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Michael R. Meadows

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## THE EVOLUTION OF CROWDFUNDING: RECONCILING REGULATION CROWDFUNDING WITH INITIAL COIN OFFERINGS

*Michael R. Meadows\**

### INTRODUCTION

Across every industry, burgeoning businesses face a common problem: lack of capital. However, the convergence of technological development and globalization presents emerging businesses with a solution. By engaging in crowdfunding campaigns, these budding ventures obtain the ability to raise capital from a number of individuals. Moreover, on top of securing capital for ventures which may otherwise fail to materialize, crowdfunding enables campaign participants to exchange information with respect to a specific campaign to assess its merits.

Although crowdfunding can be the savior of an emerging business, it is subject to a variety of regulations. One such regulation is the Securities Act of 1933 (“Securities Act”), which, in the absence of a valid exemption, requires individuals and businesses to register any offer or sale of securities.<sup>1</sup> However, after Congress passed the Jumpstart Our Business Startups Act (“JOBS Act”) in 2012, certain crowdfunding transactions became exempt from the federal registration requirement under Title III of the JOBS Act.<sup>2</sup> In an effort to implement the exemption of certain crowdfunding transactions, Congress delegated the promulgation of rules respecting crowdfunding to the Securities and Exchange Commission (“SEC”), which adopted Regulation Crowdfunding in 2015.<sup>3</sup> Regulation Crowdfunding allows eligible business ventures to

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\*J.D. Candidate, May 2019, Loyola University Chicago School of Law.

<sup>1</sup>15 U.S.C. § 77e

<sup>2</sup> U.S. Sec. and Exch. Comm’n, Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers (Apr. 5, 2017), <https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm>.

<sup>3</sup> *Id.*

raise capital, via crowdfunding transactions, while exempting such transactions from registration pursuant to Title III of the JOBS Act.<sup>4</sup> Despite the exemptions provided by Regulation Crowdfunding, certain transactions still have the potential to trigger federal securities laws.<sup>5</sup> This is especially true with the emergence of blockchain technology, which adds an additional layer of complexity in determining whether federal securities laws apply to a crowdfunding campaign.

As opposed to traditional crowdfunding, blockchain technology enables startups to engage in crypto-crowdfunding by utilizing an initial coin offering (“ICO”) as a method of raising capital. Through crypto-crowdfunding, participating consumers provide capital in exchange for virtual coins or tokens from a new venture. While ICOs serve as an effective method of raising capital, crypto-crowdfunding may repackage traditional crowdfunding models that would otherwise trigger federal securities laws. Further, limited SEC guidance and the lack of federal regulations respecting ICOs perpetuates legal uncertainty among businesses engaging in crypto-crowdfunding while subjecting participating consumers to fraud. As a result, the SEC must confront the challenge of reconciling emerging technology with existing crowdfunding regulations and federal securities laws.

This Note focuses largely on ICOs as a method of crowdfunding, as well as the unique issues crypto-crowdfunding poses to participating consumers and regulatory authorities. Part I of this Note will address crowdfunding through an explanation of traditional crowdfunding models and an examination of existing crowdfunding regulations. Subsequently, Part II will be a discussion of initial coin offerings, which will explore the technology underlying crypto-crowdfunding, the ICO process, and legal dilemmas posed by ICOs. Part III will review agency decisions and litigation focusing on the legal dilemmas presented by ICOs, as well as the rationale for such decisions. Finally, Part IV of this Note will address the future landscape for ICOs by presenting solutions to problems facing ICO issuers and participants in a manner that seeks to reconcile ICOs with the rationale underlying crowdfunding legislation.

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<sup>4</sup> SEC Final Rule: Crowdfunding, at 7 (2016), <https://www.sec.gov/rules/final/2015/33-9974.pdf> (hereinafter “Crowdfunding”).

<sup>5</sup> *Id.*

## I. TRADITIONAL CROWDFUNDING

*A. Crowdfunding Overview*

The essence of any crowdfunding campaign is utilizing the Internet to raise capital from a large number of individuals in support of a specific idea or venture.<sup>6</sup> The ideological basis of crowdfunding stems from microlending and crowdsourcing.<sup>7</sup> Crowdfunding combines these concepts to establish a system where an individual seeks small capital contributions from a large base of people, rendering the individual's goal of receiving adequate funding more manageable.<sup>8</sup>

Within any crowdfunding campaign, operation of the campaign depends upon actions from an individual or business seeking capital, as well as responses from individual consumers looking to contribute an investment. To initiate a crowdfunding campaign, an individual or business seeking capital must publish a request for funding on a crowdfunding website.<sup>9</sup> A funding request indicates the purpose of the crowdfunding campaign, a plan for the future utilization of the funds raised, and what, if anything, participants will receive in exchange for their contributions.<sup>10</sup> Once a funding request has been published, consumers can view the request and participate in the campaign by making a contribution of capital.<sup>11</sup> Outside of the request for funding, an individual investor may seek information from the crowd (the large base of individuals interested in or contributing to a specific crowdfunding campaign) in order to assess the underlying idea of a fundraising effort.<sup>12</sup> By seeking information from other campaign participants, individual

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<sup>6</sup> *Id.* at 6.

<sup>7</sup> C. Steven Bradford, *Crowdfunding and The Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 27-29 (2012) (microlending focuses on the recipient of funds, as it entails institutions loaning small amounts of money to individuals. Whereas crowdsourcing makes large capital goals more manageable by allocating small portions among a number of individuals.).

<sup>8</sup> *Id.* at 28-29.

