue for compensation, based on their reasonable reliance on information that caused their losses. The viability and the conditions to be met for such claims differ among national jurisdictions.

The above-described examples serve to illustrate how crowdfunding regulation has adopted a platform-based approach and the consequences of this regulatory approach on risk allocation and liability distribution.

VII.2. Material scope: the financial factor

As described above, crowdfunding models are in broad terms classified in at least four main categories[45] based on the type of contribution and the legal nature of the relationship

[45] Nonetheless, for the purposes of the study the *2nd European Alternative Finance Industry Report* prepared by the Cambridge Center for Alternative Finance, September 2016 (available at

concluded between the promoter and the contributor accordingly. The vast majority of jurisdictions that have passed legislation on crowdfunding have focused on those modalities sharing a financial element. Donation-based crowdfunding models as well as reward-based modalities, in most of its variations (pure reward, pre-sales), do not frequently fall into the scope of application of crowdfunding rules. Naturally, they are subject to general rules of contract law, consumer protection, sales agreements, electronic commerce rules, distance-selling transactions, and many other relevant laws, where applicable. In all such cases, the platform operator acts as an electronic intermediary (ISP)[46] and, in particular, as an electronic platform operator[47] subject to existing rules in both fields. Except for those idiosyncrasies associated with the particular nature of such platforms, operators managing crowdfunding platforms of those models do not require a special status as a new intermediary.

In contrast, the presence of a financial element means that the platform operator may be deemed a financial intermediary likely to compete with other financial institutions in allocating resources and efficiently directing the flow of credit to investment

https://www.jbs.cam.ac.uk/fileadmin/user_upload/research/centres/alternative-finance/downloads/2016-european-alternative-finance-report-sustaining-momentum.pdf), p. 31, identifies 10 alternative finance model types across continental Europe: peer-to-peer consumer lending, peer-to-peer business lending, equity-based crowdfunding, reward-based crowdfunding, invoice trading, real estate crowdfunding, donation-based crowdfunding, debt-based securities, balance sheet business lending, profit sharing crowdfunding.

[46] BAILEY, Joseph P. & BAKOS, Yannis, "An Exploratory Study of the Emerging Role of Electronic Intermediaries", *Int.J.Electronic Commerce,* vol. 1, nº 3, Spring 1997, pp. 7-20. On the liability regime for internet intermediaries, see the useful and interesting information provided by the World Intermediary Liability Map (available at http://cyberlaw.stanford.edu/our-work/projects/world-intermediary-liability-map-wilmap); in EU, VERBIEST, Thibault *et al*, *Study on the Liability of Internet Intermediaries,* November 12, 2017, available at http://ec.europa.eu/internal_market/e-commerce/docs/study/liability/final_report_en.pdf (last visit, 22/2/2017); CAVANILLAS MÚGICA, Santiago, *Deberes y responsabilidades de los servidores de acceso y alojamiento. Un análisis multidisciplinar,* Granada: Comares, 2005; PEGUERA POCH, Miquel, *La exclusión de responsabilidad de los intermediarios de Internet,* Granada: Comares, 2007.

[47] An approach to intermediaries as a trusted third party, RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, "El tercero de confianza en el suministro de información. Propuesta de un modelo contractual para la sociedad de la información", *Anuario de Derecho Civil,* 2010, Fasc. III, 2010, pp. 1245-1284. A suggestive analysis in the context of the platform economy, FROSIO, Giancarlo F., "Reforming Intermediary Liability in the Platform Economy: A European Digital Single Market Strategy" (February 6, 2017), 111 *Northwestern University Law Review Online,* 2017, Forthcoming. Available at SSRN: https://ssrn.com/abstract=2912272.

opportunities in the economy. Thus, the financial criterion can be used to draw the line between regulated and non-regulated crowdfunding platform operators. Nonetheless, the interpretation and scope of the financial criterion may differ among jurisdictions, which makes it likely that there will be incongruous scopes of application. Therefore, incorporating another approach could be more revealing. In most cases, crowdfunding is regulated when it involves carrying out regulated activities reserved by statute to authorized (and registered) institutions. Then, firms running crowdfunding platforms involving the performance of such activities are subject to regulation and supervision either by subsuming existing categories of law applicable to financial intermediaries, or by creating a new legal status of intermediary funding platform, *plataforma de financiación participativa, intermédiaire en financement participatif* or IFP, *conseil en investissement participatif* or CIP. The financial factor is then the functional link connecting some crowdfunding models to the regulatory and supervisory schemes for financial markets.

VII.3.- Geographical scope: connecting factors

The geographic scope of crowdfunding rules is highly dependent on the regulatory approach adopted in each jurisdiction. Hence, there is an appreciable diversity of legislative techniques to limit the sphere of application on geographical basis, as well as varied connecting factors.

As a starting point, it is important to remember that given the three-party scheme articulating crowdfunding transactions, connecting factors may be related to, either alternatively or cumulatively, the investor, the issuer (promoter), or the funding platform. Likewise, regulators can opt for personal factors (location, domicile, registered seat, nationality, approval, competent financial regulatory authority) or for transaction-related

factors (stream of commerce, activity directed specifically at a territory, purposeful actions to be subject to a jurisdiction, transactions at own initiative, advertising campaign, other indicia) instead. Depending on the reasons driving crowdfunding rules, regulators more or less explicitly define a specific territorial strategy to better achieve the ultimate aims and effectively protect the interests at stake.

Due to the strong financial regulatory flavor of crowdfunding rules, the territorial application sphere of such regulations is particularly relevant as it closely linked to a question of power, jurisdiction, and the capacity of financial authorities, regulators, and supervisors.[48] In addition, the limiting strategy for the territorial scope of application is conditioned by the digital component of crowdfunding.[49] Insofar as crowdfunding transactions are essentially offered, negotiated, concluded, and even partially performed through digital means, connecting factors for crowdfunding rules – factors that determine which legislation applies, or, in other words, criteria that connect a situation with a specific legislation (i.e. domicile of one of the parties, registered seat, location of the asset, place where effects take place, where activity has been address at) - must consider the digital element like electronic-commerce laws[50]. Possible connecting factors and, therefore, demarcating options are numerous and varied.

For the purposes of comparative analysis, the cross-border activity in Europe will be first described in general terms and then a deep study of a domestic case (Spanish law) will be presented as an example.

[48] National Competent Authorities (NCAs) as described by the European Securities and Markets Authority (ESMA) - www.esma.europa.eu -.

[49] SEC Release No. 33-7516, Statement of the Commission Regarding the *Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions or Advertise Investment Services Offshore*, March 23, 1998, available at https://www.gpo.gov/fdsys/pkg/FR-1998-03-27/pdf/98-8001.pdf.

[50] WILSKE Stephan and SCHILLER, Teresa, "International Jurisdiction in Cyberspace: Which States May Regulate the Internet?", 50 *Federal Communication Law Journal,* issue 1, 12-1995, Article 5, pp. 117-178.

Under US rules, the territorial scope is based on personal factors. Such an approach is consistent with the ultimate aim of crowdfunding rules as an initiative to help start-ups and small business to raise capital at a reasonable cost and in relatively low amounts from the crowd and through Internet. Simultaneously, this approach protects investors who engage in crowdfunding transactions, facilitated by funding platforms.

First, the crowdfunding exemption only applies to eligible companies. Non-US companies are ineligible. Such an eligibility requirement is a demarcating factor of the territorial scope of crowdfunding regulation. In fact, along with other exclusions,[51] foreign issuers (promoters) are not covered by the crowdfunding exemption.[52] This exclusion is consistent with the intent of the regulation to facilitate access to capital in the domestic business fabric.

Second, there are no general provisions restraining the participation of non-US investors in crowdfunding or their use of US funding platforms.

Third, as the Crowdfunding Regulation and its principal protection mechanisms revolve around the participation of an (authorized) intermediary, it is important to question whether nonresident funding platforms are allowed to operate in the US market by directly crowdfunding campaigns to local investors. To that end, it is critical to remember that in order to act as an intermediary in a transaction involving the offer or sale of securities in reliance on Section 4(a)(6) of the Securities Act, one is required to register

[51] Companies that already are Exchange Act reporting companies, certain investment companies, companies that are disqualified under Regulation Crowdfunding's disqualification rules, companies that have failed to comply with the annual reporting requirements under Regulation Crowdfunding during the two years immediately preceding the filing of the offering statement, and companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies.

[52] As explained in the *Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers* (https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm), under the Securities Act of 1933, the offer and sale of securities must be registered unless an exemption from registration is available. Title III of the Jumpstart Our Business Startups (JOBS) Act of 2012 added Securities Act Section 4(a)(6) that provides an exemption from registration for certain crowdfunding transactions.' Under the Regulation Crowdfunding adopted by the Commission in 2015, eligible companies will be allowed to raise capital using Regulation Crowdfunding starting May 16, 2016.

either as a broker-dealer under Section 15(b) of the Exchange Act or as a funding portal pursuant to Section 4A(a)(1) of the Securities Act. Considering such a registration requirement, the potential entry of foreign funding portals in the US crowdfunding market will depend on their ability to register with the Commission. The final rules (Rule 400(f) Crowdfunding Regulation) confirmed that nonresident funding platform are allowed to register with the Commission provided that certain conditions are met. Likewise, it is important that the Crowdfunding Regulation applies only to the offerings of US domestic issuers.[53]

A nonresident funding portal is a funding portal incorporated in or organized under the laws of a jurisdiction outside of the United States, or having its principal place of business in any place not in the United States.

A nonresident funding portal must file a completed and executed Schedule C to Form Funding Portal. Schedule C requires a nonresident funding portal to provide information about its arrangements for its agent for service of process in the United States, as well as a certification and an opinion of its counsel addressing the nonresident funding portal's ability to provide the Commission and the national securities association of which it is a member with prompt access to its books and records. Additionally, Schedule C requires a Funding Portal to agree to submit to onsite inspection and examination by the Commission and the national securities association of which it is a member. Although

[53] Should a non-US resident funding platform wish to access US investors on behalf of non-US companies, several regulatory considerations should be carefully understood and managed. Several approaches might be considered to deal with the regulatory broker-dealer requirements in connection to investment crowdfunding offerings. ZUPPONE, Michael L. and BLAKE, Corey B., "Non-U.S. Investment Crowdfunding Platforms Can Offer Securities to U.S. Investors under Current Securities Laws", *Insights,* May 16, 2016, at https://www.paulhastings.com/publications-items/details/?id=9c59e969-2334-6428-811c-ff00004cbded (last visit 2/1/2017).

these requirements impose costs[54] on nonresident funding portals, these requirements are expected to enhance investor protection by facilitating oversight.

Behind this decision lies a trade-off in terms of competition in the domestic market and investor protection. Certainly, although the additional costs of the regulatory burden may limit the ability of some nonresident funding portals to register, which could harm competition, opening the market to foreign platforms could actually increase competition among crowdfunding intermediaries, which in turn may reduce issuer fees. In sum, more competition is expected to increase available options in the crowdfunding market and lower costs of raising capital. Thus, capital formation would be enhanced.

Within the EU, the analysis of the territorial scope is more uncertain due to the absence of specific crowdfunding rules and the existence of several regulatory layers. As noted, the crowdfunding regime within the EU is not only jurisdictionally, but materially fragmented. Some intermediary activities can be covered by general licenses subject to harmonized rules (MiFID license), and therefore are not separately identified as pure crowdfunding activities, although they operate that way. At the same time, some countries have adopted specific regimes for crowdfunding activities. In some cases, domestic bespoke regimes have been developed under exceptions to EU rules.[55] Additionally, cross-dependence and interrelations between the two regulatory layers cloud the analysis. Therefore, crowdfunding platforms that are subject to domestic bespoke regimes and may coexist with intermediaries performing crowdfunding activities in compliance with EU rules. That makes the analysis of the territorial scope difficult, as different legal regimes with varied connecting factors and scopes may apply.

[54] As per SEC final Rules (p. 467), it is estimated that 'nonresident intermediaries will face an additional cost for outside professional services of $25,179 per intermediary to retain an agent for service of process and provide an opinion of counsel to register as a nonresident funding portal'.

[55] French national exemption regime has been developed under Article 3 of MiFID which requires entities to provide investment advice.

Against such a backdrop, some general considerations should be outlined. Data provided by the survey[56] carried out in December 2014 by ESMA of National Competent Authorities (NCAs) gathered up-to-date information on regulated investment-based crowdfunding platforms in the EU and helps to illustrate the following comments.

First, the survey confirms that there is cross-border crowdfunding activity covered either by national authorization regimes or by EU exemptions (MiFID exemption). However, those crowdfunding activities undertaken under general EU exemptions are usually not identified as such nor separately estimated. In that regard, it could be argued that cross-border activity in the European crowdfunding market is underestimated, or at least imprecisely valued.

Second, platforms operation in the common market are directly authorized/registered under European Union rules or national law, or are tied agents of authorized/registered firms. Hence, different regulatory levels coexist. Although data provided by the survey are certainly not updated and do not depict the current state of the EU crowdfunding market in the beginning of 2017 (in particular, because domestic legislation[57] has been adopted after the time period of the survey), the distribution scheme is illustrative. Of 46 entities: 18 are authorized under MiFID; 3 authorized under national law; 15 operate under the MiFID Article 3 exemption; 12 operate as MiFID tied agents of an investment firm, and hence are not directly authorized but operating under the responsibility of an authorized firm; and 1 was reported as being excluded from MiFID scope by virtue of Article 2, but authorized under national law in the UK. At present, the panorama has

[56] ESMA, *Investment-based crowdfunding. Insights from regulators in the EU,* 13 May 2015, ESMA/2015/856 Ann 1, available at https://www.esma.europa.eu/sites/default/files/library/2015/11/esma-2015-856_ann_1_esma_response_to_ec_green_paper_on_cmu_-_crowdfunding_survey.pdf (last visit 2/1/2017).

[57] For instance, the enactment of the Spanish legislation on crowdfunding as previously referred - LFFE2015 – has clearly stimulated the emergence of a domestic crowdfunding market with the participation of a number of funding platforms. Besides, in 2015, bespoke regimes for crowdfunding have been adopted in Austria, Germany and Portugal.

clearly evolved, the number of regulated platforms has increased[58] and the distribution percentages have surely changed, but the image remains. On the one hand, the lack of a unitary EU bespoke regime for crowdfunding has neither completely impeded the emergence of a crowdfunding market in Europe nor totally obstructed cross-border activity. But, on the other hand, it reveals a fragmented state of affairs that may result in discrepancies, possible jurisdictional arbitrage, and common market dilution.

