THE REGULATORY HURDLES THAT STUNT INNOVATION: SECURITIES EXEMPTIONS FOR EARLY-STAGE STARTUPS

COREY A. RACKLER*

TABLE OF CONTENTS

I. INTRODUCTION 133
II. EARLY-STAGE CAPITAL RAISING 135
A. The History of Venture Capital 135
B. Early Stage Financing 138
III. REGULATORY LANDSCAPE: A COMPLEX TAPESTRY 141
A. Regulation D 143
1. Rule 504 146
2. Rule 506(b) 148
3. Rule 506(c) 149
B. Regulation Crowdfunding 150
IV. COMPLIANCE BURDENS ON EARLY-STAGE STARTUPS 151
A. Disclosing the Future: Examination of Disclosure Requirements 152
B. The Vanishing of Crowdfunding Guidance 156
C. The Financial Tightrope: Analysis of Compliance Costs 158
V. THE AVENUE TO A MORE DYNAMIC VENTURE CAPITAL LANDSCAPE 159
A. Rethinking Crowdfunding: Accessibility and Compliance 159
B. The Non-Accredited Investor Under Rule 506(b) 161
C. Raising the Cap on Capital Raising 164
D. Harmonizing Investor Protection and Innovation 164
VI. CONCLUSION 165

I. INTRODUCTION

The sheer impact of venture capital (VC) and ambitious startups on America's global innovation edge cannot be overstated. VC investments fund these trailblazing companies when they need it most and drive breakthrough R&D, productivity enhancements, job creation, and expanded consumer access. Consider Apple, Amazon, Google, and Netflix—VC was vital in transforming these once-minute startups into conglomerate publicly-traded companies.[1] In 2022 alone, VC investments pumped roughly $235 billion into U.S. startups—quadruple the

* Candidate for Juris Doctor (2025), SMU Dedman School of Law.

[1] *See* Shaun Gold, *A Brief History of Venture Capital*, OPENVC (Sept. 26, 2022), https://openvc.app/blog/history-of-venture-capital.

amount from just a decade ago.[2] The U.S. economy can thank VC-backed companies, since they account for 41% of the total U.S. market capitalization.[3] Clearly, prudent policymaking requires appreciating VC as a launchpad fueling innovation, not an expendable financing scheme for a niche group of startups.

Unfortunately, the American dream of turning an innovative idea into a thriving business faces a sobering reality: roughly nine out of ten startups will fail.[4] The path from conception to market success is filled with obstacles, but few barriers are as frustrating as the regulatory hurdles rooted in securities laws. In a recent pronouncement, the Securities and Exchange Commission (SEC) cast a shadow of uncertainty over the foundations underpinning the private market, which would have dramatic effects on the VC industry.[5] Therefore, this Paper argues that the frequent changes to securities exemptions, while well-intentioned, can dampen innovation by imposing undue burdens on early-stage startups pursuing capital. This Paper spotlights avenues to shape a more dynamic and inclusive venture capital landscape by analyzing the historical context, capital raising mechanisms, and compliance challenges. The discussion attempts to balance the federal government's interest in informing and protecting investors with the desire to encourage innovation. This Paper does not call for the complete deregulation of securities laws, nor does it call for a significant relaxation of securities registration requirements. Instead, it argues that the growing use of the securities exemptions in the private market is merely a step in the right direction. As such, the SEC should not enhance the requirements for securities exemptions. To ensure that a clear path to continued entrepreneurial success remains in the United States, an innovation-focused approach to regulating the offering of exempt securities is required to grow the private market.

This Paper begins with a historical study of the evolutionary course of VC, followed by a nuanced exploration of early-stage capital-raising dynamics. Part III analyzes the regulatory landscape by looking at SEC rules, specifically Regulation D—covering Rule 504, Rule 506(b), and Rule 506(c)—as well as the newer Regulation CF. In Part IV, the discussion then pivots towards the sobering reality of the many compliance burdens early-stage startups face. Part V dissects the details of disclosure requirements, accredited investor status, and the challenging

---

2 *See USA*, DEALROOM.CO, https://www.cbinsights.com/research/venture-capital-2012-report/ (last visited Nov. 4, 2023); Value of venture capital investment in the United States from 2006 to 2022, Statista (Apr. 6, 2023), https://www.statista.com/statistics/277505/venture-capital-number-of-deals-in-the-united-states-since-1995/.

3 Will Gornall & Ilya Strebulaev, *The Economic Impact of Venture Capital: Evidence from Public Companies* 1-44, 3 (July 8, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2681841.

4 Joseph Camberato, *2019 Small Business Failure Rate: Startup Statistics by Industry*, NAT'L BUS. CAP. (Jan. 24, 2020), https://www.nationalbusinesscapital.com/blog/2019-small-business-failure-rate-startup-statistics-industry/.

5 *See* Caroline A. Crenshaw, Comm'r, U.S. Sec. Exch. Comm'n, Big "Issues" in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute (Jan. 30, 2023), https://www.sec.gov/news/speech/crenshaw-remarks-securities-regulation-institute-013023; *See* Press Release, SEC, SEC Enhances the Regulation of Private Fund Advisers (Aug. 23, 2023), https://www.sec.gov/news/press-release/2023-155.

balance between financial growth and regulatory compliance. Several proposals are provided to promote a more practical VC market without compromising investor protection. These propositions include an explicit call for SEC guidelines for investors and startups to utilize for crowdfunding, an emphasis on accessibility and eased compliance, an expansion on the reach of investors under Rule 506(b), and a promotion for raising the cap on capital raising. These proposals form a transformative vision grounded in adaptability, inclusivity, and balance between safeguarding investors and fostering innovative progress. Finally, this Paper stresses that innovation and federal regulations are not opposing forces but are interdependent and capable of driving the economy forward when effectively combined.

II. EARLY-STAGE CAPITAL RAISING

As one of the chief driving forces behind transforming innovative ideas into market realities, VC has a unique history interwoven with economic ebbs and flows.[6] These contributions to innovation lie at the heart of a prosperous U.S. economy.[7] Understanding the link between innovation and startups is crucial to truly appreciate the challenges faced by early-stage startups.[8] This Part examines the historical development of VC in the United States while also underscoring the many ways startups contribute to the thriving innovation that American consumers benefit from today.