<sup>9</sup> *Id.* at 10.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> Crowdfunding, *supra* note 4, at 6.

investors gauge collective knowledge with respect to a project prior to finalizing a decision to contribute funds.<sup>13</sup>

While crowdfunding campaigns share the goal of raising capital, there are various crowdfunding models that can be implemented to achieve this goal. Individuals and businesses select specific crowdfunding models based on the purpose for fundraising and the nature of the fundraiser-crowd relationship. For instance, crowd participants in a campaign utilizing donation-model crowdfunding lack an expectation of obtaining profits from their contribution.<sup>14</sup> Additionally, certain crowdfunding models subject the transactions involved to federal securities laws. Transactions under donation-model crowdfunding avoid triggering federal securities laws because contributions by crowd participants fail to constitute securities.<sup>15</sup> Alternatively, in a campaign utilizing the reward or pre-purchase model, participants receive incentives or pre-market product in exchange for their contribution of capital.<sup>16</sup> Transactions under these models also avoid triggering federal securities laws as long as participants only receive the promised reward or pre-purchased product in exchange for their capital.<sup>17</sup>

Transactions engaged in by campaigns using lending and equity-model crowdfunding also raise issues as to the applicability of federal securities laws. Generally, lending-model crowdfunding entails peer-to-peer lending through which crowd participants temporarily contribute funds with the expectation that the borrower initiating the crowdfunding campaign will repay their principal.<sup>18</sup> In addition, websites utilizing lending-model crowdfunding may entitle participants to receive interest on loaned funds—triggering federal securities laws.<sup>19</sup> In contrast, crowd participants in equity-model crowdfunding receive a share of the profits generated by the crowdfunded business, such that crowd participants harbor an expectation of profits.<sup>20</sup> Equity-model crowdfunding straddles the line between a security and a crowdfunding contract, and in the words of the SEC, “[s]uch a profit or revenue-sharing

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<sup>13</sup> *Id.*

<sup>14</sup> Bradford, *supra* note 7, at 31-32.

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

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

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 20

<sup>19</sup> *Id.*

<sup>20</sup> Bradford, *supra* note 7, at 24, 33.

model...could trigger the application of the federal securities laws because it likely would involve the offer and sale of a security.”<sup>21</sup>

### *B. Crowdfunding Legislation*

While federal legislation applicable to crowdfunding campaigns depends upon the transaction underlying the campaign, crowdfunding campaigns are regulated by established federal securities law and crowdfunding legislation enacted in accordance with the JOBS Act. Pursuant to Section 5 of the Securities Act, no security shall be sold by means of interstate commerce unless the offer and sale of the security is registered with the SEC.<sup>22</sup> However, certain securities and transactions fall under exemptions to the registration requirement. For instance, transactions that do not involve an issuer, underwriter, or dealer<sup>23</sup> may forego the registration requirement.<sup>24</sup> An exemption from the registration requirement also exists for securities issued within a state when proceeds from the sale of those securities will be used within the state of issuance.<sup>25</sup> Similarly, the Securities Exchange Act of 1934 (“Exchange Act”) establishes thresholds at which issuers must register a class of securities and requires brokers or dealers of securities sold by means of interstate commerce to register with the SEC.<sup>26</sup>

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<sup>21</sup> Crowdfunding, *supra* note 4, at 7.

<sup>22</sup> 15 U.S.C. § 77e; CHARLES MURDOCK, ILL. PRACTICE SERIES: BUSINESS ORGANIZATIONS § 7.20 (2d ed. 2017).

<sup>23</sup> 15 U.S.C. § 77b(a)(4) (defining an issuer as “...every person who issues or proposes to issue any security...”); 15 U.S.C. § 77b(a)(12) (defining a dealer as “...any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.”); THOMAS LEE HAZEN, TREATISE ON THE LAW OF SECURITIES REGULATION § 4.97 (7th ed. 2017) (explaining that the “...statutory definition of ‘underwriter’...includes (1) persons who acquire securities of the issuer with a view towards distribution, (2) all persons who directly or indirectly participate in the offering, selling or underwriting process, as well as (3) persons selling on behalf of a control person of the issuer.”).

<sup>24</sup> 15 U.S.C. § 77d(a)(1).

<sup>25</sup> 15 U.S.C. § 77c(a)(11).

<sup>26</sup> *Guide to Broker-Dealer Registration*, U.S. SEC. AND EXCH. COMM’N, <https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html> (last modified Dec. 12, 2016) (hereinafter

In 2012, congressional enactment of the JOBS Act sought to encourage “capital formation” by easing existing federal securities regulations, such as those affecting crowdfunding campaigns.<sup>27</sup> The JOBS Act was the result of legislative efforts seeking to promote deregulation and capital formation after the financial crisis of 2008. Within the JOBS Act, Title III altered the Securities Act to address crowdfunding in the context of federal securities laws. For instance, the incorporation of Section 4A into the Securities Act enumerated responsibilities for issuers and intermediaries (the party responsible for facilitating crowdfunding transactions between issuers and investors).<sup>28</sup> However, the most significant provision of Title III added Section 4(a)(6) to the Securities Act to render certain crowdfunding transactions exempt from the registration requirement of Section 5.

In order to qualify for the crowdfunding exemption established by Section 4(a)(6), a crowdfunding campaign must adhere to specific criteria. Pursuant to Section 4(a)(6), the issuer of crowdfunding transactions must not raise more than \$1 million over a 12-month period and the crowdfunding transactions of an issuer must abide by limitations set for individual investors.<sup>29</sup> If the annual income or net worth of an individual investor is below \$100,000, contributions to crowdfunding issuers are limited to the greater of \$2,000 or five percent of annual income or net worth during a 12-month period.<sup>30</sup> Individual investors with annual income or net worth exceeding \$100,000 may contribute ten percent of their annual income or net worth to crowdfunding issuers.<sup>31</sup> However, such contributions cannot exceed \$100,000 during a 12-month period.<sup>32</sup> Finally, eligibility for the Section 4(a)(6) exemption requires that crowdfunding transactions occur through a single

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“*Guide to Broker-Dealer Registration*”); *Changes to Exchange Act Registration Requirements to Implement Title V and Title VI of the JOBS Act: A Small Entity Compliance Guide*, U.S. SEC. AND EXCH. COMM’N, <https://www.sec.gov/info/smallbus/secg/jobs-act-section-12g-small-business-compliance-guide.htm> (last modified May 24, 2016) (hereinafter “*A Small Entity Compliance Guide*”).

<sup>27</sup> MURDOCK, *supra* note 22, § 7.38.

<sup>28</sup> *Id.*

<sup>29</sup> Crowdfunding, *supra* note 4, at 8-9.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.*

<sup>32</sup> *Id.*

online platform, which is operated by an intermediary registered as a broker-dealer or as a funding portal.<sup>33</sup>

Along with alterations to the Securities Act, Title III incorporated new provisions into the Exchange Act. With respect to the Exchange Act, Title III required that the SEC adopt exemptions easing the registration requirements of Sections 15(a)(1) and 12(g) for crowdfunding platforms and crowdfunding transactions. Pursuant to Section 4A, “funding portals” within crowdfunding transactions may forego the registration requirement of Section 15(a)(1).<sup>34</sup> Moreover, securities acquired in offerings falling under Section 4(a)(6) may forego the registration requirements of Section 12(g).<sup>35</sup> Following the passage of the JOBS Act, the SEC took action to implement the provisions of Title III.

