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Crowdfunding has become a popular new way for filmmakers as well as entrepreneurs, small businesses, and philanthropists to raise capital by obtaining small contributions from a large number of individuals over the Internet. Websites such as Kickstarter, IndieGoGo, RocketHub, and WeFunder have provided a portal for films like *Wish You Were Here*, *Veronica Mars*, and *Sharknado 2* to obtain needed financing. A recent legislation has the potential to change this crowdfunding and indie film landscape. On April 5th, 2012, President Obama signed into law the Jumpstart Our Business Startups Act ("JOBS Act"), which legalizes equity crowdfunding over the Internet.

Crowdfunding can be a useful tool for filmmakers in a number of ways. It can build awareness as well as a fan-base for a project. Additionally, many times filmmakers are limited in people or companies they know. Connection-based crowdfunding can help these filmmakers meet others outside of their circle. If a filmmaker is short of financing, he or she can raise the necessary funds through various crowdfunding outlets. Finally, through reward/donation-based crowdfunding, filmmakers can take on more risky projects without giving up equity for money.

To understand the impact of the new law, it is important to first appreciate the different types of crowdfunding that currently exist.

There are essentially four different types of crowdfunding: connection-based, loan- based, equity-based, and reward/donation-based. The word crowdfunding itself can be a misnomer, since many "crowd" sites do not involve any financial transactions at all. Connection-based portals focus on connecting people to people, businesses to businesses, or projects to an audience. For example, the indie film site, Slated, connects companies with pre-approved potential financiers, distribution entities, and marketing specialists, and the parties execute transactions offline. With loan-based crowdfunding, contributors receive interest in return for their contributions. Funding Circle and Kiva are two sites that provide loan-based crowdfunding services. Equity-based crowdfunding is where contributors receive equity stake in projects. Sites such as Angel List and WeFunder focus on equity crowdfunding. Reward/donation-based crowdfunding, the most popular type, is when contributors receive nothing for their contributions or non-monetary items (ex. free dvd, ticket to a premiere, etc.). Kickstarter – the most popular crowdfunding site today – implements this form of crowdfunding.

Until the JOBS Act in 2012, equity crowdfunding was not permitted in the US. The Act legalized equity crowdfunding through online portals. The section of the JOBS Act that addresses equity crowdfunding is Title III, which consists of two relevant parts: 506(c), the accredited investor exception, and 506(b), the non-accredited investor exception.

An accredited investor is someone who has an annual income of over $200k ($300k for couples) or has a net worth of at least $1million (excluding the value of their home). In the past, filmmakers were prohibited from raising funds using the Internet or broadcast media from accredited investors. 506(c) allows filmmakers to solicit equity financing from accredited investors online, and is currently in effect.

A non-accredited investor is everyone who does not qualify as an accredited investor. Filmmakers in the past could only solicit funds from accredited investors or up to $1 million from non-accredited investors with whom they had a "substantive" relationship. 506(b) allows filmmakers to raise funds from anyone, including non-accredited investors, regardless of financial status or relationship. This part of the law does not go into effect until the Securities and Exchange Commission ("SEC") approves specific guidelines. The SEC proposed guidelines in October, 2013, but they still have not been approved. Most likely, the SEC will approve these guidelines by this fall, 2014.

The JOBS Act provides specific limitations on amounts investors can contribute and companies can raise through equity crowdfunding. Over a twelve-month period, a company would be able to raise a maximum aggregate amount of $1 million through crowdfunding offerings. Investors, over the course of a 12-month period, would be permitted to invest up to either a) $2,000 or five percent of their annual income or net worth, whichever is greater, if both their annual income and net worth are less than $100,000 or b) ten percent of their annual income or net worth, whichever is greater, if either their annual income or net worth is equal to or more than $100,000. During the 12-month period, these investors would not be able to purchase more than $100,000 of securities through crowdfunding.

For 506(c) (accredited investor offerings), companies need to have a "reasonable belief" that an investor is accredited before accepting their investment. They must take "reasonable steps" to verify that their investors are accredited. Some verification means could be:

- High investment amounts that are not financed by third parties
- The average salary of someone's job title at a particular company
- Tax forms like W2, 1099, K1, or a filed 1040 over the last two years
- Bank statements, brokerage statements, certificates of deposit, tax assessments, or appraisals combined with a credit report
- A letter from a broker/dealer, investment adviser, attorney, or CPA.
- Third-parties that have a reasonable basis to be relied on

The SEC proposal includes some additional requirements. The proposal requires a disclosure document to be filed with the SEC at least twenty-one days prior to the first sale, and requires scaled financial disclosures, including audited financial statements for raises of over $500,000.