A. The History of Venture Capital

The history of modern VC is unique; it is an incredibly American-rooted concept that hinges on effective federal policy.[9] The modern VC roots trace back to the mid-20th century, a period marked by rapid technological advancements and the emergence of Silicon Valley as the national and global hub in sparking innovation.[10] Before the 1940s, affluent families like the Vanderbilts, Rockefellers, and Whitneys all played a pivotal and nearly exclusive role as the primary backers of risk capital for private companies.[11] This capital-raising method laid the

---

[6] Christopher Bai, *The Changing Landscape of Startup-VC Dynamics: Adapting to New Realities*, STREETFINS (Aug. 27, 2023), https://streetfins.com/the-changing-landscape-of-startup-vc-dynamics-adapting-to-new-realities/.

[7] *See* Bob Zider, *How Venture Capital Works*, HARV. BUS. REV., Nov.–Dec. 1998, at 131.

[8] Kelley Christensen, *Launch Oregon Takes Startups to New Heights*, OFF. OF THE VICE PRESIDENT FOR RSCH. & INNOVATION (Mar. 1, 2023), https://research.uoregon.edu/launch-oregon ("New startup companies based on innovative ideas are crucial to the U.S. economic engine but turning an idea into a thriving business is often fraught with peril.").

[9] *See* TOM NICHOLAS, VC: AN AMERICAN HISTORY 9–10 (2009).

[10] *Id.* at 206; Will Summerlin, *A New Era of Venture Capital*, ARK INV. (Sept. 23, 2022), https://ark-ventures.com/commentary/a-new-era-of-venture-capital/.

[11] *Venture Capital History*, VENTURE FORWARD, https://ventureforward.org/resources-for-emerging-vc/vc-history/ (last visited Oct. 26, 2023).

foundation for early developments in private equity and VC investment in the United States.[12]

Although VC is mainly perceived as being associated with the West Coast, it was actually founded on the East Coast.[13] In the aftermath of World War II, the U.S. economy experienced an influx of capital seeking opportunities in the growing technology sector.[14] In 1946, the first inaugural VC firm, American Research and Development Corporation (ARDC), was established.[15] ARDC was cofounded by VC pioneer Georges Doriot, who is considered to be "the father of venture capital."[16] ARDC is particularly significant because of its investment in Digital Equipment Corporation (DEC) in 1957, marking the first major success of a VC firm in backing an early-stage startup, and which became a massive success in the computer industry.[17] ARDC introduced a new era of investing by showcasing that institutional investors, and not just the traditional wealthy families, also had a prominent interest in VC investments.[18] Before the DEC investment success story, few institutional investors had shown genuine interest in this novel investment style due to its perceived risk and uncertainty.[19]

As with any new investment strategy, VC investing comes with government involvement. In the late 1950s, Congress codified the Small Business Investment Act of 1958.[20] As a result, the federal government granted the Small Business Administration authority to form Small Business Investment Companies, which in turn would invest in early-stage startups.[21] The creation of these federally charted companies was an attempt by the Americans to boost innovation in the United States to compete with the Soviet Union during the Cold War.[22] Unfortunately, significant regulation caused most VC firms to avoid these companies entirely, which led most of these companies to fail in the early 1970s.

---

12 *Id.*

13 *See* JOHN W. WILSON, THE NEW VENTURES: INSIDE THE HIGH-STAKES WORLD OF VENTURE CAPITAL 19 (1986).

14 *Id.* at 5, 31.

15 *Id.* at 19; *Georges F. Doriot*, HARV. BUS. SCH., https://entrepreneurship.hbs.edu/showcase/Pages/profile.aspx?num=16 (last visited Oct. 26, 2023).

16 Katie MacDonald, *Venture Capital*, INNOVATION IN CAMBRIDGE, https://historycambridge.org/innovation/Venture%20Capital.html (last visited Oct. 28, 2023).

17 *See* Gold, *supra* note 1 ("ARDC's most notable success story came from their $70,000 investment in DEC, the Digital Equipment Company in 1957. Over the next fourteen years, the value of DEC increased to $355 million, showcasing that a VC firm could make a major return and demonstrating the first example of the power law."); Jake Powers, *The History Of Private Equity & Venture Capital*, CORP. LIVEWIRE (Feb. 20, 2012, 9:24 AM), https://www.corporatelivewire.com/top-story.html?id=the-history-of-private-equity-venture-capital.

18 *See* Gold, *supra* note 1.

19 Paul Gompers & Josh Lerner, *The Venture Capital Revolution*, 15 J. ECO. PERSPS. 145, 146 (2001).

20 15 U.S.C. § 681(d).

21 *VC History*, VENTURE FORWARD, https://ventureforward.org/resources-for-emerging-vc/vc-history/ (last visited Oct. 29, 2023).

22 *See* Gompers & Lerner, *supra* note 19, at 147.

During the 1970s and 1980s, VC was created as an "asset class."[23] Institutional investors, such as pension funds and endowments, finally started allocating capital to VC funds.[24] One of the most significant benefits to pension funds was the "prudent man rule" change under the Employee Retirement Income Security Act (ERISA).[25] Before the change, many pension funds refused to invest in startups to avoid violating the "prudent man rule."[26] After the shift, VC saw a sharp increase in pension fund commitments, totaling over $4 billion by the late 1980s.[27] This nuanced form of institutionalization erupted as a shift in the investment industry with significant effects, even on today's private credit market.[28] This transformation exemplified how VC was a viable path to capital, even if it reshaped the traditional methods for entrepreneurial financing.[29] As institutional investors embraced VC as a distinct asset class, the following decades profoundly impacted the risk appetite and investment strategies, laying the groundwork for today's private market.[30]

With the rising interest in VC, the National Venture Capital Association (NVCA) was formed. The purpose of NVCA is to "advocate[] for policies that create U.S. economic growth and fuel entrepreneurship." [31] This organization pushes for more innovative federal government regulation and creates programs to assist early-stage startups.[32] The NVCA has suggested that because of the burdening regulation enacted by the federal government, startups are unable to afford the prohibitive cost of an Initial Public Offering (IPO).[33] Ultimately, the NVCA takes the position that the regulation surrounding the public market and compliance with such regulation is what can actually discourage startups from pursuing an IPO.[34]

Therefore, VC's history serves as a backdrop for comprehending the challenges many startups face in their quest for early-stage funding. This is due, in

---

[23] Equip South Summit, *The Rise of VC as an Asset Class*, S. SUMMIT (Sept. 2, 2022), https://www.southsummit.io/the-rise-of-vc-as-an-asset-class/. An "asset class" refers to a collection of investments that share common traits and are governed by identical laws.