Since some EU Member States have decided to adopt specific regulations for crowdfunding activities, the territorial scope is pertinent. As an example, we will dive into relevant provisions of the Spanish legislation governing crowdfunding (LFFE2015) to examine its territorial strategy and identify the connecting factors.

Article 47 LFFE2015[59] expressly delineates the territorial scope of the legal regime for *platformas de financiación particpativa* established by Title V. The provision is structured in three paragraphs.

First, Article 47.1 contains the general rule limiting the territorial application sphere and sets out the main connecting factors. It affirms that the legal provisions of Title V apply to funding platforms operating in Spain, their activity, and the participation of promoters and investors. Therefore, the rules are intended to govern not only the access to the market

[58] Only in Spain, 12 platforms have been authorized and registered in 2016 under the Spanish Act of 2015. The list of registered platforms, with the relevant information on shareholders, authorized activities and business plan, is available at https://www.cnmv.es/portal/consultas/Plataforma/Financiacion-Participativa-Listado.aspx.

[59] Article 47 LFFE2015 in its original version in Spanish: *Ámbito de aplicación territorial.*

1. Estarán sujetas a lo previsto en este título las plataformas de financiación participativa que ejerzan la actividad prevista en el artículo anterior en territorio nacional, así como la participación en ellas de los inversores y promotores.

2. A los efectos de lo previsto en este título, no se considerará que un servicio ha tenido lugar en territorio nacional cuando un residente en España participe por iniciativa propia, como inversor o promotor, en una plataforma con domicilio social en el extranjero que preste los servicios previstos en el artículo 46.1 de esta Ley.

3. A los efectos previstos en el apartado anterior, no se considerará que la actividad se pone en marcha a iniciativa propia:

a) Cuando la empresa anuncie, promocione o capte clientes o posibles clientes en España.

b) Cuando la empresa dirija sus servicios específicamente a inversores y promotores residentes en territorio español.

of funding platforms (registration, authorization, obligations) and their activity, but also some aspects of the participation of promoters and investors in crowdfunding transactions offered, concluded, or conducted through such platforms. Second, it states that the connecting factor to apply Title V rules is the exercise of the crowdfunding activity by the platform in Spanish territory. As the legal regime pivots around the crowdfunding platform, the connecting factor is linked to the activity carried out by the platform and expands the scope of application, to the investors and the promoters participating in the platform.

Second, Article 47's second paragraph aims to clarify the meaning of "activity carried out in Spanish territory" with a negative approach. It will not be deemed that the activity has taken place in Spain if a Spanish resident participates at his/her own initiative, either as a promoter or as an investor, in a platform domiciled abroad. The rationale behind the criterion "at own initiative" is that if the platform purposefully offered or developed its activity in the country where the investor or the promoter resides, then it is not reasonable that to subject the platform to domestic rules. The "at own initiative" element operates as a technique to limit the sphere of "reasonable expectations". Due to costs, commercial reasonableness, and foreseeability, a platform is not expected to adapt its activity to jurisdictions when it had no intention of directing business activity at that jurisdiction.

Third, the third paragraph (Art. 47.3 LFFE2015) constructs and specifies the meaning of "participation at own initiative". If the platform advertises, promotes, or solicits clients in Spain; or the platform directs its services specifically to promoters or investors residing in Spain, the participation of the investor or the promoter in the platform will not be considered as "at own initiative". In sum, insofar as the platform directs its commercial efforts (advertisement, promotion, commercial activities, client acquisition) towards the Spanish territory, crowdfunding activity will be subject to Spanish rules.

The nationwide regulatory approach to crowdfunding within the EU, in absence of a regional action, aggravates the complexity of limiting the territorial scope of application in relation to digital activities. As crowdfunding platform operators provide electronic services ("information society services" in the terminology used by the EU Directive on electronic commerce) and carry out their activities in a digital environment, the selection of a reasonable, effective, and unambiguous connecting factor is a critical and complex task. Essentially, policy decisions can be categorized as either of two main options: either connecting the scope with the location (of the operator or of the users), or extending the application of the relevant rules over the activity. In the first case, fixing the connecting factor is objective and relatively easy, although the cross-border tendency of crowdfunding and the ubiquity (or a-nationality) of digital activities are not fully contemplated. Under the second option, rules better protect interests at stake (general interests, investors/contributors, promoters, market stability, and so on) within a territory, but more sophisticated factors are needed to state (or presume) when a digital activity is carried out in, in connection, or directly addressed to a specific territory.

VIII. Crowdfunding in the Platform Economy: A Prior Analysis of Platform Structure, Parties and Relations

After the above-outlined comparison between the US and EU regulatory approach to crowdfunding in terms of policy decisions and macro-structure, a more detailed analysis of specific rules will now be conducted. The next sections will dive into some legal rules and regulations to identify and compare underlying principles and specific legal solutions. Regulations on crowdfunding, overall, share a common structure that is essentially based on rules defining the platform operator's legal status, rules on project promoters and rules aimed to govern crowdfunding campaigns, and protective rules on investors.

Accordingly, crowdfunding regulations are visibly conditioned by the platform-based model. It may be sustained that crowdfunding rules regulate crowdfunding platforms, but these rules do not intend to regulate crowdfunding activities running out of platforms or under different models (i.e. direct crowdfunding is not regulated).

Therefore, a proper understanding of crowdfunding rules for the purposes of comparison must be preceded by a structural, functional, and operational study of electronic platforms. It will clarify the internal contract-based relational structure supporting a platform; identify parties involved in its operation - operators and users (promoters and investors) -; and show the crucial role played by the platform operator. Upon this neutral analysis of the organizational model as a common architecture for platforms, the particularities of platforms engaged in crowdfunding activities will be revealed.

Hence, next sections VIII.1 to VIII.4 provide an X-ray of electronic platforms as an organizational model[60] that has propelled the overall transformation of digital economy into a platform economy. Platform-based alternative finance models are an illustrative and intriguing expression of this trend of digital landscape. Subsequent sections (from IX onwards) delve into some specific legal rules

This section is then structured as follows. Section VIII.1 contextualizes the emergence of platforms in the transformative evolution of digital economy. Under Section VIII.2 an efficiency analysis explains the rationale behind the shift from transactions in electronic opened environments to digital activity in closed environments (platforms). Parties involved in the creation and the operation of a platform, their functions and roles, are described in Section VIII.3. Finally, Section VIII.4 briefly exposes the internal

[60] A complete, thorough and comprehensive legal analysis of electronic platforms in RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, *Régimen jurídico de los Mercados Electrónicos Cerrados (e-Marketplaces), op.cit.*

relationships integrating the contract-based structure – membership agreement, users' relationships, and platform policies.

VIII.1.- The Emergence of Platforms as Digital Organizational Structures: A Platform Economy

The accelerated evolution of the digital economy has shown that digital technology is not only transforming the contractual process and transaction components – as the use of electronic commerce in the formation and the performance of contracts reveals – but it is also reshaping structures and organizations, and even creating new environments for business activities, social relationships, education, entertainment, public services, and cultural initiatives. The most conspicuous manifestation of such a transformative power is the pervasive expansion of electronic platforms. Certainly, the digital economy today is a platform economy. Electronic platforms are the dominant organizational model[61] for business activities, social networks, emerging businesses, public environments, and educational systems in today's digital society. Remarkably, the emergence and increasing popularity of disruptive models, such as sharing-based economy, crowdfunding or fintech variants, have not only been made possible but greatly stimulated by the platform-based organizational solution. This entails that, in most cases, the creation of real value depends on the membership of closed markets, electronic platforms, and social networks.

All such models are based on the same economic rationale and operate with a common underlying legal infrastructure, regardless of their diverse appearance in the market. From a technological perspective, all said business models must necessarily be built as a closed

[61] MALONE, Thomas W., "Modelling Coordination in Organizations and Markets", *Management Science,* vol. 33, num. 10, October 1987, pp. 1317-1332; MALONE, Thomas W.; YATES, JoAnne, BENJAMIN, Robert I., "Electronic Markets and Electronic Hierarchies", *Communications of the ACM,* (30:6), June 1987, pp. 484-497.

electronic environment able to provide controlling capacities over membership, access, exit, members' behavior, content quality, security standards, data, and information flow. In legal terms, a closed electronic environment entails contract-based self-regulation. And from an economic approach, they perform the role of intermediaries whose main aim is to repair market failures (information asymmetries, uncertainties). Precisely, the strengths associated with community-based business models are then the gains obtained from multilateral interactions managed by a centralized supervisor (platform operator) who, by exerting control over the market and its participants, generates credibility and trust. A platform operator performs the role of a Trusted Third Party. When it controls access to the closed environment, first, by selecting suitable members among applicants, and, second, by implementing a reliable access control mechanism using passwords, digital signatures, or any other identification procedures, the community operator grants a mark of trust which benefits the participants. Third persons may rely on such trust marks insofar as the manager credibility is solidly underpinned by expertise, trustworthiness, and reliability.

Not surprisingly, a growing “market of e-markets (platforms or social networks)” is emerging with several distinctive features that are clearly aligned with the rules governing the so-called “digital economy”. Indeed, electronic markets, propelled by increasing returns and economies of scale, present important network effects. Although network effects may enhance consumer welfare, they also increase market concentration, reduce the number of effective surviving competitors, and create lock-in problems due to increasing switching costs. These effects unavoidably lead markets towards monopolistic/oligopolistic structures where rivals, exploiting their network effects, compete to gain the whole market. Notwithstanding the foregoing, the resulting market situation is in fact that of a “fragile monopolist” that is permanently threatened by both

strong innovation pressure that results in a dynamic competition and by a creative *coopetition* that encourages rivals first to cooperate in order to compete afterwards. In this regard, closed environments (e-markets, trading platforms, business communities) embody a fascinating *coopetition*-inspired strategy since the creation of the e-market arises from a cooperative effort aiming at building a competitive environment. Cooperate to compete is the motto.

Electronic platforms represent one of the most fascinating digital business models in the digital economy. They have been adapted to apply to multiple sectors, types of relationships, and goals.

Electronic platforms, however, have not received much legislative attention. Therefore, a legal framework for electronic platforms has not been developed. On the contrary, attention to electronic platforms has been, and is still, fragmented, partial, and tangential. Some jurisdictions have addressed the liability exposure of electronic intermediaries and devised a specific legal liability regime in the form of a safe-harbor scheme, such as the US Section 512 *Digital Millennium Copyright Act,* and the EU *Directive on Electronic Commerce* and its incorporation in domestic legal system by Member States. But it is unclear whether platform operators are genuine intermediaries for the purposes of the specific liability regime. Therefore, rules on intermediaries do not fully cover all legal aspects of platforms. In contrast, some specific rules have been adopted in relation to sectoral platforms such as regulations on crowdfunding platforms – as analyzed in this Paper – or Alternative Trading Systems[62]/Multilateral Negotiating Systems or

[62] MACEY, Jonathan R.; O'HARA, Maureen, "Regulating Exchanges and Alternative Trading Systems: A Law and Economics Perspective", *J.Legal Stud.,* vol. 28, January 1999, pp. 17-54McCARROLL, Elizabeth M., "Regulation of Electronic Communications Networks: An Examination of Tradepoint Financial Networs's SEC Approval to Become the First Non-American Exchange to Operate in the United States", 33 *Cornell Int'l L.J.,* 2000, pp. 211-262; MACEY, Jonathan; KANDA, Hideki, "The Stock Exchange as a Firm: the emergence of close substitutes for the New York and Tokyo Stock Exchanges", 75 *Cornell L.Rev.,* 1989-1990, pp. 1007-1052

Facilities.[63] Given their sectoral scope, these rules do not embrace platforms as a whole either.

The convenience of adopting specific rules on platforms at a general level is presently being considered by the European Union,[64] China, and other domestic jurisdictions in order to assess whether specific rules are needed to update, modernize, or simply expand the scope of their electronic commerce laws. The legislative response to platforms is still partial and limited to certain jurisdictions, fragmented internationally, and non-uniform.

VIII.2. The Rationale behind Platforms as a Closed Environment: An Efficiency Analysis

Electronic platforms, in all their variants (e-marketplaces, sharing-based platforms, business communities, social networks, crowdfunding platforms) operate as closed electronic environments. The closure of an environment does not depend on a specific technology, the use of certain communication technique or the level of security, which may also be high in an open environment. The difference between an open environment and a closed one is essentially based on a legal factor. As further explained below, the closing of an environment is achieved by using of a contractual infrastructure that creates a contract-based trustworthy context for users that is self-contained, self-regulated, and,

[63] For instance, in European Union, Art.4(15) MiFID defines 'Multilateral trading facility (MTF)' as 'a multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract in accordance with the provisions of Title II'. Today, relevant rules in MiFID II and MiFIR - *Directive (EU) 2016/1034 of the European Parliament and of the Council of 23 June 2016 amending Directive 2014/65/EU on markets in financial* instruments (Text with EEA relevance), OJ L 175, 30.6.2016, p. 8–11*; Regulation (EU) 2016/1033 of the European Parliament and of the Council of 23 June 2016 amending Regulation (EU) No 600/2014 on markets in financial instruments, Regulation (EU) No 596/2014 on market abuse and Regulation (EU) No 909/2014 on improving securities settlement in the European Union and on central securities depositories* (Text with EEA relevance), OJ L 175, 30.6.2016, p. 1–7.

[64] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, *Online Platforms and the Digital Single Market Opportunities and Challenges for Europe,* SWD(2016) 172 final, COM(2016) 288 final Brussels, 25.5.2016. MAXWELL, Winston & PÉNARD, Thierry, *Regulating digital platforms in Europe – a white paper,* December 2015, at www.digitaleurope.org (last visit, 14/2/2017).

to the maximum possible extent, independent from domestic jurisdictions. Hence, an electronic platform, as a closed environment, is built by a set of agreements between the operator and the user community. In the absence of specific legal rules, obligations and rights of platform operators are laid down by the contract terms between the operator and every user, and, consequently, the role to be actually performed by operators is devised by the set of contracts supporting the platform.

Electronic transactions, social interaction, and digital activities may be negotiated, carried out, concluded or performed in an open environment (like a website) or a closed one. Nonetheless, closed environments (electronic platforms) provide a significant number of efficiencies and advantages that are attractive in commercial dealings and help the platform to retain business value.