In 2015, the SEC’s adoption of Regulation Crowdfunding established final rules for the implementation of statutory provisions set forth by Title III and clarified provisions of Title III with which issuers, participants, and intermediaries of crowdfunding transactions must comply.<sup>36</sup> For instance, Regulation Crowdfunding adopted Rule 503 and altered Section 4A(f) to expand the list of issuers precluded from relying upon the Section 4(a)(6) exemption for crowdfunding transactions.<sup>37</sup> Under Regulation Crowdfunding, issuers must disclose to the SEC information pertaining to their company and crowdfunding campaign.<sup>38</sup> Additionally, issuers must file annual reports and campaign progress updates to

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<sup>33</sup> Crowdfunding, *supra* note 4, at 151, 153 (defining funding portal as “...any person acting as an intermediary in a transaction involving the offer or sale of securities for the account of others, solely pursuant to Securities Act Section 4(a)(6), that does not: (1) offer investment advice or recommendations; (2) solicit purchases, sales or offers to buy the securities offered or displayed on its website or portal; (3) compensate employees, agents or other persons for such solicitation or based on the sale of securities displayed or referenced on its website or portal; (4) hold, manage, possess or otherwise handle investor funds or securities; or (5) engage in such other activities as the Commission, by rule, determines appropriate.”).

<sup>34</sup> *Id.* at 9.

<sup>35</sup> *Id.*

<sup>36</sup> *Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers*, U.S. SEC. AND EXCH. COMM’N, <https://www.sec.gov/info/small-bus/secg/rccomplianceguide-051316.htm> (last modified Apr. 5, 2017) (hereinafter “*Regulation Crowdfunding*”).

<sup>37</sup> Crowdfunding, *supra* note 4, at 33-40, 339-343.

<sup>38</sup> *Regulation Crowdfunding*, *supra* note 36.

comply with ongoing reporting requirements.<sup>39</sup> Similarly, intermediaries must disclose information deemed appropriate by the SEC and ensure that individual investors understand the risk associated with their contribution to a crowdfunding transaction.<sup>40</sup> However, Regulation Crowdfunding imposes additional requirements for intermediaries with respect to registration and the prevention of fraud.<sup>41</sup> Finally, Regulation Crowdfunding limits issuers' advertisement of crowdfunding transactions to a single notice disclosing general information.<sup>42</sup> When interacting with consumers on an intermediary's platform, issuers must communicate that they are the issuer of an offering and promoters must disclose their affiliation with an issuer.<sup>43</sup>

Although strict requirements exist for issuers and intermediaries in crowdfunding transactions, Title III and Regulation Crowdfunding fail to impose significant requirements on investors participating in a crowdfunding transaction. Generally, any securities purchased through a crowdfunding transaction must be held by an investor for at least one year. However, Rule 501 of Regulation Crowdfunding provides an exception to the restriction on resale for transfers of securities to enumerated individuals or groups, such as the issuer of the securities, an accredited investor, or family members of the purchaser.<sup>44</sup> Despite the existence of comprehensive crowdfunding regulations, the increasing use of crypto-crowdfunding by businesses enables issuers, intermediaries, and investing consumers to forego crowdfunding regulations while participating in initial coin offerings.

## II. THE EVOLUTION OF CROWDFUNDING: INITIAL COIN OFFERINGS

In 2017, startups and small businesses seeking capital discovered another method of raising funds directly from investing consumers: initial coin offerings. Initial coin offerings refer to the sale of virtual coins or tokens created and disseminated using blockchain technology for the purpose of raising capital to fund a

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

<sup>40</sup> Crowdfunding, *supra* note 4, at 156-57, 191-93.

<sup>41</sup> 15 U.S.C. § 77d-1(a)(1), (a)(2), (a)(5).

<sup>42</sup> *Regulation Crowdfunding*, *supra* note 36.

<sup>43</sup> *Id.*

<sup>44</sup> Crowdfunding, *supra* note 4, at 324, 326-27.

startup or business venture. Similar to crowdfunding, ICOs typically entail an issuer seeking a capital contribution from investors directly or through an intermediary. Although crypto-crowdfunding interactions parallel traditional crowdfunding transactions, the technology underlying crypto-crowdfunding and the distribution of ICO coins and tokens reveal stark differences between crypto-crowdfunding and traditional crowdfunding transactions.

### *A. Blockchain Technology*

Comprehension of initial coin offerings requires a foundational understanding of distributed ledgers and blockchain technology, which serve as central components to the creation and dissemination of virtual coins and tokens. At its core, a blockchain refers to a peer-to-peer distributed ledger of timestamped transactions.<sup>45</sup> However, the functionality of a blockchain requires the convergence of three technologies: distributed ledgers, private key cryptography, and network servicing protocol.<sup>46</sup> In contrast to a spreadsheet, a distributed ledger is a database in which each participant, or node, holds and updates entries as a component of a larger network.<sup>47</sup> The construction of records within a distributed ledger requires each node in the network to independently process every transaction. This entails each node in the network reaching a conclusion regarding the validity of a specific transaction; however, a majority of network participants must reach an identical conclusion with respect to the validation of a transaction for that transaction to become verified.<sup>48</sup> When a transaction is verified, the distributed ledger is updated to reflect the transaction and every

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<sup>45</sup> The Rossdale Group, *Mastering Bitcoin, Blockchain, & Digital Currency Law CLE*, <http://www.mcssl.com/store/legalresourcesinc/catalog/product/10a48f46dc5141e99cda0056d1eda08f> (last visited Dec. 2017); *Investor Bulletin: Initial Coin Offerings*, U.S. SEC. AND EXCH. COMM'N, [https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib\\_coinofferings](https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings) (July 25, 2017) (hereinafter "*Investor Bulletin*").

<sup>46</sup> Nolan Bauerle, *What is Blockchain Technology?*, COINDESK, <https://www.coindesk.com/information/what-is-blockchain-technology/> (last visited Nov. 19, 2017).

<sup>47</sup> Nolan Bauerle, *What is a Distributed Ledger?*, COINDESK, <https://www.coindesk.com/information/what-is-blockchain-technology/> (last visited Nov. 19, 2017).