[24] Paul A. Gompers, *The Rise and Fall of Venture Capital*, 23 BUS. & ECON. HIST. 1, 2, 14 (1994).

[25] Gold, *supra* note 1.

[26] Paul A. Gompers & Josh Lerner, *What Drives Venture Capital Fundraising?* 155-56 (Nat'l Bureau of Econ. Rsch., Working Paper No. 6906, 1999) [hereinafter Working Paper].

[27] Gompers, *supra* note 24, at 2.

[28] *See* Larry Rothman, *Pension Funds and Endowments Make Up Nearly 50% of Private Credit Fund Investors*, PENSIONS & INVS. (Apr. 20, 2023, 3:05 PM), https://www.pionline.com/interactive/pension-funds-and-endowments-make-nearly-50-private-credit-fund-investors (explaining how "[p]ension funds and endowments combined for 49% of the number of investors in U.S. private credit funds . . . .").

[29] *See id.*

[30] *See* Gompers, *supra* note 24, at 16.

[31] *Public Policy*, NVCA, https://nvca.org/public-policy/ (last visited Oct. 29, 2023).

[32] *Id.*

[33] E-mail from Mark G. Heesen, Pres., NVCA to Nancy M. Morris, Sec'y, SEC (Sept. 11, 2006), https://www.sec.gov/comments/s7-11-06/s71106-44.pdf.

[34] *Id.*

part, to the evolution of the VC industry, from individual investors taking calculated financial risks on a startup's innovative idea to a world of "regulatory red tape" disguised as a lightly regulated market.[35] In fact, the second greatest threat that businesses face is compliance with regulation, according to several CFOs.[36] Although private offerings are, in fact, less regulated than registered offerings, the approach nevertheless assumes that a private offering is inherently risky while a public offering is far less risky.[37] However, as later discussed, this is disputable.[38]

B. Early Stage Financing

There are various stages that successful and long-lived startups have to go through. This Paper focuses on the early stages of venture financing, namely the Pre-Seed, Seed, and Series A stages. The Pre-Seed stage is the earliest financing stage, typically arising before the founders even have a functional prototype.[39] At this stage, sometimes referred to as the "friends and family" round, founders reach out to family members or close friends who may be interested in investing early on.[40] Founders will typically identify the market that their product or service will fall under and establish a strategy to reach the consumers in that market.[41] The amount of money startups raise can vary but will typically be somewhere between $50,000 to $250,000.[42]

The Seed stage comes after the Pre-Seed stage, but startups sometimes skip it entirely and begin their first round of equity financing at the Seed stage.[43] When startups want to avoid the steep interest rates typically incurred by using traditional financing methods, such as borrowing from a bank, equity financing can look like

---

[35] *See* Prem Jadhav, *Regulatory Red Tape: Legal Challenges for Startups*, LINKEDIN (Oct. 15, 2023), https://www.linkedin.com/pulse/regulatory-red-tape-legal-challenges-startups-prem-jadhav-lyb2f/ (defining regulatory red tape as the "complex, bureaucratic, and often burdensome rules and regulations that businesses, including startups, must adhere to.").

[36] *See* Brian O'Keefe, *The Red Tape Conundrum*, FORTUNE (Oct. 20, 2016, 5:30 AM), https://fortune.com/longform/red-tape-business-regulations/.

[37] Thaya Brook Knight, *Your Money's No Good Here: How Restrictions on Private Securities Offerings Harm Investors*, CATO INST. (Feb. 9, 2018), https://www.cato.org/policy-analysis/moneys-no-good-here-how-restrictions-private-securities-offerings-harm-investors.

[38] *See infra* p. 37.

[39] Lachezar Zanev, *A Guide to Venture Capital Investment Stages*, LINKEDIN (Apr. 13, 2023), https://www.linkedin.com/pulse/guide-venture-capital-investment-stages-lachezar-zanev/.

[40] Paul Spitz, *The Friends & Family Round*, LINKEDIN (Mar. 31, 2015), https://www.linkedin.com/pulse/friends-family-round-paul-spitz/.

[41] *What's the Difference Between Pre-Seed and Seed Funding Rounds?*, BREX, https://www.brex.com/journal/pre-seed-vs-seed-funding-round-what-is-the-difference (last visited Nov. 7, 2023).

[42] *Id.*

[43] *See* Ryan Rutan, *Series A, B, C, D, and E Funding: How It Works*, STARTUPS.COM (Jan. 3, 2023), https://www.startups.com/library/expert-advice/series-funding-a-b-c-d-e.

an attractive substitute.[44] If a startup chooses the equity financing route, it must then sell the company's preferred stock to whoever supplies the capital, meaning that this seed investor will now have ownership of the startup.[45] To combat the inherent risks associated with investing in a startup, investors receive rather favorable terms, such as liquidation preference, anti-dilution rights, or other control rights.[46] A Seed round will raise anywhere from $2 to $5 million, depending on where the round occurs.[47]

The methods employed for early-stage financing can vary significantly, ranging from bootstrapping and angel investments to VC firm investments.[48] Bootstrapping is the concept of self-funding; it involves founders using their personal savings or revenue generated by the business to fund its operations.[49] Angel investors, often successful entrepreneurs themselves, infuse capital into startups in exchange for equity in the startup.[50] They will usually be more flexible in their investment terms vis-a-vis venture capitalists.[51] The investments are typically unmatched compared to what a VC firm can provide, but an angel investor will generally have a heightened risk tolerance for nascent startups.[52] In contrast to venture capitalists, angel investors typically forgo the rigors of a thorough due diligence process.[53] Consequently, a founder must present a well-crafted pitch deck when attempting to receive funding from an angel investor.[54]

Early-stage financing constitutes the lifeblood of startups, providing them with the necessary resources to develop their products, scale operations, and navigate the tumultuous journey from conception to market.[55] In its earliest stages, startups often lack a proven track record and face heightened scrutiny from traditional

---

[44] *See* Steve Nicastro & Ryan Lane, *Debt vs. Equity Financing: What Option Is Best for You?*, NERDWALLET, https://www.nerdwallet.com/article/small-business/equity-debt-financing (last updated June 15, 2022).

[45] Kyle Westaway, *Negotiating a Seed Round: Understanding Valuation, Liquidation Preferences, Board of Directors and Expenses*, FORBES (Jan. 12, 2023,10:15 AM), https://www.forbes.com/sites/kylewestaway/2023/01/12/negotiating-a-seed-round-understanding-valuation-liquidation-preferences-board-of-directors-and-expenses/.