In contrast, dealings in open environments face all of the uncertainties and challenges arising from the digital ecosystem: delocalization, virality, identity uncertainty, massive damages, or, among others, irrelevance of connecting factors to determine which courts have jurisdiction and which legislation applies.[65] Whereas open environments are reasonably suitable for isolated commercial transactions and are still commonplace for consumer transactions, closed environments provide an optimal atmosphere for the building and development of long-term business relationships.

Electronic platforms have pervaded the digital economy on the grounds of a number of efficiencies: cost reduction, transparency enhancement, integration and syndication opportunities,[66] and trust generation.

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[65] RODRÍGUEZ DE LAS HERAS BALLELL, Teresa, "Espacio digital y autorregulación", en REAL PÉREZ, Alicia (Coor.), *Códigos de conducta y actividad económica: una perspectiva jurídica*, Madrid: Marcial Pons, 2010, pp. 155-163.

[66] BICHLER, Martin, *The Future of e-Markets. Multidimensional Market Mechanisms,* Cambridge: Cambridge University Press, 2001; SCULLEY, Arthur B., WOODS, W. William A., *B2B exchanges. The Killer Application in the Business-to-Business Internet Revolution,* New York: Harper Business, 2001; VOLLEBREGT, Erik, "E-Hubs, syndication and competition concerns", 21 *ECLR,* issue 10, October 2000, pp. 437-443.

Electronic platforms, in all their business variants (e-marketplaces, B2B sharing-based platforms, business communities), exploit the following efficiencies:

a) *Cost reduction*. One of the most visible efficiencies that results from the migration of business activity to digital markets is the dramatic reduction of costs. All costs involved in the process of contracting,[67] transaction costs, are reduced or even radically minimized by operating on an electronic platform.[68] For example, searching costs, negotiating costs, contracting costs, monitoring costs, costs of maverick purchasing, switching costs, communication costs, and enforcing costs are all reduced.

b) *Transparency enhancement*. In economic terms, transparency denotes the ability of a market to provide relevant information. In the context of information asymmetries, the higher the transparency factor is, the lower the cost of getting relevant information to market players is. Electronic platforms centralize, efficiently process, and readily disclose information to users.

c) *Integration and syndication*. Electronic platforms for business transactions drive both intra-corporate and multi-corporation integration projects. At the intra-corporation level, upon admission by the platform operator, market users immediately proceed to redesign internal processes aimed at rationalizing management and procurement, improving stock control and optimizing the supply chain. At the multi-corporation level, the opportunity to design a fully integrated market facilitates access to new markets, alleviates the need for traditional intermediaries, reduces additional costs, and promotes "customization". Interestingly, integration projects intend to enable the implementation of "just in time" and "quick response" strategies as well. In parallel, integration opportunities lead to the development of syndication models. Market relationships veer

[67] DEMSETZ, Harold, "The cost of contracting", 82 *Q.J.Econ.,* 1968, pp. 33-53; WILLIAMSON, Oliver, "Transaction cost Economics: The Governance of Contractual Relations", 22 *J.L.&Econ.,* 1979, p. 223.
[68] BAKOS, J. Yannis, "Reducing Buyer Search Costs: Implications for Electronic Marketplaces", *Management Science,* vol. 43, num. 12, December 1997.

from bilateral-lineal-chained relations between players to more sophisticated multilateral-networked-dynamic schemes within the electronic platform. Notwithstanding the emergence of competition risks, syndication fortifies the bargaining power of weaker market players, and, in particular, benefits SMEs.

d) *Uncertainty minimization / Trust generation*. From a legal point of view, the most fascinating, albeit less visible, effect of an electronic platform is the creation of a contract-based trust environment. The centralized, supervised, and self-regulated market supported by the electronic platform creates a dramatic reduction of uncertainty. In undertaking of supervising, regulating, and monitoring tasks, the platform operator infuses the market with trust, certainty, and predictability.

The ultimate aim of a closed environment is in fact to generate trust in an uncertain playing field. Trust means predictability, reduction of uncertainties, and minimization of risks.

VIII.3. Parties involved in the operation of an Electronic Platform

In an electronic platform, the parties involved are either the platform operator or the community of users.

When joining the platform, every user enters into a membership agreement with the operator. Subsequently, registered users negotiate and conclude contracts among themselves as according to internal policies. In a crowdfunding platform, the operator is an entity authorized to operate a crowdfunding platform in compliance with the applicable legislation. Likewise, registered users will be project promoters and donors/users/lenders/investors/contributors depending upon the crowdfunding model. Concurrently, transactions concluded among users will be donation agreements, sales

agreements, loan, secured transactions, equity contributions and partnerships, or the corresponding transactions in accordance with the variant of crowdfunding.

VIII.3.A. Platform Operator

Electronic platforms are self-regulated communities managed by a platform operator. Although some functions can be designed to operate on a decentralized basis, as further explained below, electronic platforms are essentially centralized structures. The role of the platform operator is crucial in creating and maintaining a predictable, reliable, and trustworthy playing field. The scope and the extent of the operator's functions are determined in each case by the membership agreement.

a). Roles Played by the Platform Operator

In managing the platform, the operator provides added-value services, adopts rules, monitors compliance, and penalizes infringements of internal rules by users. In sum, the operator acts as a service provider, a (contractual) regulator, and a (contractual) supervisor. Whereas the provision of services (payment management, insurance, inspection, rating, marketing) has a visible commercial impact - increase of the appeal of the offer in the market, fostering of the loyalty of users, and provision of additional financial support -; the tasks of regulating and supervising are key to the creation and preservation of trust.

In those sectors where specific rules have been adopted (i.e. crowdfunding platforms), special or additional obligations can be imposed on the operators, their activities can be limited, or even specific supervising or monitoring duties may be required.

In general terms, the following functions are performed by platform operators.

a) *Provision of services*. Beyond basic services supporting the electronic trading infrastructure (software, security measures, information exchange), the operator may enhance the commercial appeal of the platform by providing a varied range of added-value services: payment services, rating, insurance, certification, inspection, or logistics services. The provision of added-value services tends to increase user loyalty (raising switching costs), impede full substitutability with competing offers, and favor integration.

b) *Adoption of platform Rules (Rulesbook)*. Electronic platforms are self-regulated environments. Per the membership agreement, the operator is entitled to adopt rules such as eligibility requirements to access the platform, a code of conduct, negotiation standards, model contracts, performance conditions, and penalties policies. By accepting the membership agreement, each user commits to comply with in-force platform rules and internal policies. Accordingly, when the user fails to act in accordance with the market's rules and policies, the operator is entitled to the default remedies.

c) *Supervision and monitoring: Penalties Policy*. Per the membership agreement, the operator is entitled to monitor and supervise compliance with rules and policies and take reasonable measures accordingly. In practice, the supervision is frequently conducted through a decentralized reporting system whereby users notify the operator of the misconduct of other users.

b). Running a Platform as a Business Activity: Revenue Model

The operator manages the platform, and thereby incurs costs. Hence, a financial model (fees, expenses, revenues) must be implemented accordingly.

The advertising-based financial model, in which users do not pay a fee and advertisers indirectly finance the platform through marketing, is well known in B2C (business to

consumer) and P2P (peer to peer) platforms (i.e. Facebook or Twitter) but less common in B2B (business to business) environments.

More extensively, operators devise fee-based revenue models to finance activity, recover investments, and make a profit. Revenue models can be classified in several categories that can be added and combined to better meet each platform's needs, considering the number of users, value of transactions, number and frequency of interaction, type of users, scope, costs, available services, structure of the market of platforms, and competition pressure.

i. Access-based Revenue Models.

Access-based models are revenue schemes that operate without regard to the level of activity. Users pay a fixed rate for access to the platform independent of the number of transactions concluded. This model comprises four main fee models: *subscription or membership fees*, *posting fees* (cost per posted offer), *listing fees* (cost of being evaluated and admitted in the market), and *hosting fees* (cost of hosting data and commercial information in the platform). Although, in practice, the total cost depends on the effective use of services, all the fees under this model are pre-determined and set without considering the activity level.

ii. Activity Level-based Revenue Models.

Under these financial models, users pay *transaction fees.* Transaction fees can be calculated as a percentage over the value of each transaction or according to a scale of fixed amounts for ranges of transaction values. Frequently, transaction fees range from a minimum fee to a maximum cap. The minimum fee purports to make the market profitable when, due to the conditions of the sector, the average value of transactions is

low. The maximum cap aims to encourage and favor high-value transactions within the platform.

This model aims to quantify market success and its level of liquidity. Not surprisingly, it is a common model among B2B platforms. In crowdfunding platforms, this revenue model can and is frequently implemented on a one-sided basis. So, access to platform can be offered for free to investors, especially minority investors, whereas project promoters must pay a transaction fee over the collected amount. As crowdfunding platforms veer towards accredited investors and high-budget campaigns, revenue strategy tends to be applied to both positions (promoters and investors).

It is worth noticing that the implementation of a revenue model based on transaction fees does not mean that the operator is acting as a commission agent on behalf of users to promote and/or conclude transactions. In contrast, the operator only purports to manage a venue without involvement in specific transactions. Hence, the payment of transaction fees does not create an agency relationship between each user and the operator.

iii. Revenue Model Based on Added-value Services.

Services-based revenue models used to be applied in combination with other principal revenue models. Interestingly, in these models, unlike the two above-mentioned ones, fees and prices can be paid not only by users (although that is typically what happens), but also by third parties.

On the one hand, *information fees* remunerate the access and/or provision of up-to-date and duly processed information. Third parties might be interested in accessing processed data provided by the operator.

On the other hand, *service fees* remunerate the provision of added-value services by the operator. In theory, services are expected to mainly address the platform's users, but there

is no reason to refuse the possibility of providing services to third parties. Depending on the type of service, fees are estimated according to specific relevant factors. Added-value services can consist of credit rating, legal advising, product inspection, tracking, insurance, marketing design, market analysis, quality reviewing, and payment services. If the operator is a reputable company in the market or has outsourced such services to renowned service providers – but while the operator handles the payments -- the provision of added-value services may represent a significant and substantial source of income.

It is important to remember that the provision of certain services can require authorization and the prior fulfilment of a set of requirements. In such cases, the operator would be duly authorized to perform reserved activities (payment services, investment services, debt- or equity-crowdfunding, credit rating) or outsource them to organizations holding the required license.

iv. Infrastructure-based Revenue Models

With a clear additional character, infrastructure-based revenue schemes enable operators to commercially exploit both the software and the hardware that supports the operation of the platform. For instance, the operator licenses principal software (apps, main software, antivirus, auction software) that users need to access and participate in the electronic market. Likewise, the operator may sell, rent, lease, or license specific hardware devices that users may require to simply start operating in the platform or access certain functionalities (such as, card reader devices, biometric scanners, warehouse automation systems, robotics). Presently, however, private networks (VPN) have been broadly replaced by web-based business models. Therefore, payment of network-use fees has lost relevance accordingly.

VIII.3.B.- Platform Users

The broad term of "users" describes all registered members of the platform irrespective of their position in the transactions concluded within the market (buyer/seller, lessor/lessee, licensor/licensee, promoter/investor).

From a legal viewpoint, every user is the counterpart of the operator in the membership agreement, and, at the same time, a prospective contracting party in relation to other users in platform transactions. From a technical perspective, upon registration, users are entitled to access the platform, use its functionalities, and benefit from services. In practice, by logging in the user is able to exercise rights and enjoy services in accordance with the contractual framework (membership agreement and service provision agreements).

If platforms are subject to specific sectoral regulations, such as crowdfunding rules, mandatory legal rules apply to users' activity over internal contractual rules within the platform (obligations of promotes, limits on investment, protection rules, investors' rights, campaigns' conditions). If the specific regulations are not mandatory, then they would apply as default rules in the absence of internal contractual rules.

Upon registration, users join the business community, which is bound by platform policies (internal protocols, rulesbook, codes of conduct).

As a result, if the applicant is admitted, the user password/key/signature is activated. By entering the user password, every member enters into the platform. Thereby, each member is entitled to access the services according to the membership agreement. From a legal perspective, member keys (user names, passwords) serve as an electronic signature. More precisely, they operate as a contract-based electronic signature for a natural or legal person.

The basic rule under the membership agreement is that the legal signatory (as the contracting party) is responsible for the safekeeping, protection, and proper use of his/her keys. Accordingly, any use of the keys entitles the platform operator (and the rest of the users) to presume that the legal person whose keys have been used is duly represented and acting on an authorized basis. The burden to break from this presumption is on the key holder. The same rationale behind the risk allocation scheme in case of non-authorized use of credit/debit cards applies here. Consequently, unless the wrongly represented member has promptly and previously notified the operator a non-authorized use, effects and liabilities are allocated to the member holding the keys, without prejudice of any liability arising from the non-authorized use between the material signatory and the legal signatory.

Therefore, any legal person has to deal internally with representation issues. The use of platform keys should be restricted to specific individuals who are duly empowered to that end. Internally, the legal person is the principal and the material signatories are agents. This agency relationship, however, is not disclosed to third parties and is irrelevant for the purposes of interacting within the platform. In sum, under the newly activated account, only one user (the legal person) is empowered to act.

Some platforms instead contemplate the possibility of creating "authorized user" accounts under the main user account. In such cases, although the main account is linked to the legal person applying, other dependent accounts can be opened with limited uses. Dependent accounts are held by employees, managers, or department directors empowered to act on behalf of the company (market user) within a certain scope. When using those sub-accounts, key holders are authorized to access certain services (such as to access information, but not to negotiate) or in established conditions (such as only accessing from company premises and during office hours), some functionalities can be

deactivated or limited (i.e. by transaction value, by counterparty, by type of transactions, by product), and critical operations likely to affect the main account are locked (change of conditions, modification of main account profile information). In creating such dependent accounts, the account profile serves as a certificate in electronic signatures. Thus, the dependent user is technically unable (functionalities will not be working) and legally unauthorized to act, negotiate, or conclude transactions beyond the scope of attorney power.

From a legal standpoint, the main user is the principal and the dependent users are agents. Unlike the previously-analyzed case of material signatories with undisclosed agency relationships, dependent users act and are recognized as agents. Likewise, the main user is clearly considered as a named principal under a *contemplatio dominii* scheme. The platform operator is responsible for providing control mechanisms to guarantee that authorized users are entitled to operate in the market exclusively within the scope and under the conditions laid down by the principal in the certificate (the account profile).