<sup>48</sup> *Id.*; Ameer Rosic, *What is Blockchain Technology? A Step-by-Step Guide for Beginners*, BLOCKGEEKS, <https://blockgeeks.com/guides/what-is-blockchain-technology/> (last visited Feb. 26, 2018).

node in the network maintains an identical copy of the ledger.<sup>49</sup> The result is a consistently updated database, which replaces centralized authorities (such as notaries or banks) as the primary source of trust in digital transactions.<sup>50</sup> Within a blockchain, private key cryptography serves as an ownership tool by which each user satisfies authentication requirements to verify their identity prior to engaging in a digital transaction.<sup>51</sup> Finally, each network participant must apply a blockchain's network servicing protocol, or programmed rules governing transaction validity and verification, in order for the authorization of transactions to occur.<sup>52</sup>

### *B. Crypto-Crowdfunding Through ICOs*

Despite procedural similarities between crypto-crowdfunding and traditional crowdfunding transactions, technological aspects of the ICO process differentiate crypto-crowdfunding from traditional crowdfunding models. Similar to crowdfunding transactions, initial coin offerings involve an issuer seeking capital for a business venture. In the context of ICOs, an issuer may be a startup, business, or virtual organization utilizing smart contracts (computer coding designed to autonomously execute an action upon the occurrence of a specified event) to automate the issuance of virtual coins or tokens.<sup>53</sup> Prior to any initial coin offering, the issuer seeking capital must create a virtual coin or token. Virtual coins or tokens represent rights, such as the ability to interact with an online platform, granted to investing consumers that hold such

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<sup>49</sup> Bauerle, *supra* note 47; Ameer Rosic, *What is Blockchain Technology? A Step-by-Step Guide for Beginners*, BLOCKGEEKS, <https://blockgeeks.com/guides/what-is-blockchain-technology/> (last visited Feb. 26, 2018) (explaining that a verified transaction "...is combined with other [previously] verified transactions to create a new block of data for the [distributed] ledger..." Subsequently, "[t]he new block of data is...added to the existing blockchain...and the transaction is complete." The addition of a new block to the existing blockchain updates the distributed ledger to reflect the newly verified transactions.).

<sup>50</sup> Bauerle, *supra* note 47.

<sup>51</sup> Bauerle, *supra* note 46.

<sup>52</sup> *Id.*; Nolan Bauerle, *How Does Blockchain Technology Work?*, COINDESK, <https://www.coindesk.com/information/how-does-blockchain-technology-work/> (last visited Feb. 2, 2018).

<sup>53</sup> *Investor Bulletin*, *supra* note 45.

coins or tokens.<sup>54</sup> Depending upon the underlying reason for raising capital, ownership of an issuer's virtual coin or token may enable crowd participants to access a platform, use a type of software, or otherwise engage with a project or application created by the issuer.

After creating a virtual coin or token, issuers attempt to build awareness of their campaigns in order to generate attention among potential investors and disseminate information pertaining to the ICO. Issuers generally produce a "white paper," which details their project, development timeline, team members, the terms of the ICO and subscription details, to generate attention from potential crowd participants.<sup>55</sup> Subsequently, issuers announce the publication of their white paper and advertise their ICO's subscription period within forums and websites to distribute information to potential investors within the cryptocurrency community.<sup>56</sup> As seen with traditional crowdfunding, the dissemination of information among crowd participants becomes central to an investor's decision to participate in an ICO. However, the potential for fraud exists in the dissemination of information between potential investors, as some issuers reward crowd participants with virtual coins or tokens for marketing an ICO on cryptocurrency forums.<sup>57</sup> Rewarding crowd participants for their marketing efforts incentivizes individuals to promote an ICO—even when claims rise to the level of material misrepresentations or omissions of facts.

Pursuant to an issuer's white paper or website, the subscription period of an ICO dictates the time duration for an issuer's virtual coin or token sale; however, transactions before and after the subscription period affect an ICO's crowd participants. Generally, ICOs entail a subscription process in which investing consumers transfer fiat currency<sup>58</sup> or cryptocurrencies, such as Bitcoin

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<sup>54</sup> *Id.*; Steve Gatti, Megan Gordon, Daniel Silver & Clifford Chance, *SEC Enforcement Against Initial Coin Offerings*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Oct. 30, 2017), <https://corpgov.law.harvard.edu/2017/10/30/sec-enforcement-against-initial-coin-offering/>.

<sup>55</sup> Gatti et al., *supra* note 54.

<sup>56</sup> *Id.*

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

<sup>58</sup> U.S. SEC. AND EXCH. COMM'N, Release No. 9592, In re Erik T. Voorhees (June 3, 2014), <https://www.sec.gov/litigation/admin/2014/33-9592.pdf>. (defining fiat currency as "...coin and paper money of a country

or Ether, to an online wallet belonging to an ICO's issuer or a designated address comparable to an account number.<sup>59</sup> Pre-sale transactions allow issuers to provide preferential discounts and terms to certain target markets before offering their virtual coins or tokens to the public.<sup>60</sup> A common practice is for issuers to target hedge funds in pre-sale transactions because institutional investors have demonstrated an increasing interest in ICOs.<sup>61</sup> Following expiration of an ICO's subscription period, ICO tokens transfer from an issuer to an online wallet or designated address, and the issuer receives the proceeds of the virtual coin or token sale. While issuers liquidate some ICO proceeds for funding purposes, issuers may hold or trade cryptocurrencies received as consideration during an ICO on virtual currency exchanges. However, such an action by issuers may deplete ICO proceeds contributed by crowd participants.

Prior to liquidating cryptocurrencies received as consideration during an ICO, issuers trading on virtual currency exchanges can jeopardize ICO proceeds, including the issuer's own virtual coins and the rights of crowd participants holding virtual coins or tokens. Dramatic fluctuations in the value of cryptocurrencies incentivize issuers to trade ICO proceeds, as well as their own virtual coins, on virtual currency exchanges in order to generate profits or mitigate losses. The SEC defines "virtual currency exchanges" as an individual or entity operating as a medium of exchange by which the transfer of virtual currencies for fiat currency, funds, or other virtual currencies occurs.<sup>62</sup> Generally, virtual currency exchanges charge users fees for the service of exchanging cryptocurrencies between buyers and sellers.<sup>63</sup> By utilizing virtual currency exchanges for trading ICO proceeds, issuers risk depletion of such proceeds resulting from trading losses and fees incurred when using these exchanges. Further, virtual currency exchanges serve as

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that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country.").