[46] *Id.*

[47] *Id.*

[48] *6 Types of Funding for Startups: Definitive Guide*, FOUNDERS NETWORK, https://foundersnetwork.com/blog/types-of-funding-for-startups/ (last visited Oct. 26, 2023) [hereinafter *Definitive Guide*].

[49] *Id.*

[50] *Id.*

[51] *See* FasterCapital, *Alternative Financing Options for Startups*, LINKEDIN (June 21, 2023), https://www.linkedin.com/pulse/alternative-financing-options-startups-fastercapital/.

[52] *Id.*

[53] Will Jiang, *Differences Between an Angel Investor and a Venture Capitalist*, BUSINESS.COM, https://www.business.com/articles/angel-investors-vs-venture-capitalists/ (last updated Mar. 22, 2023).

[54] FasterCapital, *supra* note 51.

[55] *See* Ryan Rutan, *A Guide to Different Stages of Funding for Startups*, STARTUPS.COM (June 5, 2023), https://www.startups.com/library/expert-advice/different-stages-of-funding-for-startups.

lenders.[56] Thus, VC from either an angel investor or a VC firm is there for the startup to utilize as an alternative to traditional bank lending.[57] Startups that receive capital from VC firms are typically viewed as a more stable investment than non-VC-firm-backed startups, especially those with high growth potential, such as "unicorns."[58] Venture capitalists not only provide capital but also expertise, mentorship, and access to a plethora of networks that can serve as the driving force behind a startup's success.[59] The relationship between venture capitalists and startups is characterized by interdependence with both sides sharing the inherent risk of failure and the potential for high rewards of success.[60]

Despite its pivotal role, early-stage financing presents numerous challenges. Even with early-stage financing as a source of capital, a startup must defy the odds in an industry where 90% of startups will fail, competition is fierce, and access to capital is not guaranteed.[61] The regulatory hurdles, as discussed throughout this Paper, add yet another layer of hardship that startups face in pursuing rapid growth. Thus, legislators and regulators must understand the drawbacks of increased regulation on the private market. Lawmakers can significantly benefit the U.S. economy by increasing access to capital for startups.[62] Of course, whatever action takes place will need to maintain a regulatory framework that ensures investor protection while also facilitating and encouraging the flow of capital to fuel the innovative engines of the economy.[63]

---

[56] *See* EY Netherlands, *The Ultimate Guide to Financial Modeling for Startups*, EY (Oct. 3, 2019), https://www.ey.com/en_nl/finance-navigator/the-ultimate-guide-to-financial-modeling-for-startups.

[57] FasterCapital, *supra* note 51.

[58] *Definitive Guide*, *supra* note 48; Ofer Eldar & Jillian Grennan, *Common Venture Capital Investors and Startup Growth* at 4 (Eur. Corp. Governance Inst. – Fin., Working Paper No. 902, 2023) ("[O]ur evidence suggests that common VC investors are linked to real benefits for startups. Specifically, we find that common VC investment is associated with (1) a higher probability of an exit through an IPO, (2) higher valuations when startups undergo IPOs, (3) a higher probability of sale, and (4) a lower probability of failure.". The term "unicorn" refers to "a startup company valued at over $1 billion."), *Venture Glossary*, VELA WOOD, https://velawood.com/glossary-term/unicorn/ (last visited Oct. 26, 2023).

[59] *Definitive Guide*, *supra* note 48.

[60] Vilashini V, *Startups and Investors*, LINKEDIN (Sept. 22, 2023), https://www.linkedin.com/pulse/startups-investors-vilashini-v/?trk=article-ssr-frontend-pulse_more-articles_related-content-card.

[61] *See id.*; *see also* Josh Howarth, *Startup Failure Rate Statistics (2023)*, EXPLODING TOPICS (Mar. 16, 2023), https://explodingtopics.com/blog/startup-failure-stats.

[62] *See* Emily Liner & Ryan Bhandari, *America's Got Talent—Venture Capital Needs to Find It*, THIRD WAY (Feb. 16, 2017), https://www.thirdway.org/report/americas-got-talent-venture-capital-needs-to-find-it (explaining how "[a]ccess to capital is critical for . . . productivity increases that drive long-term growth in the economy.").

[63] Editorial Team, *Venture Capital: Fueling Innovation in the Tech Industry*, CEO HANGOUT (May 26, 2023), https://ceohangout.com/venture-capital-fueling-innovation-in-the-tech-industry/.

III. REGULATORY LANDSCAPE: A COMPLEX TAPESTRY

To look at the overall growth and success of the VC market requires a complete understanding of the regulatory framework that shapes and constrains the early-stage funding process. The Securities Act of 1933 (the "Securities Act") is at the very root of securities exemptions.[64] The purpose of the Securities Act is to (1) provide potential investors with sufficient information to allow them to make a well-informed decision before investing and (2) prevent fraudulent offerings from occurring.[65] The Securities Act's definition of a "security" is expansive,[66] so nearly any method by which a startup plans to raise capital will involve offering a security through issuing company stock. Under Section 5 of the Securities Act, any offer or sale of a security must either be registered with the SEC or fall within an applicable exemption.[67] The objective of the SEC is to carry out the Securities Act's purpose and take enforcement actions against companies that fail to follow the requirements concerning securities.[68] It is important to note that even if a securities is exempt under Section 5, it is still subject to the "anti-fraud" provisions set forth in the Securities Exchange Act of 1934.[69] Generally, these anti-fraud provisions prohibit any company from making material misstatements concerning an offering or sale of its securities.[70]

---

[64] 15 U.S.C. § 77a.

[65] *See* Preamble of the Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified at 15 U.S.C. §§ 77a–77aa (2018)) ("An Act to provide full and fair disclosure of the character of securities sold in interstate . . . commerce . . . and to prevent frauds. . . .").

[66] 15 U.S.C. § 77b ("The term 'security' means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.").

[67] 15 U.S.C. §§ 77d, 77e.

[68] *See Our Goals*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/our-goals (last modified Apr. 6, 2023) [hereinafter *SEC Goals*] ("The SEC's long-standing three-part mission—to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation—remains its touchstone."); *see also* 15 U.S.C. § 77s(a) (highlighting the SEC's broad rulemaking power); *Investor Bulletin: An Introduction to The U.S. Securities and Exchange Commission – Rulemaking and Laws*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_rulemaking (last modified Feb. 6, 2017).

[69] 15 U.S.C. § 77l(a)(2).