Given that authorized users are by nature limited in their capacity to act and power to bind the company, validation or confirmation processes must be jointly implemented. Purely electronic mechanisms allow the principal (the main user) to ratify, confirm, and complete the limited power of the authorized users. In practice, the transaction initiated by the authorized users lacking capacity would be temporarily paused pending confirmation by the principal.

The design of multi-account schemes instils dynamism, complexity, and versatility in the operations of multidivisional companies.

In sum, user account keys serve as contract-based electronic signatures for the purposes of any action to carry out within the electronic platform. It is commonplace that the platform operator acts as a certification agency issuing the keys, monitoring the use, and

managing cancellation, expiration, and further circumstances likely to affect the validity of the contractual electronic signature. Nevertheless, the issuance and the monitoring of the electronic signature could also be entrusted to a third certification agency. In that case, the function of controlling user access would be, at least partially, outsourced.

VIII.4.- Relations between Parties within a Platform

VIII.4.A- Membership Agreement

The membership agreement is concluded between the platform operator and each of the users meeting the eligibility requirements and successfully registered with the platform. Schematically, the membership agreement has the following features:

a) It is concluded electronically.

b) It may be B2B contract or a B2C one depending on the user (professional, business, consumer).

c) Although it does not fit into a typical contractual model, it reasonably qualifies as a service provision contract with mixed obligations.

d) It is a standard term contract. Terms are pre-drafted by the operator and apply to all membership agreements of the same category (vendors, buyers, licensors, licensees). In general, the user is unable to negotiate, does not participate in the drafting and has to adhere to the contract on a "take-it-or-leave-it" basis.

Even if the membership agreement aims to regulate the relationship between the platform operator and each user, its performance casts over the whole community, its terms deal with users' interaction and it contains obligations that the user and operator exert in relation to other users. In sum, the membership agreement is the foundation of the electronic platform. Interestingly, by virtue of the agreement, each user commits to

comply with internal policies and market rules not only in interacting with the platform operation but also in dealing with other users. Therefore, in the case of a breach of rules, the operator is entitled to resort to available remedies on grounds of breach of contract, and, likewise, injured users can ask the operator to adopt agreed-upon measures against the infringing user (according to infringements and penalties policy) or claim compensation from the operator.

VIII.4.B.- Internal Policies, Platform Rules, and Codes of Conduct

In its role as regulator, the platform operator adopts rules of varied nature to govern access to content, use of services, conclusion and performance of transactions, and the exchange of information within the platform. Per the membership agreement, users are required to abide by the market rules. The most widely adopted model is the centralized regulatory one. Under this model, the operator is empowered by users to freely adopt, modify, or amend rules for the platform. More exceptionally, however, a model wherein users' involvement in the regulatory process is encouraged is preferable. If a goal of the platform is to stimulate community spirit, a more participatory model should be designed. If so, users would be informed, consulted, or even called to vote in reform projects, amendments, or enactment of new policies.

IX.- Applying Crowdfunding Rules to Platform Operators: A Comparative Analysis

Platform operators play a critical role in the crowdfunding market by centralizing resources, facilitating transactions, reducing dramatically transaction costs, and effectively allocating assets in investment projects. Crowdfunding has thrived as a platform-based market. Platforms perform intermediary functions that are crucial for the

growth and the sustainability of crowdfunding sector. Not surprisingly, crowdfunding market health strongly depends upon platforms' competition, regulation, and operations. Given the enabling role played by platforms for crowdfunding activity, regulatory responses have focused on regulating platforms. These responses have included: access to market, registration/authorization, capital requirements, services provided, duties, conflicts of interest, liability. In devising a legal regime for platform operators, diverse regulatory strategies are possible. Platform operators can be regulated as mere enablers of market transactions, as trusted third parties infusing confidence to market operators, or even as genuine first-line enforcers entrusted to detect and prevent fraud and even adopt measures to reduce potential infringements in the future. The strategy adopted in most cases is not explicitly declared in the legal text, but it can be inferred from the provisions that shape the functions of crowdfunding platform operators. Effectively, regulations, by specifying obligations, limitations, prohibitions, and services to be provided by platform operators, define the role of the platform and set the standards operators should follow in performing their functions.

Since the role of platform operators is not expressly declared in the regulations, for the purposes of comparison, the comparative process focuses on two factors: the specific obligations operators are subject to, and the standards set to assess operators' compliance of those duties as an intermediary, including the 'reasonable basis' standard, due diligence, reasonable reliance, and reasonable evidence. The policy decision in defining applicable standards for operators' obligations indirectly represents a functional choice for platforms in the crowdfunding ecosystem. Accordingly, fixing the compliance standard for platform operators has a substantial impact on the configuration of the whole system, and, in particular, on nascent intermediaries.

A quick glance at crowdfunding rules in US and in EU Member States helps to initially conclude that obligations normally entrusted to platform operators refer to information requirements and risk warnings to investors, conflicts of interest, reductions in risks of fraud, and control of access. However, the formulation of the scope of the obligation and the standard of compliance may result in diverging functional outcomes. At least three scenarios can be envisioned.

First, the operator could be a mere facilitator in charge of providing a venue for crowdfunding transactions. In this case, the operator is simply committed to provide and manage an environment in compliance with the terms of the agreement (promoter-operator / investor-operator), which may include the proper functioning of the software, information duties, the provision of value-added services, and the protection of data. If the platforms are defined as mere enablers of crowdfunding transactions, then regulations only establish obligations relating to its role as facilitators. Under this model, operators do not intervene in negotiations, nor do they participate in transactions concluded within the platform, review or verify published information, or endorse any offer or project.

This model can be devised so that the operator does not perform any tasks related to the parties or the transactions, or as a safe-harbor-like model emulating the specific liability regime for internet providers of intermediary services (Section 512 DMCA in the US, Articles 12-15 EU Directive on Electronic Commerce). Under the second model, operators do not have a general duty to supervise, but upon receiving actual knowledge they must act expeditiously. In a crowdfunding context, the following situations may arise. The operator would not be responsible for the accuracy and the completeness of the information provided by the promoter about the project. However, upon being notified (usually thorough report systems implemented by the platform) of certain false information provided by the promoter, the operator may (or must) act accordingly by

informing the promoter, asking for verification, or directly removing the information and warn the investor.

Second, the operator could act as a trusted third party likely to provide services intended to generate trust. The ability of the platform to infuse confidence in investors and promoters depends upon different factors, like credibility, reputation, professionality, competition, the regulatory framework, and previous experience. In this case, the operator performs functions aimed to create a trustworthy environment but it does not participate in the crowdfunding transactions. For instance, regulations may state that operators must ask the promoter to provide complete and accurate information. This obligation does not mean that the operator guarantees that the information is actually accurate and complete. Or, another example is if a crowdfunding platform implements its own rating system to classify promoters and/or projects according to a pre-determined set of criteria. Then, the operator commits itself to correctly apply the classification, accurately publish ratings, and properly manage the rating system. Beyond the scope of the rating system, the operator does not endorse any project or guarantee profitability, success, or investor protection.

Third, the operator could become a first-line supervisor and enforcer of regulatory compliance. Under this model, the strictest one for platforms, operators would assume the obligation not only to regularly supervise compliance with regulations by promoters, but also to ensure the accuracy and completeness of available information about projects, and even endorse the viability, success, or profitability of projects. Operators adopt measures to detect fraud and prevent infringement.

An analysis of Rule 301 of the US Crowdfunding Regulation and the subsequent discussion to issue SEC final rules after notice and comment illustrates the value of the standard as a tool to adjust the role of operators.

X.- Crowdfunding Rules relating to Investors

In the jurisdictions examined in this comparative analysis, the regulatory attention paid to investors has largely focused on implementing protection goals. If a bespoke regime has been devised, then consequently a range of measures for investor protection has been anticipated and set out in the regulations. In the absence of specific rules on crowdfunding, there should be an effort to ensure that protective measures provided for by existing laws apply, either partially or in their entirety, to investors in debt-based and equity-based crowdfunding campaigns.

Hence, investors under certain thresholds are essentially treated as parties to be protected both in their relationships with the platform operators (as pure registered users) and in their transactions with project promoters. As a consequence, protection schemes are basically designed as obligations on the platform operators' and promoters' side. Therefore, most of the protective measures are devised as duties and obligations to be fulfilled by platforms and promoters. Thus, protection measures consist of "know your customer rules"; disclosure duties by issuers; information requirements and risk warnings by platforms; or due diligence requirements. In sum, the responsibility to ensure an educated, well-informed, conscious, and free decision by investors devolves upon platforms and promoters. They both have to provide mechanisms, in the form of warnings, disclosure duties, and transparency obligations, to mitigate risks, reduce mistakes, and enable self-protecting decisions. In that regard, and despite the particularities of these obligations in the crowdfunding context, these mechanisms do not greatly differ from protective measures available in financial market regulations. Information asymmetries would be tempered by disclosure duties and transparency obligations.

Such protection measures are commonplace in crowdfunding rules both in the EU and in the US, although with different scope and disparities in content. In some cases, they have been expressly provided for by specific legislation; in other cases, they are contemplated by existing regulations and extensively applied to crowdfunding investors.

Along with the above-mentioned protection measures, based on disclosure duties and due diligence requirements, a specific additional technique has been commonly implemented in crowdfunding regulations for investor protection purposes: fixing limits on the maximum investable amounts in crowdfunding. This legislative policy decision instils a visible degree of caution and containment in the crowdfunding sector. In practice, setting caps on investable amount restricts the magnitude of competition among finance sources and restrains the effective size of the crowdfunding market. Therefore, it represents a legal solution specifically tailored for crowdfunding transactions.

Against this backdrop, the following discussion will focus on how limits-based techniques for crowdfunding have been articulated in the US and the EU, and what consequences might flow from a violation of such limits.

X.1. Investment limits: An Assessment

Setting investment limits is a commonplace measure for protecting investors in crowdfunding regulations (with exceptions of France, and, to a certain extent, Italy and UK). Nevertheless, investment limits for protection purposes and the very formulation of such limits and their conditions have been debated, questioned, and reconsidered. On the one hand, they appear to be objective mechanisms and operate as effective loss-containing techniques, provided that the formulation is clear and easy to apply. But, on the other hand, they constrain the financial capacity of investors and, in practice, are based

on setting thresholds with estimated figures and percentages that can always be challenged.

Not surprisingly, comments received by the SEC on the Proposing Release[69] to implement Title III of JOBS Act referred to investment limits and reflected opposing views regarding the establishment of any type of limits, the proposed amount, and the application of limits in practice. Member States domestic legislation, if they have contemplated investment limits, differ in amount and scope. Local particularities and specific market conditions explain the diversity of formulations. These limitations take different forms and range from fixed maximum ceilings to variable shares of personal income, wealth, or financial assets. Whereas under certain regulations, these ceilings are calculated per offering, other specific regimes estimate based on the total investment in a given timeframe (typically, one year). In general, the investment limits depend on the categories of investors, which are classified as retail, sophisticated and professional investors; accredited and non-accredited investors; and natural and legal persons. In essence, such disparities prove the variability that the measure permits and the inconsistency of the underlying legal policy.

Regardless of these questions, investment limits are present in most crowdfunding regulations. Certainly, they prove to be effective loss-containing mechanism. Should the statutory language aim to clarify ambiguities and ensure easy calculations of maximum permitted amounts, investment limits may operate with objectivity and automatism. Likewise, the quantitative limitation of investment provides a resultant effective control of risks that facilitate insurability on both sides. Considering those advantages, the limit-based regulatory option have been preferred by regulators.

[69] Rel. No. 33-9470 (Oct. 23, 2013) [78 FR 66427 (Nov. 5, 2013)] (the "Proposing Release"), available at http://www.sec.gov/rules/proposed/2013/33-9470.pdf.

From a macro-perspective, the option of investment limits also impacts the crowdfunding sector as a whole. Due to these limits on the investable amount in crowdfunding projects, it could be that crowdfunding remains a secondary investment option that completes investment decisions in other traditional areas in the investor's portfolio. At the same time, investment limits tend to preserve the crowd-distribution structure of crowdfunding campaigns and preserve the micro character of the contribution, especially if the caps apply to all types of investors. The latter effect seems to reinforce the roots of crowdfunding as an alternative finance method for microfinance.

X.2.- Investment limits: Applicable Conditions

For the comparative analysis, the following criteria will be discussed: models of crowdfunding, time factors, investment thresholds, types of investors, and monitoring. Against this backdrop, two issues deserve particular attention. First, whether the investor is entitled to voluntarily renounce the protective measure and exceed the applicable limits. Second, what the effect is when the investment limit is exceeded.

a). Investment limits depending on crowdfunding modalities

The first factor to consider in the formulation of investment ceilings is whether they apply to all crowdfunding models or only certain variants.

As a general rule, no limits have been established for contributions in non-financial crowdfunding modes – namely, donation-based and reward-based crowdfunding. That is a natural consequence of the commonly-adopted regulatory policy of excluding non-financial models from the specific regimes for crowdfunding.[70] As a matter of fact, an eventual establishment of limits to the contributions in those cases would entail an

[70] Portuguese legislation does, nevertheless, cover donation-based and reward-based variants as well.

unintended, and surely undesirable, direct imposition on free patronage decisions – tax policy could indirectly disincentive donations - and even fix prices in competitive markets. Contributions to non-financial crowdfunding campaigns are not investment but donations and pre-paid prices.

Therefore, ceilings logically apply to loans and securities. Nonetheless, neither rules are common for both modalities (loan-based and securities-based), nor are limits applicable to loans and securities necessarily homogeneous. In some cases, that disparity derives from the fact that debt-based crowdfunding does not fall with the scope of bespoke regimes. Hence, there are not specific rules for debt-based contributions.

The application of investment limits solely to securities-based crowdfunding represents the predominant regulatory policy. It is worth noting that securities also include debt securities. In that regard, the classical distinction between pure equity-based and debt-based crowdfunding blurs securities-based crowdfunding. For the purposes of the analysis of investment limits, securities-based crowdfunding is relevant and will be used for comparison.