<sup>59</sup> Gatti et al., *supra* note 54.

<sup>60</sup> Michael Graham, Austin Moldow & Scott Suh, *Crypto Quarterly – Q4/17*, CANACCORD GENUITY, at 11 (Nov. 14, 2017), <https://www.scribd.com/document/364523190/Crypto-Quarterly-Q4-17>.

<sup>61</sup> *Id.* (discussing that during Q4 of 2017, an estimated 80% of ICOs engaged in presales).

<sup>62</sup> *Investor Bulletin*, *supra* note 45.

<sup>63</sup> *Id.*

a secondary market for the trading of virtual coins and tokens distributed during an ICO, but trading within such markets causes virtual coins and tokens to fluctuate in value.<sup>64</sup> Where virtual coins and tokens are used to interact with an issuer's platform, a substantial decrease in the value of a virtual coin or token may affect the ability of crowd participants and investing consumers to exercise the rights granted by their virtual coin or token. This occurs, in part, because issuers possess the ability to increase the amount of tokens necessary to interact with a platform.

### *C. Legal Dilemmas Posed by ICOs*

Because ICOs adapt elements of traditional crowdfunding transactions by integrating blockchain technology, ICOs constitute an extension of traditional crowdfunding models. Regardless of whether a startup or business engages in an ICO or a crowdfunding campaign, the rationale for such action stems from the desire to raise capital through small contributions from a large pool of individuals. Further, crowdfunding transactions and ICOs share a process by which an investing consumer contributes capital to an issuer in a transaction that, at some point, utilizes an intermediary for the exchange of funds. For instance, websites operating as funding portals in crowdfunding transactions bear responsibility for exchanging the capital from investing consumers to the issuer of the crowdfunding transaction. With respect to ICOs, virtual currency exchanges operate as the platform by which issuers exchange cryptocurrencies received from ICO crowd participants for capital. Despite similarities between crowdfunding transactions and ICOs, a dilemma arises when attempting to classify the sale of virtual coins or tokens distributed pursuant to an ICO as a crowdfunding transaction.

Pursuant to SEC guidance, the facts and circumstances of each ICO dictate the status of virtual coins or tokens as securities; however, a lack of judicial decisions illustrating circumstances which deem ICO tokens as securities results in uncertainty as to applicable federal law.<sup>65</sup> Virtual coins or tokens that are deemed securities are subject to federal securities laws, which governs the offer and sale of virtual coins or tokens occurring through the ICO process.<sup>66</sup> If virtual coins or tokens fail to meet the definition of a

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<sup>64</sup> *Id.*

<sup>65</sup> Crowdfunding, *supra* note 4, at 156-57, 191-93.

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

security, the distribution of ICO tokens may be deemed a crowdfunding contract, such that the offer and sale of virtual coins or tokens must comply with the requirements of Regulation Crowdfunding.<sup>67</sup> A determination that the offer and sale of virtual coins or tokens falls under federal securities laws or Regulation Crowdfunding requires examining the essence of the terms and transactions fundamental to an ICO.

Depending upon the terms underlying the issuance of virtual coins or tokens, ICOs replicate pre-purchase model crowdfunding or equity-model crowdfunding. Where a virtual coin or token grants crowd participants the right to interact with a future platform or service created by the issuer, the ICO replicates pre-purchase model crowdfunding in which a crowd participant receives a good or service in exchange for a capital contribution. Issuers engaging in an ICO replicating pre-purchase model crowdfunding trigger federal securities laws upon promising crowd participants anything beyond the rights established by ownership of a virtual coin or token. Alternatively, ICO issuers modify equity-model crowdfunding such that crowd participants receive a virtual coin or token with the belief that the coin or token will yield a return on investment or share of the profits generated by an issuer's business. If issuers or promoters of an ICO lead crowd participants to expect a return on their investment or a share in business profits, virtual coins or tokens offered and sold likely constitute securities and are therefore subject to federal securities laws. However, uncertainty with respect to federal law governing crypto-crowdfunding transactions constitutes one of the many dilemmas faced by investing consumers participating in ICOs.

Because federal regulations fail to address ICOs, investing consumers encounter fraud throughout the lifespan of an initial coin offering. While generating awareness of an ICO, issuers and promoters, acting on behalf of issuers, utilize fraudulent tactics, such as posting material misrepresentations about a virtual coin or omitting timing details relating to project development, to induce investing consumers into participating in an ICO. Alternatively, issuers enlist celebrities to make public statements or promotional posts on social media platforms as a method of inducing consumers by utilizing the credibility and influence of public figures. For instance, Centra Tech, a startup seeking to develop a debit card for cryptocurrencies, recruited Floyd Mayweather, Jr. to promote the

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<sup>67</sup> *Id.*

Centra ICO on social media platforms.<sup>68</sup> After the conclusion of an ICO, consumers trading virtual coins and tokens in secondary markets become targets of market manipulation on virtual currency exchanges. Within virtual currency exchanges, users may employ automated bots designed to buy and sell virtual coins at set price levels, so as to exploit the volatility of cryptocurrency markets to inflate prices or crash the market for a virtual coin.<sup>69</sup> However, limited remedies exist for consumers encountering fraud, manipulation, and theft on virtual currency exchanges, as a lack of federal regulation enables such exchanges to operate without offering investing consumers protections available on stock exchanges.<sup>70</sup>

In addition to traditional litigation hurdles, features of blockchain technology serving as the foundation for virtual coin and token ownership render the decision to pursue litigation problematic. From the outset, the inability to identify an individual or organization responsible for the injury underlying a legal claim inhibits litigation efforts by consumers.<sup>71</sup> Because blockchain technology utilizes private key cryptography as an ownership tool for authentication, the owner of a private key avoids the need to submit personal information as a method of verifying transactions.<sup>72</sup> As a result, tracing fraud, theft, and manipulation occurring with respect to virtual coins tends to result in identification of a private key, but the owner of the private key likely remains anonymous. Additionally, ICOs and the development of the projects and initiatives underlying ICOs occur on a global scale, such that consumers attempting to file claims against the issuers of an ICO encounter jurisdictional challenges.<sup>73</sup> Similar to litigation efforts in other

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<sup>68</sup> Stan Higgins, *Class-Action Suit Targets ICO Promoted by Floyd Mayweather, Jr.*, COINDESK, <https://www.coindesk.com/class-action-suit-targets-ico-promoted-floyd-mayweather-jr/> (last visited Dec. 15, 2017).