[70] Of the most widely used antifraud provisions is Rule 10b-5 under the Securities Exchange Act of 1934. *See* 17 C.F.R. § 240.10b-5; *see also* 15 U.S.C. § 78j(b).

If a securities offering must register with the SEC, rest assured that the process will be costly and laborious.[71] Making a "public offering" is generally burdensome because of the unneeded legal costs that go into an IPO, which is why most startups utilize the SEC exemptions.[72] The public offering process usually commences when a startup files a Form S-1 with the SEC, commonly referred to as the "registration statement."[73] The first part of the registration statement is a legal form called the "prospectus."[74] A prospectus typically includes information regarding the "business operations, the use of proceeds, total proceeds, the price per share, a description of management, financial condition, the percentage of the business being sold by individual holders and information on the underwriters."[75]

In the past, the typical IPO process could last anywhere from three to six months.[76] Now, a company can expect the IPO process to take anywhere from several months to over a year.[77] During the IPO process, a startup typically hires multiple investment banks who act as the "underwriters."[78] Underwriters can charge anywhere from 5% to 7% of the offering, but the price can vary depending on other factors affecting the offering.[79] Aside from underwriter fees, a startup's legal and accounting fees are similarly remarkable. Several factors can contribute to the cost of legal fees, but a startup can expect to spend anywhere from $500,000 to $1 million.[80]

In contrast to a public offering, a securities offering exempt from SEC registration requirements is often called a "private placement" or a "private offering."[81] Due to substantial requirements and costs associated with public

---

[71] Justin Lurie et al., *Securities Law for Entrepreneurs*, GROWTH STUDIO (Oct. 1, 2020), https://growthstudio.crowell.com/securities-law-for-entrepreneurs/.

[72] *Id.*

[73] *Id.*; 17 C.F.R. § 239.11.

[74] *See* 15 U.S.C. § 77j.

[75] Will Kenton, *SEC Form S-1: What It Is, How to File It or Amend It*, INVESTOPEDIA, https://www.investopedia.com/terms/s/sec-form-s-1.asp (last updated Mar. 21, 2022) (summarizing the information included under 15 U.S.C. § 77eee).

[76] Sophia Kunthara, *Want to Take Your Startup Public? What It Actually Costs to IPO*, CRUNCHBASE NEWS (Nov. 4, 2020), https://news.crunchbase.com/public/want-to-take-your-startup-public-heres-what-it-actually-costs-to-ipo/.

[77] *What Is an IPO?*, CARTA (Mar. 2, 2023), https://carta.com/blog/initial-public-offering/.

[78] *Id.*

[79] Caleb Christensen, *The Costs of Going Public*, IPOHUB (Mar. 27, 2018), https://www.ipohub.org/article/costs-going-public.

[80] *See e.g.*, Brayden Call, *Legal's Role in an IPO*, IPOHUB (Feb. 17, 2022), https://www.ipohub.org/article/legals-role-in-an-ipo; Patricia Ntiamoah, *2020 IPO Accounting and Legal Fees*, IDEAGEN (Feb. 9, 2021, 12:43 PM), https://blog.auditanalytics.com/2020-ipo-accounting-and-legal-fees/; *Ten Things to Think About Before Making an Initial Public Offering*, FINDLAW, https://www.findlaw.com/smallbusiness/business-finances/ten-things-to-think-about-before-making-an-initial-public.html (last modified Sept. 26, 2022).

[81] *See Private Placements – Rule 506(b)*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/education/smallbusiness/exemptofferings/rule506b (last modified Apr. 6, 2023) [hereinafter *Private Placements*].

offerings, many startups opt to raise capital by utilizing the private market.[82] In 2022, for example, the value of the U.S. private capital market (roughly $268 billion) outpaced the IPO market (roughly $7 billion) by a wide margin.[83] The stark variation between the two numbers demonstrates how significant the impact the private market has on the U.S. economy.[84] However, the rapid growth of the private market may be viewed as an impediment to the public market.

Over the last decade, the U.S. public market has seen a trending decline in the number of IPOs per year.[85] Some suggest that the burdensome legal requirements that companies must comply with when attempting to register their securities contribute to this decline.[86] Others claim that market "volatility and policies undertaken to combat inflation" were among the several factors contributing to the stark decrease the U.S. market saw in 2022.[87] Regardless of the true reason for fewer IPOs in the United States, one thing is certain: The process is overly burdensome and costly for companies seeking to register their securities with the SEC. If the SEC wants more companies to IPO, then the process itself must simplified and expedited. Part III examines the SEC's regulation concerning registration requirements exemptions for securities offerings, focusing on Regulation D and Regulation CF.

A. Regulation D

To fully understand the reason behind the creation of Regulation D and Regulation CF, it is best to start with Section 4(a)(2). In the early stages of their startup's life, founders who

---

[82] *See* Mark Flickinger, *Venture Capital Fundamentals: Why VC Is a Driving Force of Innovation*, FORBES (Mar. 29, 2023, 3:50 PM), https://www.forbes.com/sites/markflickinger/2023/03/29/venture-capital-fundamentals-why-vc-is-a-driving-force-of-innovation/.

[83] *Is the Private Markets Boom Here to Stay?*, J.P. MORGAN (Feb. 16, 2023), https://www.jpmorgan.com/insights/banking/private-capital-markets/private-markets-outlook.

[84] *See* Louis Lehot & Patrick Daugherty, *Looking at the Impact of Venture Capital and the Future of Technology Innovation*, LAW.COM (Aug. 10, 2023, 12:05 PM), https://www.law.com/legaltechnews/2023/08/10/looking-at-the-impact-of-venture-capital-and-the-future-of-technology-innovation/ ("[T]he US VC industry is causally responsible for the growth of one-fifth of the largest 300 US public companies, and three-quarters of the largest US VC-backed companies may not have existed or could not have achieved their current scale without an active VC industry.").

[85] *See e.g.*, Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 466–72 (2017) (arguing that the deregulation of private capital over the past few decades has played a role in the decline of equity capital raising in the public market); Giri Devanur, *The Current IPO Market: Factors in Its Decline and Reversing the Trend*, FORBES (Feb. 1, 2023, 10:00 AM), https://www.forbes.com/sites/forbesbusinesscouncil/2023/02/01/the-current-ipo-market-factors-in-its-decline-and-reversing-the-trend/.

[86] *See* Andrew N. Vollmer, *Investor-Friendly Securities Reform to Increase Economic Growth*, BLOOMBERG L. (June 2, 2017, 4:24 PM), https://news.bloomberglaw.com/securities-law/investor-friendly-securities-reform-to-increase-economic-growth.