Limits fixed by US rules apply to securities-based crowdfunding. Within the EU, among the domestic regulations enacted to date, Spain, the UK, France, and Portugal include pure lending-based crowdfunding. Whereas Spain and Portugal provide for the same limits and under the same conditions that are laid down for equity-based crowdfunding, regulatory solutions in the UK and France differ. The UK rules do not contemplate any limits for loans, although some restrictions apply to investment crowdfunding in certain conditions. On the contrary, French regulations, which do not provide for limits in equity-based crowdfunding, set specific limits for loans. Specifically, lenders can finance up to €1,000 per project in the form of a loan with interest and up to €4,000 per project for an interest free loan.

b). Time factor

Some rules calculate investing limits on the basis of the aggregate amount invested during a period. A 12-month period is common. Thus, US rules provide an illustrative example of that approach by establishing the following scheme. An investor is limited to investing: (1) the greater of $2,000 or 5 percent of the lesser of the investor's annual income or net worth if either annual income or net worth is less than $100,000; or (2) 10 percent of the lesser of the investor's annual income or net worth, not to exceed an amount sold of $100,000, if both annual income and net worth are $100,000 or more. The SEC final rules explain (SEC final rules, p. 25) that such an approach reaches a balance between the need to access capital and to minimizing risk exposure. In the EU, Belgium sets a €5,000 global limit per year as well.

With the same time factor (per year) for the aggregate amount, other jurisdictions, such as Portugal and Spain, combine two references to the investment limit: a maximum amount per project (€3,000) and an aggregate maximum amount in crowdfunding per year (€10,000).

As specified below, those limits can vary depending on the category of investor and other criteria.

c). Thresholds and conditions

For calculating investment ceilings, regulators resort to two main formulas. First, there are fixed ceilings that apply to all investors meeting a set of conditions. Second, there are progressive ceilings that are based on select variables. Very frequently, both formulas are combined operating under either a 'lesser of' approach or a 'greater of' approach, as explained below.

Models based exclusively on fixed amounts are used in Spain, Portugal (which as detailed above sets a maximum amount per project (€3,000) and an aggregate maximum amount per year (€10,000)) Belgium (€1,000 per year), and Austria (€5,000 per year). In those jurisdictions, the same ceilings apply to those investors (see d) below) who are subject to the investment limits as they do not comply with the eligibility conditions to be deemed as accredited investors according to a set of thresholds. But ceilings do not apply when thresholds are exceeded and the investor is treated as an accredited investor. Then, no limits apply to invested amounts.

As detailed above, the US rules use a combined formula mixing fixed amounts and percentages, and setting two scenarios depending on investor's annual income or net worth. The threshold is set at $100,000. If either annual income or net worth is less than $100,000, the first scenario applies; if both annual income and net worth are greater than $100,000, the second ceiling applies. Under the proposal, the annual income and net worth of a natural person is calculated in accordance with the Commission's rules for calculating the annual income and net worth of an accredited investor, and an investor's annual income or net worth could be calculated jointly with the annual income or net worth of the investor's spouse. Securities Act Rule 501 specifies the manner in which annual income and net worth are calculated for purposes of determining accredited investor status[71].

Interestingly, the final wording of the rules establishing the applicable investment amounts have been refined to avoid ambiguities present in the previous version. As a result of the comments received, the SEC decided to clarify the criteria. Under the final rules, the first scenario applies when either the investor's annual income or net worth is less than $100,000; whereas the second scenario requires that, simultaneously, both the

[71] Instruction 1 to paragraph (a)(2) of Rule 100 of Regulation Crowdfunding. 57 17 CFR 230.501.

annual income and the net worth equal or exceed that amount. Even if the final draft could place constraints on capital formation, as compliance with the higher financial thresholds has become stricter, the final rules minimize investors' exposure to risk. In fact, concerns had been expressed about the number of households that experience a significant gap between the annual income and the net worth. Hence, a rule formulated under an alternative approach could lead those investors to be able to invest higher amounts.

With a similar format, the German rules focuses on two main situations, distinguished by whether the investor has freely available assets of at least €100,000. If so, the investor is allowed to invest up to €10,000 in an issue. Otherwise, if the investor does not have freely available assets of at least €100,000, a two-fold limit is set: an investor may invest twice his monthly income, but not more than €10,000. In all other cases, particularly if the investor does not provide a statement on assets and income, the ceiling is fixed at €1,000. These regulatory options show that the limits-based solution permits a high degree of variability in chosen conditions. Although the eligibility criteria should be soundly based on economic data and statistics representing average household incomes and wealth distribution in each country, the final configuration of the limits may, and indeed do, greatly vary in the quantitative ceilings, the use of fixed amount or percentages, and the basis of calculation (per project and/or per year).

Overall, the comparative analysis of solutions leads to three main conclusions. First, the use of percentages instead of fixed-amount ceilings injects a progressive variable in the system that provides more refined protection. If a whole category of investors under certain thresholds (e.g. assets of less than €100,000) have their investment amounts fixed (e.g., at €10,000), the ceiling might be too high at the lowest stretches of the income frame (e.g. less than €20,000), while being unreasonably low at the highest incomes (or net worth values) very close to the eligibility limit (e.g. €99,000). On the contrary, ceilings

calculated by percentages progressively incorporate real income/net worth. Nonetheless, determining an adequate percentage will be controversial. Second, fixed-amount ceilings are nevertheless easier to implement and require fewer and simpler control mechanisms than percentage-based ones. Third, the regulatory decision to establish both investment limits per project and per year creates a policy that favors two distinctive features of crowdfunding: relatively reduced investable amounts per investor, and the distribution of risk.

d). Types of investors

Beyond the disparities in amounts, calculation methods or formulas, it is particularly significant that the comparative analysis contrast decisions about the scope of the application of investment limits. Should investment ceilings be established, regulatory models may opt to apply ceilings to all investors, or only to certain categories of investors according to certain eligibility criteria. In that regard, the different approaches between the US and the European countries and within the EU are notable.

It is remarkable that the US has decided to apply investment limits equally, albeit with different ceilings, to all investors, including retail, institutional, and accredited investors. The convenience of such a comprehensive approach has been discussed by some commenters. It is questionable whether accredited investors really need such a protection measure, and it might place too many constraints on the growth potential of crowdfunding in the credit market. Nevertheless, the SEC decided not to alter the investment limits for any investors, due to the possibility that issuers (promoters) could rely on other exemptions to offer and sell securities to accredited and institutional investors. Therefore, concurrent offerings to those types of investors are possible through diverse exemptions. In fact, the limit on capital raised through crowdfunding does not include the amount

raised by other means on an aggregate basis. Yet, in practice, crowdfunding will act as an additional mechanism of capital raising.

In sum, under US crowdfunding rules, investment limits apply equally to all types of investors in the corresponding amount depending upon the eligibility criteria (as explained above, annual income and/or net worth).

The US comprehensive approach to investment limits contrasts with the predominant model implemented by European countries, which tends to use limits-based protection measures only for non-accredited investors. On the extreme end, Italy and France do not provide for any limit at all.

Although who qualifies as an eligible investor differs among European countries generally, some similar decisions, articulating a common policy, can be pinpointed. Legal persons, professional investors, and accredited investors are not subject to investment limits. Definitions of accredited investors also differ. As an example, under the UK rules, accredited investors are those who do not qualify for non-accredited investors, where non-accredited investors are: retail investors who do not take advice, investors who are not high net worth, and investors who are not sophisticated. Under the Spanish legislation, for instance, accredited investors are (i) institutional investors; (ii) companies with €1 million of assets, €2 million of annual turnover or €300,000 of equity; (iii) individuals with €50,000 of annual income or €100,000 of financial assets.

In conclusion, in line with the explanations provided by the SEC in support of their decision to equally applying limits to all types of investors, making investment ceilings transversal measures tends to allow crowdfunding to operate as an additional method of raising capital. In contrast, those regulatory models that confine limit-based protection measures to non-accredited investors allow crowdfunding to become the sole capital-

raising method for some companies. As a consequence, crowdfunding would be able to grow more in the credit market and to effectively compete with other financing options.

e). Monitoring, compliance, and liability

Once the investment-ceiling-based protection scheme is formulated under the described rules, decisions on two critical issues must be adopted: implementation and enforcement. The design of an implementation policy will determine the feasibility of the protection scheme; whereas decisions on enforcement will determine the effectiveness of the measure.

In practice, both decisions lead to two questions. First, who provides the information for assessing the eligibility criteria for the investment limits? Is the investor the only one responsible for providing the required information? Or should the promoter or the platform operator ask for that information? Second, who must verify, control, or monitor the compliance of investment limits. Is the investor responsible as a self-defense measure? Is this a burden on the promoter? Or, is the platform operator expected to take on that responsibility?

As a consequence, tasks will be distributed among involved parties in crowdfunding and, more importantly, risks and liabilities will be allocated accordingly. The different outcomes that can be possibly shaped are not trivial. Each risk-allocation scheme embodies a different policy about the role of platforms and their trust-generating capacity. As previously discussed, from the initial disintermediation stage in financial markets, the pervasive penetration of platforms in the crowdfunding sector ushers in a visible re-intermediation stage. Whereas the increasing use of crowdfunding first entailed the removal of traditional financial intermediaries (banks, brokers, investment services entities) from the investment allocation process (disintermediation phase), resorting to

crowdfunding platforms means the emergence of new intermediaries (the own platform operators) – the reintermediation phase. Platforms (need to) create value. To that end, platform operators perform intermediary roles. If platform operators are responsible for controlling, monitoring, or even enforcing statutory protection measures, they would become trusted third parties to the extent that they inspire confidence in the market. But, they would assume the resulting risk burden. Are there enough incentives to promote trust in crowdfunding transactions?

Legislative policies may decide to define a legal model for platforms or to let various business models compete. Likewise, legislators can release promoters from any duty to verify and from responsibility for monitoring, or place incentives on them to adopt preventive and tracking measures instead.

Most regulations do not include specific provisions expressly dealing with these issues, but stances on these issues can be inferred from other provisions or extracted from commentaries.

Under the US rules, the SEC (p. 27) affirms that, as Instruction 3 to paragraph (a)(2) of Rule 100 of Regulation Crowdfunding states, "(a)n issuer would be able to rely on the efforts of an intermediary to determine that the aggregate amount of securities purchased by an investor will not cause the investor to exceed the investment limits, provided the issuer does not have knowledge to the contrary". Therefore, it first confirms that the platform is responsible for determining compliance with the investment limits, and therefore, the promoter can rely on its assessment. However, it does not totally free the promotor from the responsibility of observing limits if it has knowledge to the contrary. Hence, promoters have incentives to be careful if they have conflicting information about the aggregate amount invested.

European rules can be illustrated by two examples. Under Italian rules, the model operates on the self-declaration by investors. On the other hand, under Spanish law, platforms must assess the experience and knowledge of clients and verify that they can make their own investment decisions and understand and prioritize information risks; likewise, platforms will verify and ensure that non-accredited investors are not investing or committed to invest amounts exceeding or likely to exceed the investment limits.

XI.- Rules on Project Promoters and Crowdfunding Campaigns: disclosure obligations and size of offerings

Rules applicable to project promoters and their crowdfunding campaigns are commonly classified in three areas: disclosure and information duties; liability for misstatements; and limits on the capital raised or a duty to prepare and issue a prospectus, depending on the size of the offer.

Along with other specific requirements (reporting, filing, advertising), in some jurisdictions, most regulations impose on promoters (issuers) disclosure duties, and obligations to disclose risk warnings and information to platform operators and prospective investors. Except for some jurisdictions that make these obligations conditional upon certain thresholds (such as in Austria or Lithuania when the offer must be at least up to 100,000 Euros), disclosure is required in all equity-crowdfunding campaigns (the rest of EU Member States that have adopted specific regimes), and in crowdlending campaigns where regulated (Spain, France, UK, Portugal). The rationale behind disclosure and risk warnings is to remedy underlying information asymmetries and enable well-informed and educated investment decisions by future investors. Given that, however, legislation differs on the policy decisions regarding the allocation of risks and obligations. Incentives-allocation outcomes are therefore diverse. Where some

jurisdictions impose disclosure obligations on project promoters, others opt for placing these obligations on platform operators on an isolated basis (i.e. in Spain, except for the liability of the promoter on the information provided to investors) or concurrently with promoters (i.e. France, US SEC Final Rules p. 68). These rules should be driven by the desire to allocate duties to the least cost avoider and the desire to effectively implement measures to protect interests involved. From this perspective, promoters can better provide information about the project and the offer, whereas platform operators are prepared to supply information about the platform, general risks warnings about investing in the projects published on the platforms, and other key information relevant for investors in crowdfunding campaigns (Lithuania, Spain, Portugal or Finland). Under the US Crowdfunding Regulation, these disclosures and risk warnings are included in the educational material to be provided by the operators.[72]

Disclosure obligations are crucial in alleviating asymmetries, and should be carefully devised. The decision to impose obligations on platform operators defines the role of operators in different ways. At the same time, clear rules allocating obligations and risks enable operators to better devise their business models.

The other rule commonly included in existing crowdfunding regulations is the establishment of maximum amount of funds that can be raised through crowdfunding. Normally, setting this threshold is intimately associated with prospectus requirements in financial regulations. As a result, crowdfunding tends to fill the finance gap and is relieved of the formalities and complexities that offerings of certain magnitude are otherwise subject to.

Within the EU, quantitative thresholds and time limits differ. A common threshold is 5 million Euros over a 12-month period (Finland, Lithuania, UK or Italy). Spain lowers the

[72] (Rule 302(b)(1) of Regulation Crowdfunding would require intermediaries to deliver to investors, at account opening, educational materials including a list of specific items).

threshold to 2 million Euros per project and per platform and maintain the 5 million Euro limit for offers limited to accredited investors. This latter condition is also embraced by Portugal, which also fixes a general limit of 1 million Euros in all other cases.

Since the Commission published its report on *Crowdfunding in the EU Capital Markets Union* in May 2016, several developments in the regulatory framework for crowdfunding activities have taken place, both at EU and the domestic level. On 8 December 2016, the European Parliament, the Council, and the Commission decided to revamp prospectus regulations in order to improve access to finance for companies and simplify information for investors. Under the reformed regulation, the smallest capital raisings and crowdfunding projects up to €1 million will not need to issue a prospectus at all. Thus, the costs and complexities for these projects are alleviated and the burden of the prospected lifted. On the other hand, some domestic legislative amendments aligned to the EU policy to enable access to finance have been undertaken. For example, a 2016 reform in France raised the size of offers from €1 million to €2.5 million per year per project.