<sup>69</sup> Timothy Tam, *How Bots are Manipulating Cryptocurrency Prices*, VENTUREBEAT, <https://venturebeat.com/2017/12/14/how-bots-are-manipulating-cryptocurrency-prices/> (last visited Dec. 14, 2017).

<sup>70</sup> *Investor Bulletin*, *supra* note 45.

<sup>71</sup> Michaela Ross, *Initial Coin Offerings Set Stage for Litigation Wage*, BLOOMBERG BNA (Sept. 14, 2017), <https://www.bna.com/initial-coin-offerings-n57982087857/>.

<sup>72</sup> Bauerle, *supra* note 46.

<sup>73</sup> Ross, *supra* note 71.

industries, ICO issuers and virtual currency exchanges include arbitration provisions in their terms of service to hinder the ability of investing consumers to pursue litigation.

### III. AGENCY DECISIONS AND LITIGATION

When classifying virtual coins or tokens sold pursuant to an ICO, an issuer must rely upon SEC guidance provided by the Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: *The DAO*. Within the report, the SEC identifies *The DAO* as a virtual organization created by a German corporation, Slock.it UG, to fund projects with assets held and acquired by the creation and sale of DAO Tokens to investors.<sup>74</sup> To fund projects, the co-founders of Slock.it acted as promoters by creating a website upon which they posted information, promotional materials, and a link to *The DAO's* White Paper.<sup>75</sup> Additionally, Slock.it's co-founders sought attention from media outlets and members of blockchain technology forums by posting frequent updates about *The DAO* and manners enabling investors to participate in the virtual organization.<sup>76</sup>

Upon creating DAO Tokens, *The DAO* sought Ether,<sup>77</sup> a virtual currency based upon the Ethereum Blockchain,<sup>78</sup> from investors in exchange for the issuance of DAO Tokens in proportion

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<sup>74</sup> U.S. SEC. AND EXCH. COMM'N, Release No. 81207, Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: *The DAO* (July 25, 2017), <https://www.sec.gov/litigation/investreport/34-81207.pdf>.

<sup>75</sup> *Id.*

<sup>76</sup> *Id.*

<sup>77</sup> ETHEREUM FOUNDATION, <https://www.ethereum.org/ether> (last visited Feb. 2, 2017) (describing Ether as "...a fuel...for operating the distributed application platform Ethereum." Ether constitutes a "...form of payment by clients of the platform [developers and their applications] to the machines executing the requested operations [network participants].").

<sup>78</sup> *Id.* (explaining that Ethereum is a "...decentralized platform that runs smart contracts." These smart contracts contain developer-built applications that are executed "...exactly as programmed without any possibility of downtime, censorship, fraud, or third-party interference."); Alyssa Hertig, *How Ethereum Works*, COINDESK, <https://www.coindesk.com/information/how-ethereum-works/> (last visited Feb. 2, 2018) (explaining that the Ethereum Blockchain stores all ether transactions and smart contracts built upon the platform.).

to the investor's contribution of Ether.<sup>79</sup> The DAO's offering resulted in the sale of 1.15 billion DAO Tokens in exchange for 12 million Ether, which maintained a value of \$150 million during the time at which the DAO Token subscription period closed.<sup>80</sup> DAO Tokens held by investors entitled the investors to vote upon the utilization of Ether received from existing projects so as to enable DAO Token holders to determine whether to fund new projects or make distributions of DAO Tokens to investors.<sup>81</sup> Further, promotional materials released by The DAO bolstered DAO Token holders' expectations of sharing in the earnings of The DAO and receiving a return on investment in the form of DAO Tokens.<sup>82</sup>

While investors could choose to hold DAO Tokens to participate in future projects, a secondary market for DAO Tokens existed upon virtual currency exchanges, which used webpages and social media platforms to indicate support of DAO Token trading.<sup>83</sup> At the conclusion of the subscription period for DAO Tokens, the SEC Report of Investigation indicates that one virtual currency exchange executed more than 557,378 buy and sell transactions for DAO Tokens by more than 15,000 customers.<sup>84</sup> Shortly after the subscription period, a discovery of vulnerabilities in The DAO's code led to an exploitation of the code, which enabled an individual or group to divert one third of the Ether raised by The DAO to an Ethereum Blockchain address controlled by that individual or group.<sup>85</sup> After conducting an investigation into The DAO and its issuance of DAO Tokens, the SEC determined that DAO tokens constituted securities.<sup>86</sup>

Although the SEC declined to pursue an enforcement action, the Report of Investigation clarifies that DAO Tokens constituted investment contracts. Therefore, federal securities laws applied to The DAO, DAO Tokens, and platforms for secondary market trading of DAO Tokens. Prior to reaching a conclusion, the SEC invoked Sections 5 and 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act to reiterate the registration re-

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<sup>79</sup> Release No. 81207, *supra* note 74.

<sup>80</sup> *Id.*

<sup>81</sup> *Id.*

<sup>82</sup> Release No. 81207, *supra* note 74.

<sup>83</sup> *Id.*

<sup>84</sup> *Id.*

<sup>85</sup> *Id.*

<sup>86</sup> *Id.*

quirements for the offering and sale of securities, including investment contracts.<sup>87</sup> The SEC reasoned that investment contracts do not require an investment in the form of cash, such that the contribution of Ether from investors in exchange for DAO Tokens constituted a contribution of value giving rise to an investment contract.<sup>88</sup> Further, the SEC identified Slock.it promotional materials regarding DAO Tokens which conveyed to investors the ability to vote on funding proposed projects so as to share in potential profits resulting from such contracts.<sup>89</sup> As such, the SEC determined that investors exchanging Ether for DAO Tokens held an expectation of profits.<sup>90</sup> When combined with the voting and ownership rights of DAO Token holders, the SEC determined that DAO tokens constituted investment contracts and federal securities laws applied to the offer and sale of DAO Tokens.