[87] Lauren Mosery, *Global IPO Market Went from Record-Breaking to Full-On Abating*, EY (Dec. 15, 2022), https://www.ey.com/en_gl/news/2022/12/global-ipo-market-went-from-record-breaking-to-full-on-abating.

wish to issue common stock to themselves or friends and family typically rely on the Section 4(a)(2) exemption.[88] A Section 4(a)(2) exemption is limited to particular offerings without ensuring against having to register the security later on.[89] Moreover, Section 4(a)(2) offerings do not preempt "Blue Sky" laws, which are additional regulations imposed at the state level for intrastate securities offerings.[90] Under the Section 4(a)(2) exemption, any offer or sale by an issuer need not be registered with the SEC so long as it does not include anything that can be considered a "public offering."[91] Because the term "public offering" is not defined under the Securities Act, startups cannot be entirely certain that their offerings are, in fact, exempt under Section 4(a)(2).[92] This uncertainty led to the SEC's creation of Regulation D in 1982.[93]

Under Regulation D, the SEC provided three separate safe harbor rules applicable to Section 4(a)(2) private offering exemptions.[94] These safe harbor rules include Rule 504,[95] Rule 506(b),[96] and Rule 506(c).[97] Each safe harbor rule establishes specific threshold requirements that, if met, allow a startup to forego the registration process entirely.[98] Because the provisions are safe harbors to the Section 4(a)(2) exemption, they are non-exclusive.[99] In other words, even if a startup does not qualify for an exemption under Regulation D, its offering may nevertheless be exempt under Section 4(a)(2) due to its overly broad definition of a "public offering."[100] The safe harbor rules give an issuer more certainty, rather than attempting to comply with the SEC's complex registration requirements.[101] Despite this added clarity, the remaining limitations on these Regulation D exemptions are the real problem.

---

88 *See* 15 U.S.C. § 77d(a)(2); Adam Waks, *Securities Law for Startups*, DAVIS WRIGHT TREMAINE LLP (June 30, 2020), https://www.dwt.com/blogs/startup-law-blog/2020/06/securities-law-for-startups.

89 *See* 15 U.S.C. § 77d(a)(2). To qualify under Section 4(a)(2), an investor must be either sophisticated or able to bear the investment's economic risk, have access to prospectus-level information, and agree not to resell or distribute the securities publicly. *Private Placements*, *supra* note 81.

90 *See* 15 U.S.C. § 77d(a)(2); *Frequently Asked Questions About Exempt Offerings*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/education/smallbusiness/exemptofferings/faq (last modified Apr. 6, 2023) [hereinafter *SEC Frequent Questions*].

91 Jon T. Coffin et al., *What Is the Difference Between Section 4(a)(2) and Regulation D?*, JOHNSTON ALLISON HORD (Mar. 23, 2022), https://www.jahlaw.com/what-is-the-difference-between-section-4a2-and-regulation-d-news-and-events/.

92 *See* 15 U.S.C. § 77d(a)(2); *Private Placements*, *supra* note 81.

93 *See* 17 C.F.R. §§ 230.500–508; Revision of Certain Exemptions from Registration for Transactions Involving Limited Offers and Sales, 47 Fed. Reg. 11,251, 11,252, 11,262 (Mar. 16, 1982).

94 *See* 17 C.F.R. §§ 230.504, 230.506(b), 230.506(c).

95 17 C.F.R. § 230.504.

96 17 C.F.R. § 230.506(b).

97 17 C.F.R. § 230.506(c).

98 *See* 17 C.F.R. §§ 230.504, 230.506(b), 230.506(c).

99 Elliot Weiss, *Understanding Regulation D of the Securities Act: A Summary Guide for Company Management*, MICHELMAN & ROBINSON, LLP (Sept. 5, 2023), https://www.mrllp.com/understanding-regulation-d-of-the-securities-act-a-summary-guide-for-company-management/.

100 *Id.*; 15 U.S.C. § 77d(a)(2).

101 Hamilton & Associates, *Regulation D Rule 504, Rule 506(b), Rule 506(c) Offering Exemptions*, SEC. LAW. 101, https://www.securitieslawyer101.com/2023/regulation-d-rule-504-rule-506b-rule-506c-offering-exemptions/ (last visited Oct. 27, 2023).

To recognize the distinction between the various exemptions and their limitations, a proper understanding of how the Securities Act differentiates between an "accredited investor" and a "non-accredited investor" is required.[102] An accredited investor, as defined in Regulation D Rule 501, essentially means an investor with financial sophistication and capacity to assess the risks of the private offering.[103] Rule 501 provides a list of 13 different categories in which an individual may fall to be considered an accredited investor.[104] The SEC effectively bases the qualification of an accredited investor on an individual's wealth, income, or licensure.[105]

An individual qualifies as an accredited investor if he or she has a net worth of at least $1 million, individually or with a spouse.[106] In 2010, the Dodd-Frank Act instructed the SEC to exclude a person's primary residence when calculating a person's net worth.[107] Moreover, an individual may qualify as an accredited investor if he or she has an income of at least $200,000 (individually) or $300,000 (with a spouse) in each of the prior two years and reasonably anticipates receiving the same for the current year.[108] The SEC then attempted to modernize the accredited investor status by expanding the definition to include certain professionals with any listed financial licenses proscribed by the SEC.[109] Even with this attempt, roughly 15% of households nationwide qualify as accredited

---

102 *See* 17 C.F.R. § 230.501(a).

103 *See id.*; *SEC Frequent Questions*, *supra* note 90.

104 17 C.F.R. §§ 230.215, 230.501(a). *See* THOMAS LEE HAZEN & KRIS MARKARIAN, FEDERAL SECURITIES LAW n.275 (4th ed. 2022) 2022 WL 2253214 ("(1) banks, brokerage firms, insurance companies, investment companies, and specified employee benefit plans, (2) private business development companies, (3) charitable or educational institutions with assets of more than $5 million, (4) any of the issuer's directors, executive officers, or general partners, (5) any natural person with a net worth of more than $1 million, (6) natural persons with an annual income of more than $200,000 (or, together with his or her spouse or spousal equivalent, more than $300,000), (7) trusts with more than $5 million in assets which is managed by a 'sophisticated person,' (8) any entity in which all of the owners are accredited investors, (9) an entity not formed for the purpose of the securities offered owning more than $5 million in investments, (10) anyone in good standing with professional certifications approved by the SEC, (11) knowledgeable employees of the issuer as defined in Investment Company Act of 1940 Rule 3c-5(a)(4), (12) family offices with more than $5 million under management, and (13) any 'family client,' as defined in Investment Advisers Act of 1940 Rule 202(a)(11)(G)-1.").