Under the US regulatory framework, the exemption from registration provided by Section 4(a)(6) is available to a U.S. issuer provided that "the aggregate amount sold to all investors by the issuer, including any amount sold in reliance on the exemption provided under [Section 4(a)(6)] during the 12-month period preceding the date of such transaction, is not more than $1,000,000." Consistent with the statute, Rule 100(a) of US Crowdfunding Regulation limits the aggregate amount sold to all investors by the issuer in reliance on the new exemption to $1 million during a 12-month period. Capital raised through other exempt transactions would not be counted in determining the aggregate amount sold in reliance on Section 4(a)(6).

XII.- Conclusions on a Regulatory model for Crowdfunding Platforms: the *outside effect* and the *inside effect*

This comparative analysis of Crowdfunding Rules in the EU and US leads to some general conclusions relating to the regulatory model for crowdfunding platforms. These conclusions pivot around a main thesis: crowdfunding, as an alternative finance model, exerts a visible and clearly perceived *outside effect,* which has been noticed by regulators, and a widely unnoticed *inside effect* that has been to date majorly ignored by crowdfunding regulations. As a consequence, the comparative analysis has helped verify that regulatory actions, both in the US and within the EU, are largely inspired by and focused on the outside effect of crowdfunding. Accordingly, crowdfunding regulations essentially aim to provide a legal regime for crowdfunding platforms operators (operator-based approach) with rules, techniques, and solutions typically adopted in the fashion of financial markets regulations. Nevertheless, the so-called *inside effect* has passed largely unnoticed. With a few exceptional cases with very limited scope, crowdfunding regulations do not contemplate the implications of alternative finance in corporate governance and company structure. Such a lack of attention demonstrates the need for further research on the effect of crowdfunding-based financing strategy on company structure, decisions, and governance.

The following remarks aim to summarize the key ideas of this study, provide conclusions, and devise the thesis on the two-sided effects of crowdfunding: outside effects and inside effects.

1). Financial Models of Crowdfunding, unlike non-financial variants, have attracted regulators' and supervisors' attention and aroused legal concerns

Some crowdfunding models, such as donation-based or reward-based ones, have peacefully settled in sectors (music, arts, scientific research) that have eagerly claimed a diversification of financing sources. But purely financial versions, namely equity-crowdfunding and debt-crowdfunding, have aroused legal concerns and attracted regulators' attention, insofar as they invade the natural fields of regulated markets. Notwithstanding the complexity added by the cross-border factor of crowdfunding financing transactions, general contract rules and consumer laws apply to donation-based and reward-based crowdfunding. Therefore, general protection mechanisms for consumer transactions would be activated in pre-sales, reward-based, or, to a certain extent, donation-based modalities. Such crowdfunding schemes are therefore not totally free of legal concerns. It is worth noting, that the mere concept of crowdfunding financing transactions as consumer transactions in all cases is questioned. In pre-sales models where the promoter carries out the activity on a regular basis, the application of consumer rules is more easily justified, but in many P2P transactions (activities that are undertaken sporadically, microcredit for personal/family purposes, donation for non-professional projects, P2P social lending, non-habitual activities) an imbalance of power between the parties is nonexistent.

In contrast, lending and equity-based crowdfunding encroach upon highly regulated sectors. Attempts to subsume these transactions within the general legal framework for lending contracts and corporate finance are insufficient. Supervision and regulatory schemes on intermediaries, market conditions, and client protection rules require more complex considerations in order to devise the legal machinery for purely financial crowdfunding. Successively, reports, consultation papers, and legislative initiatives have been elaborated and adopted in different jurisdictions (as described in this paper above,

this includes: Italy, the United States, France, the United Kingdom, Spain, and other EU Member States).

2). Regulatory approaches tackle the *outside effect*

All regulatory initiatives come from observing that funding platforms have entered the capital market scene and joined the ecosystem of financial intermediaries. A number of regulatory and supervisory issues immediately derive from this observation. This is the most visible effect of crowdfunding, the ***outside effect***, and regulators have perceived and skillfully tackled it. Tellingly, many of the adopted rules so far deal with such issues aiming to manage risks, protect investors' interests[73], prevent systemic effects, ensure market functioning, and enhance transparency.

Schematically, adopted regulations on all levels provide for rules related to three actors engaged in crowdfunding financing: funding platforms, project promoters, and investors/lenders ("the crowd").

3). Common rules on Platform Operators

With regard to crowdfunding platforms, although legal models differ in specific requirements, regulatory schemes are essentially underpinned by the following elements: registration, license/approval, and prudential requirements (including minimum capital, insurance, and organizational form). Under such a regulatory policy, two main approaches are feasible.

[73] BARITOT, Jacques F., "Increasing Protection for Crowdfunding Investors Under the Jobs Act", 13 *U.C. Davis Bus. L.J.*, 2012-2013, pp. 259-281; BURKETT, Edan, "A Crowdfunding Exemption? Online Investment Crowdfunding and U.S. Securities Regulation", 13 *Transactions Tenn. J. Bus. L.*, 2011-2012, pp. 63-106; FINK, Andrew C., "Protecting the Crowd and Raising Capital through the Crowdfund Act", 90 *U. Det. Mercy L. Rev.*, 2012-2013, pp. 1-34; WEINSTEINT, Ross S., "Crowdfunding in the U.S. and Abroad: What to Expect when You're Expecting", 46 *Cornell Int'l L.J.*, 2013, pp. 428-453.

On the one hand, countries may opt to apply general rules of financial intermediaries to crowdfunding platform operators, provided that the financial intermediaries effectively provide regulated services. For example, under US regulation[74] a funding platform must hold a broker license and comply with broker-dealer regulations. On the other hand, legislators may decide to devise a new legal framework for crowdfunding platforms. Newly adopted regulatory requirements would arguably result in a trade-off between the need to protect involved interests and prevent unfair competition with incumbent players and the inadvisability of imposing excessive regulatory burden on crowdfunding platforms likely to asphyxiate the emerging sector. So, in France[75], platform operators have to obtain a newly created license as "investment-crowdfunding adviser" (*conseillers en investessements participatifs*), and in Spain[76], platforms have to be registered, obtain a license, and be named, on an exclusive basis, as a "participative financing platform" (*Plataforma de Financiación Participativa*, PFP). Italy[77] provides an alternative hybrid model. In Italy, platforms must be attached to a financial institution.

In sum, all regulatory requirements create barriers to entry, limit the number of players in the market, and impose costs on the platforms accordingly. On the other hand, regulatory requirements are expected to prevent fraud, enhance the market's stability, enable

[74] Title III "Capital Raising Online While Deterring Fraud and Unethical Non-Disclosure Act of 2012" or simply "CROWDFUNDING Act" of *Jumpstart Our Business Startups Act* (H.R. 3606, of 5 of April of 2012)*, JOBS Act.*

[75] *Décret nº 2014-1053 du 16 septembre 2014 relatif au financement participatif / Ordonnance nº 2014-559 du 30 mai 2014.*

[76] Business Finance Promotion Act, number 5 of 2015 (hereinafter, LFFE2015), of 27 of April (*Ley 5/2015, de 27 de abril, de Fomento de la Financiación Empresarial*), as published in the Official Bulletin (BOE) num. 101, of 28 of April of 2015. Title V is entirely devoted to crowdfunding platforms legally named "Plataformas de Financiación Participativa".

[77] *Legge 221/2012,* of 17 December 2012, *di conversione in legge, con modificazioni, del decreto-legge 18 ottobre 2012, n. 179, recante ulteriori misure urgenti per la crescita del Paese*. (12G0244), in forcé since 13th of January of 2014. Subsequently, CONSOB (*Commissione Nazionale per le Società e la Borsa*) adopted *Regolamento sulla raccolta di capitali di rischio da parte di start-up innovative tramite portali on-line*. *Delibera* num. 18592 and the attached Regulation of 26 of June of 2013 were published in *Gazzetta Ufficiale* num. 162 dated on 12 of July of 2013.

supervision, and minimize risks. Since compliance entails costs, insofar as domestic regulations differ, risks of forum shopping increases.

4). Measures to protect investors' interests: investment limits and disclosure

In order to protect investors' interests and minimize systemic risks, investing is limited or capped by statute. Legislation may require prospective investors to be previously accredited in accordance with a set of criteria or establish limits on investments/credits by maximum amount (per project, per investor, in a period of time), frequency, or percentages. Diverse forms of caps on investment aim to cushion risk of loss. Notwithstanding this protective purpose, it has been debated whether thresholds are too low or are likely to hamper crowdfunding potential.

In general terms, quantitative caps are effective, easy to apply, and free of interpretative difficulties. Nevertheless, protection can be achieved or enhanced by the implementation of more sophisticated mechanisms. Providing a set of obligations to inform helps the potential investor make an informed decision, assess risks, and self-protect. These mechanisms operate on a qualitative basis and alleviate the rigidities arising from the application of simple quantitative thresholds. In-force legislation indeed combines both approaches. Spanish legislation, as an example, relies on a combination of investment limits. First, investors are divided into two categories (Art. 81 LFFE2015): accredited and not accredited according to a set of criteria (incomes, revenues, patrimony). Second, funding platforms are required to monitor non-accredited investors' investing decisions and prevent them from investing more than 3,000 Euros in the same project on one platform or more than 10,000 Euros in all projects on the same platform within 12 months (Art. 82.1 LFFE2015). Such quantitative thresholds intend to lessen the financial risk

taken on by non-accredited investors. Certainly, setting a cap on investments per specific project reduces the depth of risk exposure in case of failure and forces diversification.

It is worth pointing out that some trust-generating formulas implemented by national legislation aim to provide retail investors with additional factors to assess the risks and potential benefits of each project. The participation of professional investors or the funding platform in the crowdfunding campaign is supposed to give indicia of credibility to the decision-making and valuation. In that regard, for example, Italian regulation requires that 5% of the subscription of shares (equity-crowdfunding) must be made by professional investors. Professional investors play the role of trusted third parties. A critical point for further investigation is if there is potential liability arising from incorrect valuation by professional investors. Theoretically, crowdfunding platforms could perform the role of trusted third parties as well. But, more legal concerns are aroused, however, by the participation of funding platforms because the trade-off between the prescription effect (trust generation) and the risk of conflict of interest should be carefully managed. Whether funding platforms can or are required to invest in every project they accept to publish, a serious valuation and precautionary risk analysis of the project are expected by other investors. On the other hand, conflicts of interests are more likely to arise, insofar as the funding platform stop acting as a neutral venue and becomes inclined to favor projects in which it holds interest.

Spanish rules on crowdfunding illustrate how a compromise can be managed. First, funding platforms must formulate and publish a policy on preventing conflict of interests and internal rules guiding the participation of the platform in projects. Second, funding platforms are entitled (but not obliged) to participate in any project that they publish, subject to a limit. The platform's participation cannot be higher than 10% of the financing

goal nor entitle it to control the company. Moreover, in such cases, investors have to be informed about the platform's participation.

Nevertheless, is has been long discussed whether simply fixing investment limits and accreditation requirements is wise given that non-accredited investors cannot request to be classified as accredited investors unless they meet the accreditation criteria. As a matter of fact, some successful funding platforms began operating before the enactment of the current legislation in Spain intended to offer a platform for angel investors (informal venture capitalist). The average amount invested was considerable, with a minimum of 3,000 Euros per contribution. Clearly, under the newly enacted rules, only accredited investors are eligible. The rationale behind the crowdfunding business model is to exploit crowd-based benefits at a later stage of the business finance cycle. Searching, monitoring, and transaction costs also impact the investment process of business angels, venture capitalist, or other private equity transactions. Funding platform provide these investors with a centralized venue to access available projects, compare variables, select projects in accordance with predetermined factors, exchange information, request further data, and make investment decisions.

Although placing static limits is not a particularly sophisticated legal technique, in practice the accreditation criteria set out by the Spanish legislation are reasonably attainable: for natural persons, they require annual incomes higher than 50.000 Euros or financial patrimony (a term used in the legislation to describe the financial assets owned by the investor) of at least 100.000 Euros; for companies, they require assets value higher that 1 Million of Euros, revenues of at least 2 Millions of Euros, or resources of at least 300,000 Euros. Additionally, SMEs are entitled to be deemed accredited investors on request, provided that the funding platform evaluates the requestor's experience and knowledge and ensures the investor can make informed investing decision and understand

the involved risks. Therefore, the reasonability of limits can only be assessed in relation to non-accredited investors. Such points of reference can be compared to other jurisdictions. Yet, US regulators elected to limit the amount and frequency of investments. All individuals can annually invest up to a threshold: if the investor's net worth plus income is less than $40,000 USD, then he/she can only invest up to $2,000 USD; if his/her net worth and income combined are less than $100,000 USD, then investment is limited to up to 5% of his/her income; in the case of income or net worth greater than $100,000 USD, the limit is raised to 10 % of his/her income.

5). Rules on Project promoters and crowdfunding campaigns: Limits can be qualitative or quantitative in nature.

The Italian case is most revealing in demarcating the personal scope of crowdfunding on grounds of the nature of the project promoter. Thus, regulations permit equity crowdfunding only for innovative start-ups. To qualify as innovative, the start-up may not be older than 48 months, with a yearly turnover value not exceeding 5 million Euros; it must aim to develop, produce, and market innovative products and services of high technological value, and invest a minimum level in research and development. Additionally, innovative start-ups can only raise up to 5 million Euros in a 12-month period. Interestingly, Italy combines limits on the personal scope with a cap on the offering amount. In that manner, Italian regulations align with other jurisdictions regulating crowdfunding.

US regulations, as well as French rules, limit the maximum offering amount up to 1 million Euros every 12 months. The UK regulation also limits the amount raised to 5 million GBP in a 12-month period to avoid having to abide by the prospectus requirement. Likewise, under Spanish legislation on crowdfunding, each campaign cannot exceed 2

Million Euros per year and per platform, unless the project is exclusively addressed to accredited investors, in which a case the limit is increased to 5 Million Euros.

6). Corporate governance for crowdfunded businesses: the *inside effect*

Despite considerable regulatory attention on crowdfunding, a second effect has been largely unnoticed: the ***inside effect***, which is the effect of *crowdfunding* on the inside of the company raising capital. In effect, a *crowdfunding*-based financing strategy challenges traditional company law rules. Rules governing non-public companies are overall neither well designed nor effectively operational for managing multiple dispersed partners, atomized capital, and public-company-like duties. Since recent rules on crowdfunding are mainly inspired by capital market regulatory concerns, dysfunctions are amplified. Suddenly, non-public companies embarking on crowdfunding campaigns have to struggle with an unfamiliar field with challenging endeavors, such as corporate governance requirements, disclosure duties, complex decision-making, exit strategies for illiquidity, partners with purely speculative purposes, public exposure, and reputational strategies. Is company law flexible enough to internalize all of these required adaptations? Can solutions be implemented by bylaws? Or is legal reform needed?