Because DAO Tokens met the definition of securities and failed to qualify for a valid exemption, federal securities laws required that The DAO, as the issuer of DAO Tokens, register the offering and sale of DAO Tokens pursuant to Section 5 of the Securities Act.<sup>91</sup> Where any person participates in an unregistered offering and sale of securities not subject to an exemption, the Report of Investigation indicates that liability for violations of Section 5 apply.<sup>92</sup> After addressing Section 5 with respect to DAO Tokens, the SEC indicated that registration requirements for an exchange under Section 3(a)(1) of the Exchange Act applied to virtual currency exchanges acting as a secondary market for DAO Tokens. Due to the failure of such exchanges to register as a national securities exchange and the absence of an exclusion for virtual currency

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<sup>87</sup> *Id.*; see SEC v. W.J. Howey Co., 328 U.S. 293, 301 (1946) (defining an investment contract as “...an investment of money in a common enterprise with a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others.”).

<sup>88</sup> Release No. 81207, *supra* note 74 (illustrating that “...an investment of Bitcoin, a virtual currency, meets the first prong of Howey.”).

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* (explaining that “...a reasonable investor would have been motivated, at least in part, by the prospect of profits on their investment of ETH in The DAO.”).

<sup>91</sup> *Id.* (stating that “...those who participate in an unregistered offer and sale of securities not subject to a valid exemption are liable for violating Section 5.”).

<sup>92</sup> *Id.*

exchanges, such platforms violated the requisite registration requirements established by federal securities laws.<sup>93</sup>

In arriving at a decision respecting DAO Tokens, the SEC relied on *SEC v. Shavers* to determine that contributions of Ether constituted an investment of money, within the meaning of the *Howey* test, enabling the creation of an investment contract.<sup>94</sup> Pursuant to *SEC v. W.J. Howey Co.*, an investment contract refers to a transaction where an individual invests money with the expectation of receiving profits solely from a promoter of the common enterprise in which he invested or a third party.<sup>95</sup> Although *Shavers* addressed a Bitcoin investment scheme, the decision of the United States District Court for the Eastern District of Texas highlights virtual currencies, such as Bitcoin, as a medium of exchange similar to money.<sup>96</sup> However, the Court's decision in *SEC v. Shavers* holds significance beyond confirming the validity of virtual currencies as a form of money, as the case addresses fraud in the context of virtual currencies.

With respect to fraud in the context of virtual currencies, the court's decision in *SEC v. Shavers* provided a roadmap for future courts that encounter fraudulent cryptocurrency transactions. Through his investment scheme, Bitcoin Savings and Trust ("BTCST"), Mr. Shavers converted Bitcoins invested by consumers into cash for personal use. In doing so, Mr. Shavers simultaneously misrepresented BTCST's use of consumers' Bitcoins to current and potential consumers.<sup>97</sup> As a result of Shavers' intent to misrepresent BTCST to investors and misuse investors' funds, the court held Shavers and BTCST jointly and severally liable for, among other things, violations of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.<sup>98</sup> Although *Shavers* does not involve fraud within the context of an ICO, the decision to hold Shavers and BTCST jointly and severally liable provides a foundation for future cases in which courts must confront material misrepresentations and the misuse of investor funds stemming from an ICO's issuer.

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<sup>93</sup> *Id.*

<sup>94</sup> *SEC v. Shavers*, No. 4:13-CV-416, 1-2 (E.D. Tex. Aug. 26, 2014).

<sup>95</sup> *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

<sup>96</sup> *Shavers*, No. 4:13-CV-416 at 2 (explaining that Bitcoin may be utilized for the purchase of goods and services, as well as traded for fiat currency.).

<sup>97</sup> *Id.* at 16.

<sup>98</sup> *Id.* at 21.

Despite the initial success of conducting ICOs, the ability to generate and transfer substantial amounts of capital to an anonymous wallet address gave rise to fraud and theft. As a result, emerging litigation targets issuers and promoters that utilize fraud and manipulation to secure investments. After obtaining \$232 million through an ICO, the founders of the Tezos Foundation, a project striving to create a blockchain with governance rules for stakeholders, face numerous class-action complaints stemming from the Tezos ICO.<sup>99</sup> The class-action complaints allege that Tezos's founders utilized the popularity of blockchain technology and cryptocurrencies to conduct an unregistered sale of securities through an ICO.<sup>100</sup> Moreover, the class-action complaints allege that misrepresentations, factual omissions, and dissipation of ICO proceeds by Tezos's founders preclude the possibility of ICO participants obtaining a return on their investment.<sup>101</sup> Similarly, charges filed by the SEC's recently established Cyber Unit, allege that the issuers of the PlexCoin ICO, which promoted itself as "the next decentralized worldwide cryptocurrency," made false statements to prospective investors resulting in ICO proceeds of \$15 million.<sup>102</sup> In the absence of fraud or theft, consumer litigation against ICO issuers and promoters attempts to hold such individuals liable for the unregistered sale of securities, as seen in a class-action complaint against the Centra ICO, which utilized Floyd Mayweather, Jr. as a promoter.<sup>103</sup>

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<sup>99</sup> Aaron Stanley, *Tezos Founders Hit with Second Class Action Suit*, COINDESK, <https://www.coindesk.com/tezos-founders-hit-second-class-action-suit/> (last visited Nov. 15, 2017); *Governance*, TEZOS, <https://www.tezos.com/governance> (last visited Dec. 21, 2017).

<sup>100</sup> Nikhilesh De, *New Class-Action Suit Filed Against Tezos Founders*, COINDESK, <https://www.coindesk.com/new-class-action-suit-filed-tezos-founders/> (last visited Dec. 18, 2017).

<sup>101</sup> Stan Higgins, *Tezos Founders Sued for Securities Fraud in Potential Class Action*, COINDESK, <https://www.coindesk.com/tezos-founders-sued-securities-fraud-potential-class-action/> (last visited Nov. 3, 2017); Stanley, *supra* note 99; De, *supra* note 100.

<sup>102</sup> Stan Higgins, *SEC Files Fraud Charges Against ICO Organizer*, COINDESK, <https://www.coindesk.com/sec-files-fraud-charges-canadian-ico-organizer/> (last visited Dec. 4, 2017).

<sup>103</sup> Higgins, *supra* note 68.