105 *See Accredited Investor*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/education/capitalraising/building-blocks/accredited-investor (last modified July 12, 2023).

106 17 C.F.R. § 230.501(a)(5); *"Accredited Investor" Net Worth Standard*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/info/smallbus/secg/accredited-investor-net-worth-standard-secg#_ftn1 (last modified Feb. 27, 2012).

107 *See* Net Worth Standard for Accredited Investors, Securities Act Release No. 33-9287, 2011 WL 6415435 (Feb. 27, 2012); Press Release, U.S. Sec. & Exch. Comm'n, SEC Adopts Net Worth Standard for Accredited Investors Under Dodd-Frank Act (Dec. 21, 2011), https://www.sec.gov/news/press/2011/2011-274.htm (last updated Dec. 21, 2011).

108 17 C.F.R. § 230.501(a)(6).

109 SEC. & EXCH. COMM'N, ACCREDITED INVESTOR DEFINITION, Release No. 33-10824, 85 Fed. Reg. 64234 (Oct. 9, 2020) (codified at 17 C.F.R. pts. 230 & 240).

investors.[110] If an individual fails to qualify as an accredited investor, he or she will be deemed a non-accredited investor.[111]

1. Rule 504

Rule 504 was a promising avenue for startups to secure capital without the burden of SEC registration, at least initially.[112] However, it is quite evident that the rule's significant limitations hinder its effectiveness.[113] At its core, Rule 504 allows a startup to offer its securities to both accredited and non-accredited investors.[114] The intent behind Rule 504 was to provide an avenue for smaller companies to access "seed capital" without registering their securities with the SEC.[115] Originally, the exemption allowed a startup to raise a whopping $1 million.[116] The SEC currently limits the capital raised to $10 million within a 12-month period.[117]

Following its original intent, Rule 504 is precious for early-stage startups that lack the financial ability to follow the extensive regulatory requirements imposed by the SEC.[118] Admittedly, Rule 504 can open doors for a broader pool of potential investors, allowing early-stage startups to receive investments from accredited and non-accredited investors.[119] By not restricting who can participate in this type of offering, Rule 504 seems to be a relatively democratizing approach to providing startups with access to capital from whoever is willing to invest. However, there are significant drawbacks to the exemption that render its use out-of-date compared to other Regulation D exemptions.[120]

Despite its merits, Rule 504 grapples with inherent limitations that dampen its efficacy, especially for startups with ambitious growth plans.[121] The most glaring

---

[110] PK, *How Many Accredited Investors Are There in America?*, DQYDJ (Oct. 20, 2023), https://dqydj.com/accredited-investors-in-america/ (estimating that, "in 2023 there were 19,444,975 accredited investor households in America.").

[111] *See* 17 C.F.R. § 230.506(c).

[112] *See* 17 C.F.R. § 230.504.

[113] *See id.*

[114] 17 C.F.R. § 230.504(b)(2).

[115] *See* Revision of Rule 504 of Regulation D, the "Seed Capital" Exemption, Securities Act Release No. 7541, 63 Fed. Reg. 29,168, 29,169 (May 28, 1998); Carol M. Kopp, *Seed Capital: What It Is, How It Works, Example*, INVESTOPEDIA, https://www.investopedia.com/terms/s/seedcapital.asp (last updated May 24, 2022) ("Seed capital is the money raised to begin developing an idea for a business or a new product.").

[116] 17 C.F.R. § 230.504(b)(2) (1999) ($1 million cap), *amended by* 17 C.F.R. § 230.504(b)(2) (2016) ($5 million cap). The cap was again raised to $10 million in 2020, which is current as of 2023. 17 C.F.R. § 230.504(b)(2) (2020).

[117] 17 C.F.R. § 230.504(b)(2).

[118] *See* Zachary A. Bruchmiller, *Navigating the Private Offering Exemptions: A Guide for Practitioners*, 46 No. 1 SEC. REGUL. L.J. (Spr. 2018).

[119] *See id.*; 17 C.F.R. § 230.504(b).

[120] *See* Chris Stewart, *Rule 504: What You Need to Know*, THINKING BIGGER (Aug. 30, 2017), https://ithinkbigger.com/rule-504-need-know/.

[121] *Id.*

constraint is the cap on the amount a startup can raise.[122] While understandably intended to mitigate risk, this cap serves as a significant barrier for startups that aspire to scale rapidly. Because no startup is the same, some may be in a sector that requires a substantial amount of capital upfront, such as technology or biotech, whereas others may not.[123] The cap on Rule 504 can be a fatal barrier for a promising startup with high potential.[124] The very essence of early-stage startups is often rooted in innovative ideas and exponential growth aspirations, with the cap serving as a blatant restriction on their potential.[125]

Moreover, Rule 504 operates within the broader context of states' Blue Sky laws, adding yet another layer of complexity to the capital-raising process.[126] The process is complex because Rule 504 exemptions do not preempt Blue Sky laws.[127] Complying with the various state-level requirements and filings prevents startups from utilizing Rule 504.[128] While the bare federal exemption offers a certain degree of certainty, the idiosyncrasies of state regulations require startups to seek counsel that understands each jurisdiction's requirements.[129] This results in startups finding themselves in a maze of rules governing securities offerings, investor qualifications, and filing requirements.[130]

This intricate dance between federal and state regulations underscores the need for a more harmonized approach. In fact, some call for an outright preemption of Blue Sky laws.[131] Preemption would result in a more streamlined framework that aligns state-level requirements with federal exemptions and could significantly alleviate the compliance burden on startups.[132] Such an attitude would simplify the regulatory landscape and revive the effectiveness of Rule 504 as a viable avenue

---

[122] *See* 17 C.F.R. § 230.504(b)(2).

[123] *See* Lehot & Daugherty, *supra* note 84.

[124] *See* Lehot & Daugherty, *supra* note 84.

[125] *See* Simon Kleinert, *The Promise of New Ventures' Growth Ambitions in Early-Stage Funding: On the Crossroads Between Cheap Talk and Credible Signals*, SAGE J. (Apr. 12, 2023), https://journals.sagepub.com/doi/10.1177/10422587231164750?icid=int.sj-abstract.citing-articles.3#bibr88-10422587231164750.