6.1). Managing a scattered, fragmented, and extensive ownership base

First, crowdfunders prioritize investing interests over motivations as partners (willing to be engaged in the management and the decision making), which is changing shareholding patterns in closed corporations. Under the traditional distinction between public and private companies, private companies are commonly characterized by a singular involvement of partners in company matters. Since the personal attributes of partners in closed corporations matter, they are not usually deemed simple investors but, in contrast,

are supposed to be interested in the decision-making, management, and business evolution. Unlike closed corporations, the more open a company becomes, the more likely there is a capitalist or financial partner/shareholder.

In sum, since many companies launching crowdfunding campaigns are at the start-up stage, they will have to deal with different types of partners. Along with the founders and other subsequent partners willing to get engaged in company issues, other participants will be simply motivated by financial aims. Even more, a number of micro/small investors may coexist with the founding partners (who might be majority partners in most cases). Such a scattered and extensive ownership base has to be managed. Decision-making criteria, director appointing, and voting majorities should be devised accordingly.

Likewise, a scattered and fragmented base of investing partners fortifies the control of the reduced number of partners, but, if it is very extensive, may also dilute the decision-making process due to abstention by shareholders, passivity, and solely financial interest in receiving higher dividends.

6.2). The problem of illiquidity and the future emergence of secondary markets for crowdfunding

Second, equity investment in non-public companies is highly illiquid due to the absence of a secondary market. Therefore, exit options have to be carefully considered in the bylaws. Illiquidity certainly is the weakest operational feature of crowdfunding as an alternative finance model, as compared to exchange markets or other functionally equivalent competing schemes. Although crowdfunding emulates exchange markets' operation in the fundraising stage insofar as it facilitates entry and increases the benefits of collecting funds from the public, today they are still unable to provide liquidity at the exit phase.

Along with business risks, crowd-investors have to face and manage exit risks. Crowdfunding investments lack the uniformity that might enable negotiability in a liquid market. Investors are exposed to the risk of becoming a prisoner of a project. Illiquidity is not a problem created or aggravated by the crowdfunding. Certainly, investors, and business angels also face such exit difficulties when investing in start-ups and emerging business. Nonetheless, illiquidity does, as a matter of fact, hamper the ability of crowdfunding to effectively compete with traditional financial markets. It would be reasonable that in response to illiquidity, investors would contribute in limited amounts. Accordingly, it would be difficult for crowdfunding to take off.

Given that, it is my prediction that funding platform will (and should) evolve towards supplying secondary market functionalities. Within the same platform, as an added-value service, or through another platform entirely specialized in enabling negotiability, a secondary market could operate to trade interests (shares, stakes, units) in crowdfunding projects. Thus, funding platforms would be fueled by higher liquidity. In practice, such liquidity-providing platforms would act as an emerging exchange likely to compete with traditional markets. The regulatory response would likely be similar to the approach initially followed to deal with Alternative Trading Systems[78] (or Multilateral Trading Facilities, as labelled under EU MiFID Directive)[79].

In that regard, any restriction on transferring (holding period or transfer solely under limited circumstances) shares, securities, or interests held by investors in crowdfunded

[78] LEE, Ruben, *What is an Exchange? The Automation, Management, and Regulation of Financial Markets,* Oxford: Oxford University Press, 1998, in particular, pp. 117-139. DE BEL, Jan, "Automated Trading Systems and the Concept of an "Exchange" in an International Context. Proprietary Systems: A Regulatory Headache!", *U.Pa.J.Int'l Bus.L.,* vol. 14, 1993, pp. 169-211; NYQUIST, Polly, "Failure to Engage: The Regulation of Proprietary Trading Systems", *Yale L.&Pol'y Rev.,* vol. 13, 1995, pp. 281-337, specifically, pp. 309-331; and MAYNARD, Therese H., "What is an "Exchange"? – Proprietary Electronic Securities Trading Systems and the Statutory Definition of an Exchange", 46 *Wash.& Lee L.Rev.,* 1992, pp. 833-912.

[79] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [Official Journal L 145 of 30.4.2004], subsequently amended.

companies as laid down in regulations should be taken into consideration in assessing the scope and feasibility of the proposed secondary-market facilities.

6.3). Transparency polity, disclosure duties, and costs

Third, although publicly traded companies are familiar with multifarious disclosure duties, such obligations can represent a huge burden for unlisted companies[80] and for small private enterprises. Regulations on crowdfunding have essentially opted for disclosure duties as the most effective instrument for enhancing transparency, market efficiency, and investor protection. Like in stock markets, project promoters have to disclose relevant information and provide platforms, prospective investors, and investors with an increasing amount of varied data. The ultimate aim is to prevent insider trading and ensure an informed investing decision. The benefits of access to finance would arguably compensate publicly traded companies for the high cost of complying with disclosure. For start-ups and SMEs, however, the increasing information requirements might exhaust the expected benefits of collecting funds.

Along with other legal concerns related to confidentiality and idea protection, disclosure and reporting duties in crowdfunding should ideally strike a balance between, on the one hand, the need to protect investors and promote market efficiency and, on the other, the costs on project promoters and the reasonableness of such duties, taking into consideration the size, stage of evolution, and the organizational base of the enterprises.

In certain jurisdictions, the specific aim of current regulatory reform has been to provide regulatory relief to emerging growth companies in order to encourage initial public

[80] Whereas some opinions stress the enormous potential benefits of crowdfunding as a genuine revolution for corporate finance – PRIVÉ, Tanya, "Top 10 Benefits of Crowdfunding", *Forbes,* December 10, 2012 – criticism is also aroused by the complexity of the investment, the difficulty to standardize the investing process, the high cost of regulation compliance – ISENBERG, Daniel, "The Road to Crowdfunding Hell", *Harvard Business Review,* April 23, 2012 -.

offerings. That might entail exemptions or phasing-in of certain requirements. However, should duties and requirements be improperly gauged, the process may become expensive and time consuming.

6.4). Corporate governance for crowdfunded non-public companies

Fourth, crowdfunded (non-public) companies will be required to comply with corporate governance standards. Crowdfunding provides an extraordinary opportunity for start-ups and SMEs, along with individuals and unincorporated businesses, to access to finance. In return, project promoters opting for crowdfunding accept being subject to market scrutiny. Likewise, if a funding campaign results in a wide and fragmented investing crowd, then promoters will suddenly face the complications and challenges that openness entails, and with which a closed corporation is usually unfamiliar.

To illustrate the implications for corporate governance, some of these new challenges will be briefly mentioned for further analysis in due course.

i) First, the crowdfunded company should protect and facilitate the exercise of partner/shareholder rights. Given the potentially high number of investors, the supposedly reduced participation in the company, the possible cross-border element, and the frequent investing/financial profile of investors, the company will have to design and adapt corporate schemes to facilitate decision-making. In that regard, it is illustrative that the Spanish legislation requires promoters' bylaws include the right to participate and attend shareholder meetings through electronic means and the right to use proxy representation at those meetings. Provisions regulating both rights must be necessarily included in promoters' bylaws. Certainly, the use of digital technology in company operations minimizes corporate governance challenges for crowdfunded

companies. Not surprisingly, considering the availability of digital technologies for corporate participation, it will be difficult to defend any obstacle that prevents the free exercise of shareholder rights.

The same rationale lies behind the need to consider using bylaws to fix the minimum number of shares needed in order to attend and/or vote in company meetings. Otherwise, it could be that shareholder/company member meetings become so massive that quorum is difficult to attain, or that the exercise of the right to be informed about company issues overloads company managers with information requests. A wise use of digital technology and interactive applications make it possible to manage a company, irrespective of the company's size and the number of members, with a proper protection of rights and interests. Nonetheless, an effective electronic exercise of rights has to be based on state-of-the-art electronic procedures and interactive environments. The cost and accessibility of these techniques cannot be ignored. In my opinion, funding platforms may find an appealing business opportunity in this area. Interestingly, platforms can decide to offer, as an added value to their users (promoters and investors), technological infrastructure to enable digital meetings, live interaction, and other functionalities to assist promoters in facilitating the management of a crowdfunded company.

ii) Second, any agreement that is likely to affect the exercise of voting rights in the company or that may impact the merchantability (limiting or subjecting to any condition the transfer) of shares/stakes should be immediately communicated to all company members. This is the rule, for instance, provided for by Spanish legislation. In practice, it means the extension of a

typically financial-market-oriented mechanism to unlisted (or private) companies.

Carefully managing new corporate governance challenges for crowdfunded companies will make the *inside effect* of crowdfunding more visible, and may lead us to consider whether regulatory action in this area may be needed in the future.

ANNEX

Figure 1. *2013 SMEs' Access to Finance Survey,* Analytical report by European Commission and European Central Bank, conducted by Ipsos Moris, 14 November 2013.

Most pressing factors for SMEs in Europe

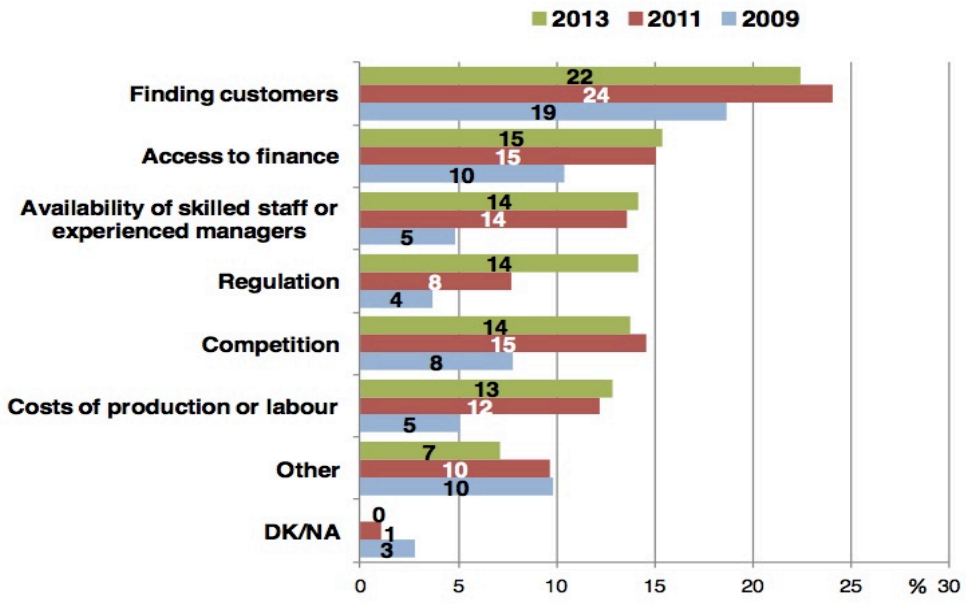

Figure 2. European Central Bank *2016 Survey on the Access to Finance of Enterprises in the euro area*

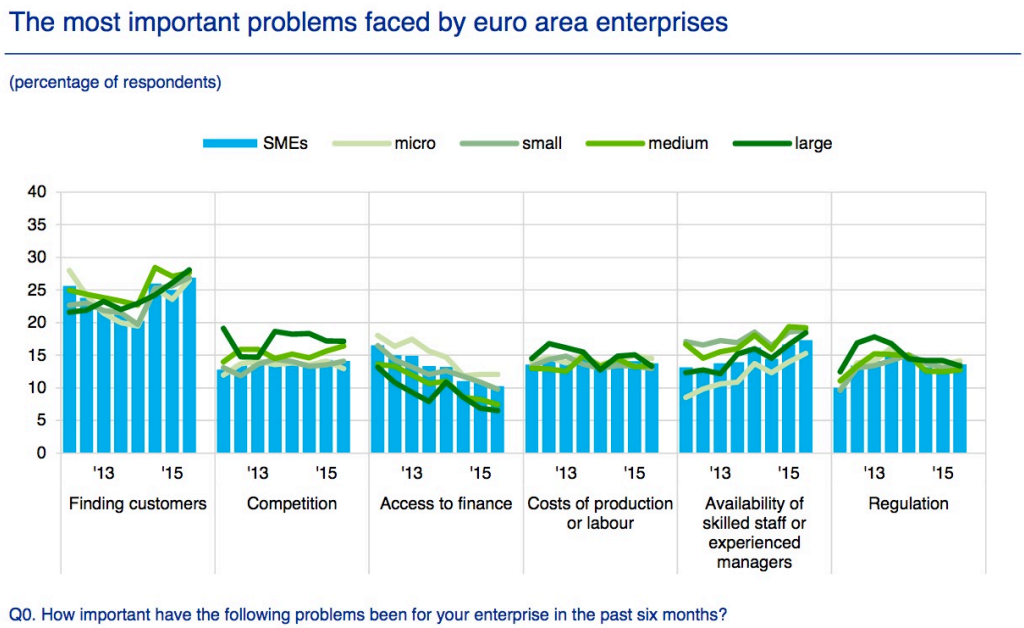

Figure 3. *2013 SMEs' Access to Finance Survey,* Analytical report by European Commission and European Central Bank. External v. Internal Funding Options for SMEs in Europe

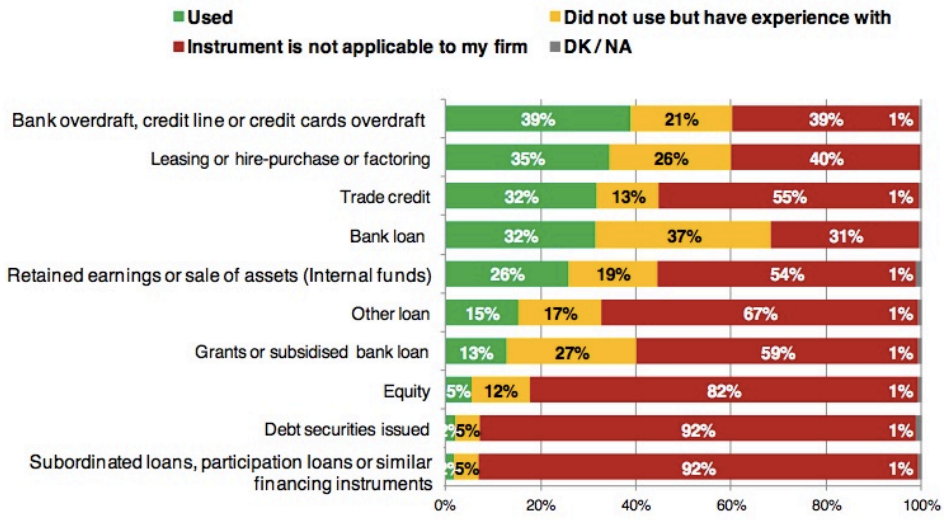

Figure 4. European Central Bank *2016 Survey on the Access to Finance of Enterprises in the euro area.*

Financing Structure

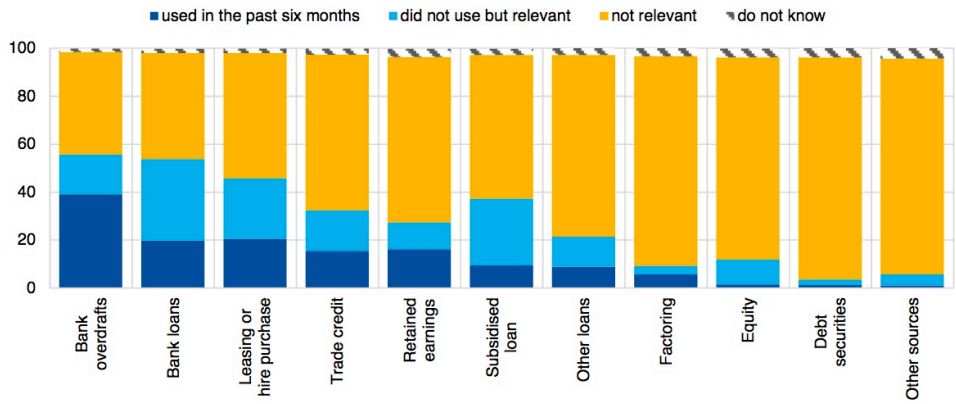

Figure 5. *2nd European Alternative Finance Industry Report* prepared by the Cambridge Center for Alternative Finance, September 2016.