## IV. THE FUTURE LANDSCAPE OF ICOS

While ICOs exhibit potential to operate as efficient and effective methods of crowdfunding, the practices by certain issuers of virtual coins and tokens jeopardize the legitimacy as a capital-raising tool for startups and businesses. In order to adequately protect consumers participating in ICOs, federal oversight of the ICO process and secondary market must occur, so as to minimize fraud, theft, and manipulation affecting consumers. Further, federal regulations governing securities and crowdfunding transactions must incorporate provisions dedicated to ICOs, so that such regulations reflect the utilization of blockchain technology by businesses while offering consumers recourse from bad actors. By incorporating the regulation of ICOs into existing federal securities laws and crowdfunding regulation, the intent and purpose of the JOBS Act, as well as Regulation Crowdfunding, will be preserved and extended into a new technological era.

Although the issuance of ICOs and secondary market trading of ICO tokens occurs on a global scale, federal agencies must incorporate ICO oversight into existing agencies to provide adequate protection to consumers participating in the ICO process and secondary market trading. On September 25, 2017, the SEC initiated steps towards ICO oversight by federal agencies through the addition of a Cyber Unit to its Enforcement Division.<sup>104</sup> While the focus of the Cyber Unit extends beyond ICOs and distributed ledger technology, the SEC enumerated the focus of violations in such areas within its press release unveiling the Cyber Unit. In addition to monitoring violations involving initial coin offerings, the Cyber Unit's focus on misconduct targets practices, such as market manipulation through the dissemination of false information on social media and cyber-related threats to trading platforms, that occur at an increasing rate within the ICO process and secondary market for virtual tokens. Despite sufficient oversight by the SEC's Cyber Unit in many respects, preventing coordinated efforts to influence ICOs and virtual currency exchanges requires collaboration among federal agencies. For instance, preventing or mitigating an attack upon the infrastructure utilized by virtual currency exchanges in the United States may require coordination between the Cyber Unit and various agencies of the Intelligence

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<sup>104</sup> Press Release, SEC, SEC Announces Enforcement Initiatives to Combat Cyber-Based Threats and Protect Retail Investors, No. 2017-176 (Sept. 25, 2017), <https://www.sec.gov/news/press-release/2017-176>.

Community. By pooling information pertaining to ICOs and virtual currency exchanges, federal agencies could remain updated as to issuers and secondary market listings while making certain information available as educational materials for consumers.

Along with oversight by federal agencies, federal securities laws and crowdfunding regulations must incorporate provisions respecting ICOs and virtual currency exchanges to reflect the manner in which consumers and businesses participate in ICOs with accuracy. By attempting to fit transactions occurring in an ICO within existing crowdfunding and securities regulations, uncertainty arises among issuers and participants. As such, amendments to federal securities laws must enumerate criteria enabling a clear determination by consumers and businesses as to the laws governing transactions occurring in the context of an ICO. Where an ICO replicates pre-purchase model crowdfunding, regulations similar to crowdfunding laws should govern the transactions between the ICO issuer and crowd participants. For instance, a provision similar to Section 4(a)(6) for crowdfunding transactions should provide the ICO an exemption from the registration requirements imposed by Section 5 of the Securities Act. To inhibit consumers from trading virtual coins or tokens, issued pursuant to an ICO replicating pre-purchase model crowdfunding, federal regulations must restrict consumers' ability to resell the virtual coins and tokens in order to categorize ICO transactions.

However, federal securities laws must govern ICOs where consumers use the issuance of virtual coins or tokens to share in business profits or receive a return on an investment. Ensuring governance will provide heightened protections to consumers participating in ICOs. Where an ICO triggers federal securities laws, issuers of ICO tokens and virtual currency exchanges must be subject to requirements and restrictions similar to crowdfunding portals, such as ongoing reporting requirements for issuers and taking steps to reduce the risk of fraud. If an ICO issuer or virtual currency exchange is located outside of the United States, regulation should not preclude consumer participation. Federal agencies overseeing the ICO process should supplement regulatory protections by enabling investing consumers to access educational information about an issuer or exchange that is compiled routinely through agency investigative work.

When drafting provisions amending federal law to incorporate ICOs and virtual currency exchanges, provisions must reflect the congressional intent underlying crowdfunding regulation so as to extend the purpose of crowdfunding regulations to crypto-

crowdfunding. To contribute to the JOBS Act's overarching goal of enabling capital formation, Title III reduced the cost of low-dollar offerings of securities in a manner enabling startups and businesses to secure capital.<sup>105</sup> While attempting to reduce the cost of low-dollar offerings of securities, Congress stressed the importance of protecting investors engaged in crowdfunding transactions through the incorporation of mechanisms such as investment limits and required disclosures by issuers.<sup>106</sup> In Regulation Crowdfunding, the SEC expands upon the congressional intent of Title III by explaining that the definition of crowdfunding renders crowdfunding transactions under Section 4(a)(6) available to all investors.<sup>107</sup> However, the SEC utilized Regulation Crowdfunding to express concern over the ability of certain households, such as those where a sizeable gap exists between net worth and annual income, to withstand the risk of loss posed by crowdfunding transactions.<sup>108</sup> With respect to ICOs and virtual currency exchanges, federal regulation must strive to preserve the goal of enabling startups and small businesses to secure capital at a reduced cost. Further, any federal regulation of ICOs and virtual currency exchanges must not preclude subsets of consumers from participation, but protection mechanisms and educational materials must be available to consumers from all socioeconomic backgrounds.

## V. CONCLUSION

While traditional crowdfunding and crypto-crowdfunding serve as useful tools for solving businesses' capital deficiencies, federal securities laws and crowdfunding regulation must adapt to incorporate the use of blockchain technology. Despite increases in the popularity of ICOs throughout 2017, investing consumers lack clear guidelines as to the applicable federal laws and regulations governing transactions underlying the sale of virtual coins and tokens. As a result of coverage gaps in federal securities laws and crowdfunding regulation, investing consumers will continue to face fraud, manipulation, and theft when attempting to participate in crypto-crowdfunding. By amending federal securities laws and crowdfunding regulations to address issues pertaining to ICOs,

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<sup>105</sup> MURDOCK, *supra* note 22, § 7.38; Crowdfunding, *supra* note 4, at 6.

<sup>106</sup> Crowdfunding, *supra* note 4, at 6.

<sup>107</sup> *Id.* at 29.

<sup>108</sup> *Id.* at 26.

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Congress can protect investing consumers from the current pitfalls of ICOs while ushering in regulation for a new technological era.