A company that completes an equity crowdfunding round must also file annual reports with the SEC.

Many venture capitalists and filmmakers are wary of equity crowdfunding because they are uncomfortable having many small investors who might put their follow-on financing at risk (ex. collecting signatures, etc.). To address those concerns and not risk future financings, many sites have pooled these investors together as part of one individual fund. For example, equity-crowdfunding site, Wefunder, can manage "WeFunds" for startup investors so companies only have one shareholder on their cap table. When an investor applies to invest, they digitally sign the investment documents and enter their bank account information. Companies can then choose to accept or deny the investment. Once accepted, the investment is sent to an escrow account. The money will be transferred to the company's corporate account seven days after the escrow trigger has been met and the company's round is closed.

Because 506(b) is still in limbo awaiting SEC approval, various States have passed legislation allowing companies to solicit non-accredited investors online. Since these state laws may be contrary to the SEC law when passed, they are at risk of preemption, meaning the federal law can eventually cancel out the state law. States that have passed such laws thus far are: Maine, Washington, Wisconsin, Michigan, Indiana, Georgia, Kansas, Alabama, California, Alaska, New Mexico, Utah, Idaho, Louisiana, Mississippi, Florida, Pennsylvania, Connecticut, NC, SC, and Virginia. According to the SEC, a state may regulate the portal, but cannot impose rules that are different or additional to what is required under the JOBS Act. Additionally, according to the SEC, companies can only raise money from residents of the same state and cannot use social media to raise awareness of their crowdfunded offerings, given that these communication tools extend beyond state boundaries. This has been an extremely difficult limitation for state-based equity crowdfunding portals.

It will be interesting to see what the SEC includes in their finalized guidelines, as there are numerous questions that remain. How will the SEC track the investing limit per person? Is it going to be self-reporting, or is there going to be a real-time database that is going to see if you've gone over your limit? Also, does reward/donation-based crowdfunding need to be handled in a separate portal than equity-based funding? Will the limitations on the amount you can invest be broadened or no?

As of November 21, 2013, 2.2 billion has been raised through equity crowdfunding. This has been solely through accredited investors, since the non-accredited portion of the law is still not in effect. The SEC has been able to track this through Form D filings. Forbes also confirms that equity crowdfunding has had an increase on company sales. Although all methods (reward, debt, etc.) reported a 24% average quarterly increase in sales, equity crowdfunding scored a whopping 341% post-crowdfund quarterly sales average. This could be because investors become dynamic brand advocates since they have aligned monetary incentives.

There are also a lot of risks associated with equity crowdfunding. Non- accredited investors will now have access to a new market and they may not be as comfortable with the risk. If something goes wrong, they might blame the issuers for losing money and cause problems. Accredited investors are typically more sophisticated and probably understand more thoroughly the risks associated with any investment. In addition, funding portals might spur fraud and litigation due to lack of due diligence and online shams. Since there will be so many companies and portals raising money, it will be difficult to decipher legitimate businesses from fraudulent ones.

In my personal opinion, equity crowdfunding is not worth the risk and cost for a production company to utilize. There is such a high cost of implementation for issuers to solicit online; including audited financial statements, tracking, and legal fees. These costs can outweigh the amount raised. Also, because there is limited contact with potential investors, it is nearly impossible to know a great deal about them. Lastly, the JOBS Act and the SEC guidelines when put together are over five hundred pages. It is incredibly complex and convoluted with many legislators finding it extremely difficult to follow. Thus, it would be incredibly costly to comply with, and there would be high potential for SEC violations.

Connection-based crowdfunding could be an alternative and safer way to secure funding for productions companies. If a production company needs to find new financiers, a distributor in another country, or a production partner, this seems like a great way to connect to a pre-approved group of people and execute transactions offline. Either way, the road for crowdfunding is one that is uncertain. It is definitely an industry that is growing, but its growth might come with added dangers and risks. Hopefully, the SEC will provide some much needed clarity by the end of this year once it approves guidelines.

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