Market Share in the EU (excluding UK) of the different Crowdfunding modalities

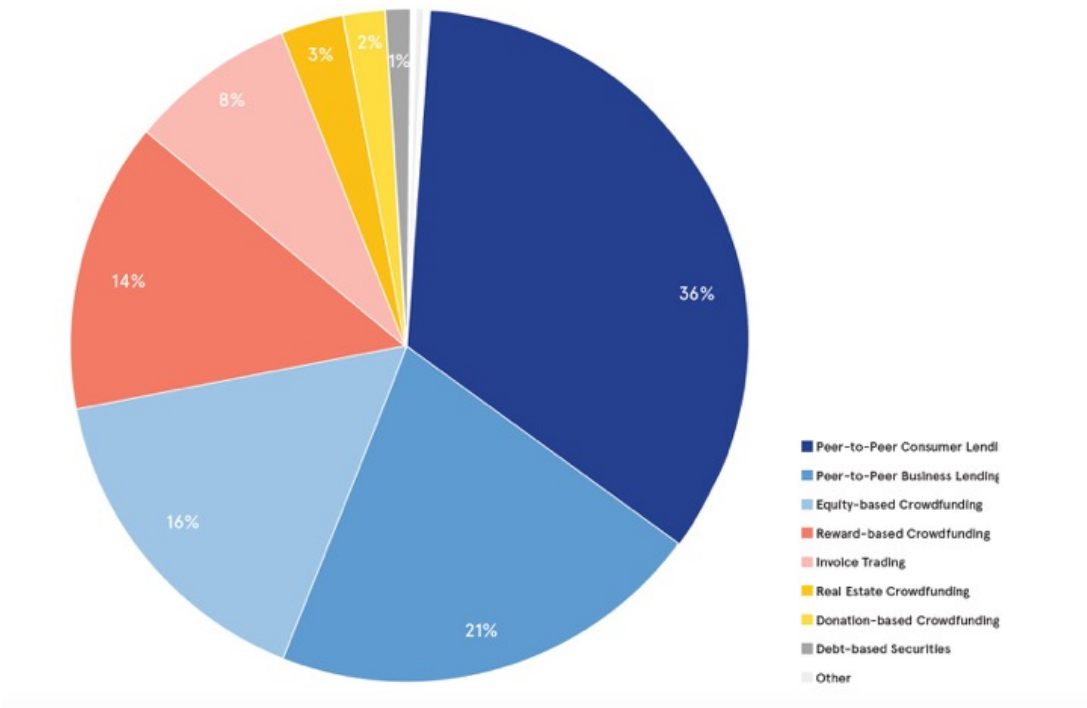

Figure 6. *2nd European Alternative Finance Industry Report* prepared by the Cambridge Center for Alternative Finance, September 2016.

Alternative Finance Volume by model in EU (excluding UK)

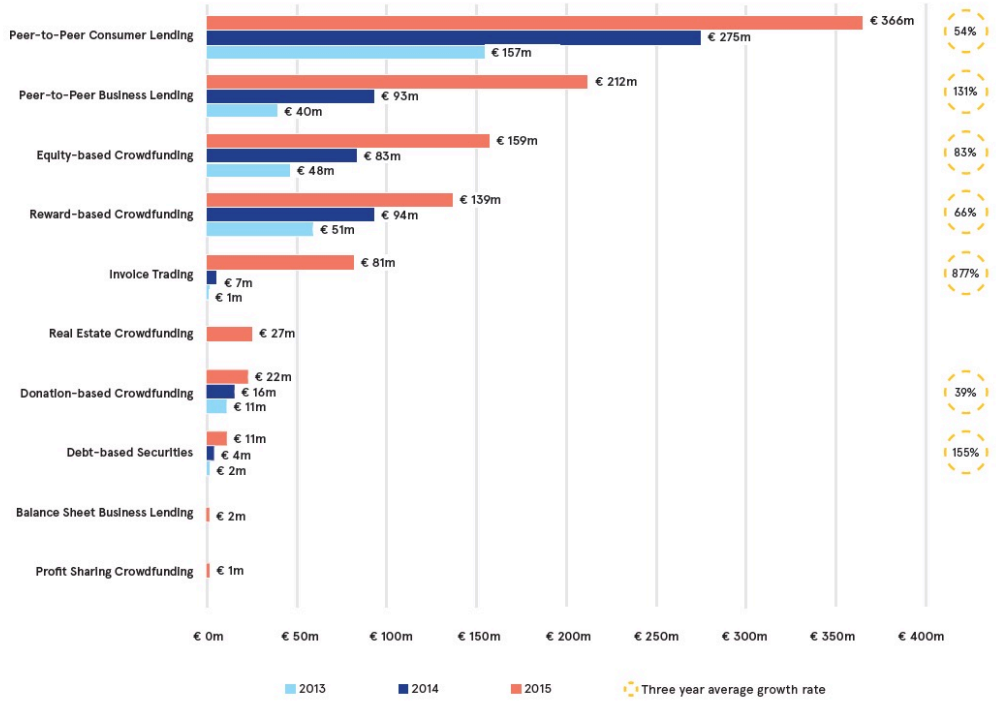

Figure 7. Source *2nd European Alternative Finance Industry Report* prepared by the Cambridge Center for Alternative Finance, September 2016. Included in the *Note to the Expert Group of the European Securities Committee, European Commission,* Update on Crowdfunding, January 2017 (p. 5).

Cross-border activity of crowdfunding platforms: foreign outflows and foreign inflows

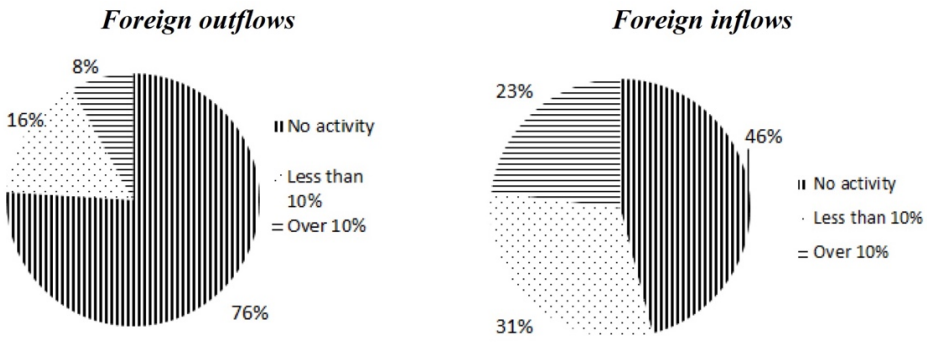

Figure 8. WealthInsight Report (http://www.wealthinsight.com/IndexReports) estimating the growth prediction of high net worth individuals in the US (last visit 25/2/2017).

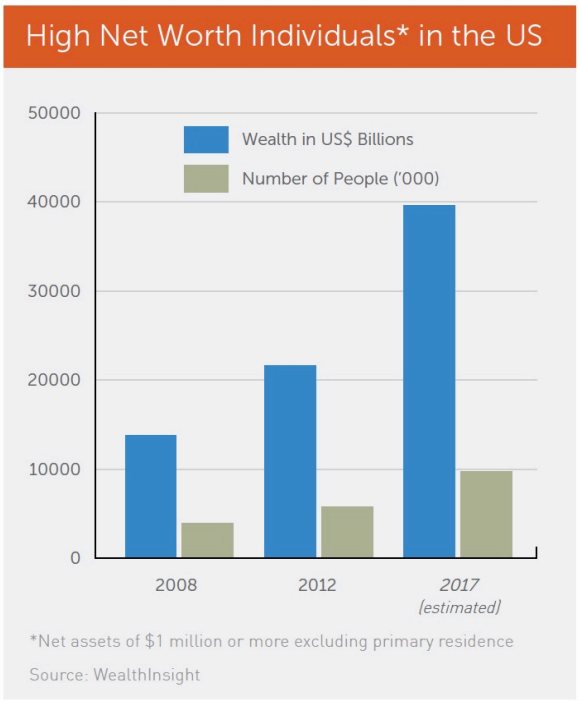

Figure 9. *2nd European Alternative Finance Industry Report* prepared by the Cambridge Center for Alternative Finance, September 2016. Proportion of Institutional Funding (2013-2015) (excl. UK)

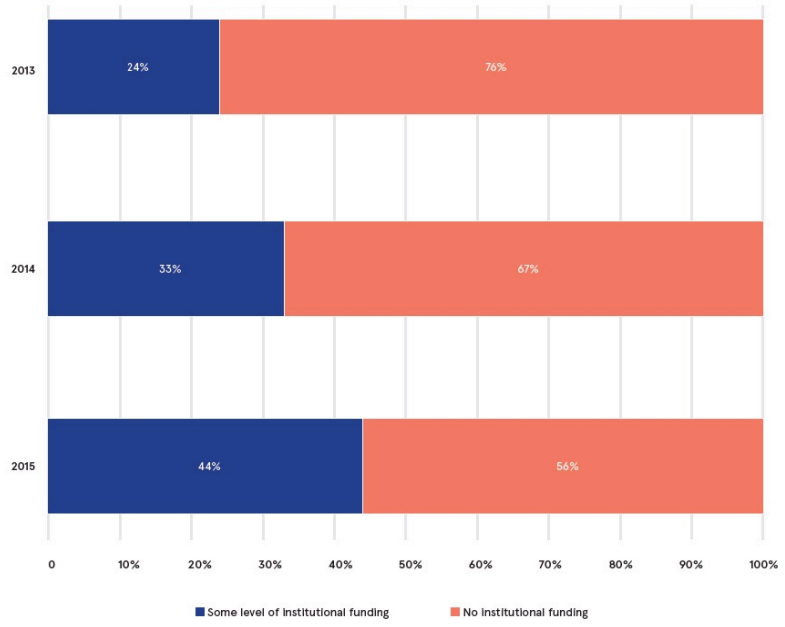

Figure 10. *2nd European Alternative Finance Industry Report* prepared by the Cambridge Center for Alternative Finance, September 2016

Average Fundraise by Model in Europe in 2015 (excluding UK)

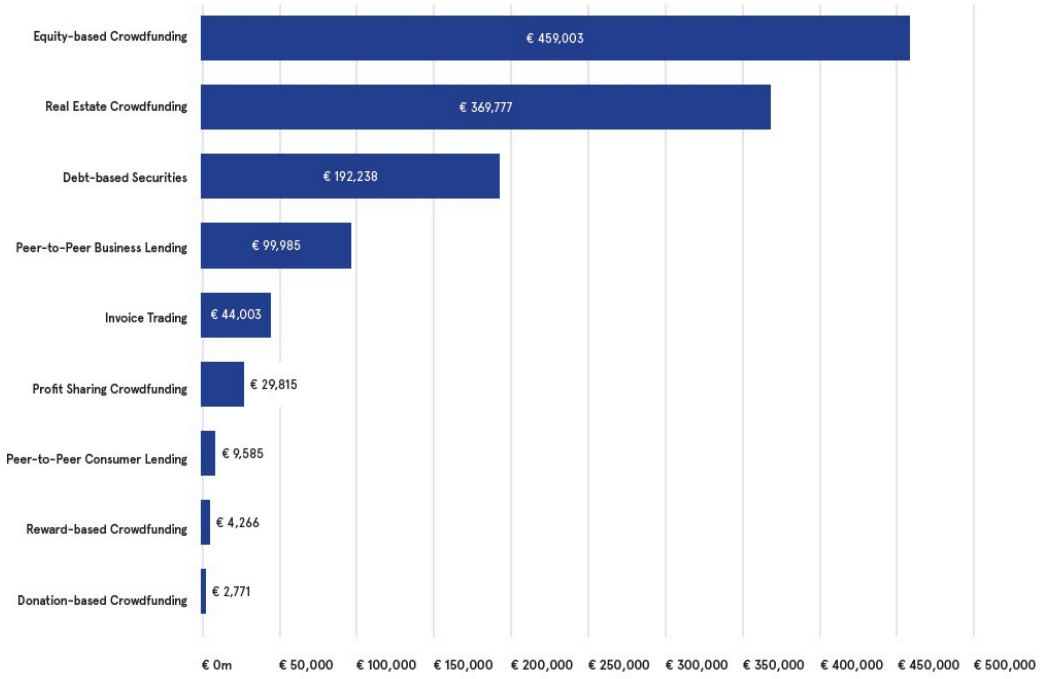

Figure 11. *Crowdfunding: Mapping EU markets and Event Study,* 30 September 2015, commissioned by the European Commission and prepared by Ernst & Young and Crowdsurfer.

Number of live platforms in Europe, 2014