[126] *See Exemption for limited offerings not exceeding $10 million—Rule 504 of Regulation D*, U.S. SEC. & EXCH. COMM'N (Apr. 6, 2023), https://www.sec.gov/education/smallbusiness/exemptofferings/rule504.

[127] Allen C. Page, *Approaching the Tipping Point for "Public-Private Offerings": The Current Trajectory of Rule 506(c)*, 17 J. BUS. & TECH. L. 27, 31 (2022).

[128] Tilden Moschetti, *Rule 504 of Reg D – The Former Heavyweight Syndication Champ*, MOSCHETTI SYNDICATION L. GRP., https://www.moschettilaw.com/rule-504-of-reg-d/ (last visited Nov. 4, 2023).

[129] Page, *supra* note 127.

[130] *See* Moschetti, *supra* note 128.

[131] Rutherford Campbell, *The Case for Federal Preemption of State Blue Sky Laws*, HERITAGE FOUND. (Feb. 28, 2017), https://www.heritage.org/markets-and-finance/report/the-case-federal-pre-emption-state-blue-sky-laws (calling for "[t]he federal government [to] completely pre-empt state authority over the registration of securities.").

[132] *Id.*

for early-stage capital raising.[133] For revivification to occur, the cap on raised capital must be reconsidered, especially in recognition of the diverse funding needs of startups across different industries.[134] Otherwise, Rule 504 will become even more obsolete than it already is.

2. Rule 506(b)

According to the SEC, Rule 506 exemptions are by far the most widely used exemptions in the United States.[135] These exemptions supposedly account for roughly 95% of all securities exemptions.[136] From July 2021 to July 2022, Rule 506(b) alone raised roughly $2.3 trillion, a significantly greater amount than all registered offerings, which yielded $1.2 trillion.[137] Again, Rule 506 contains two parts: Rule 506(b) and Rule 506(c).[138] This two-part split of Rule 506 came as a result of the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act").[139] As this section delves into the nuances of this widely utilized exemption, separating accredited and non-accredited investors arises, sparking a conversation about fairness and democratization in the securities market.

At the forefront of all securities exemptions stands Rule 506(b), which serves as a pivotal exemption under Regulation D, offering both opportunities and challenges.[140] Rule 506(b) extends a vital lifeline to startups by allowing the sale and offer of securities to a broad spectrum of investors.[141] This rule grants startups significant flexibility to engage with unlimited accredited investors and up to 35 non-accredited investors, providing startups with a diversified pool of potential

---

[133] *See id.*

[134] *See* Sarath, *Top Industries/Sectors That Received VC Funding*, EQVISTA (June 25, 2023), https://eqvista.com/industries-sectors-received-vc-funding/ (discussing the various industries in which VC firms invest in most often).

[135] *The Most Common Exemption – Regulation D Rule 506*, CAP. FUND L. GRP. (May 3, 2023), https://www.capitalfundlaw.com/blog/2015/04/05/the-most-common-exemptionregulation-d-rule-506 [hereinafter *Rule 506*].

[136] Gilbert J. Bradshaw, et. al., *Finders But Not Keepers: The Regulation of Unlicensed Finders in Small Private Capital Raises*, 19 N.Y.U. J.L. & BUS. 137, 168 (2022) ("In 2018, the amount raised by Rule 506(b) offerings was $1.5 trillion, much larger than the $1.4 trillion raised through registered offerings."); *See* Scott Bauguess et al., U.S. Sec. & Exch. Comm'n, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017*, at 9 (2018), https://www.sec.gov/files/dera-white-paper_regulation-d_082018.pdf (highlighting how 37,785 of the 41,101 total private offerings in 2017 were conducted using Regulation D).

[137] Press Release, U.S. Sec. & Exch. Comm'n, 2022-229, SEC Small Business Advocacy Office Releases Annual Report on Capital Raising (Dec. 16, 2022), https://www.sec.gov/news/press-release/2022-229; Off. Advoc. for Small Bus. Cap. FORMATION, U.S. SEC. & EXCH. COMM'N, Ann. Rep. for Fiscal Year 2022, at 13 (2022), https://www.sec.gov/files/2022-oasb-annual-report.pdf.

[138] *See* 17 C.F.R. §§ 230.506(b)-(c).

[139] Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012) (codified as amended in scattered sections of 15 U.S.C.).

[140] *See* 17 C.F.R. § 230.506(b) (2021).

[141] *See id.*

backers.[142] Accredited investors benefit from being excluded from the requirements accompanying non-accredited investor status, which requires the non-accredited investor have "sufficient knowledge and experience" before investing.[143] On the contrary, investors who invest under the Rule 506(b) exemption may self-certify that they are, in fact, accredited investors.[144] An investor can achieve this by completing the startup's accredited investor questionnaire.[145]

For a non-accredited investor who participates in a Rule 506(b) offering, a startup must ensure that he or she is a "sophisticated investor."[146] According to the SEC, a sophisticated investor has "sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment."[147] One may view the inclusion of non-accredited investors as a tacit admission that sound investment decisions do not always correlate with wealth or income. For all non-accredited investors, a startup must disclose various financial documents and be available to respond to questions from prospective purchasers with non-accredited investor status.[148] Additionally, a startup is restricted from conducting any "general solicitation," which means they can't publicly advertise their securities.[149]

3. Rule 506(c)

Rule 506(c) similarly allows a startup to raise an unlimited amount of capital without registering its securities offerings with the SEC.[150] Startups tend to utilize Rule 506(c) less frequently than Rule 506(b), partly because of the verification steps that issuers must take.[151] In contrast to Rule 506(b), Rule 506(c) permits general solicitation, enabling startups to publicly advertise for capital.[152] However, this comes with a caveat—only accredited investors are eligible to participate in

---

142 *See id.*
143 *See id.*; *Private Placements*, *supra* note 81; *see also* Rebecca Baldridge & Benjamin Curry, *How to Become an Accredited Investor*, FORBES ADVISOR (Mar. 15, 2022, 8:28 AM), https://www.forbes.com/advisor/investing/how-to-become-accredited-investor/.
144 Weiss, *supra* note 99.
145 Weiss, *supra* note 99.
146 *See Private Placements*, *supra* note 81; 17 C.F.R. § 230.501(i)(2).
147 *Private Placements*, *supra* note 81.
148 *Private Placements*, *supra* note 81; 17 C.F.R. §§ 230.502, 230.506(b).
149 *See* 17 C.F.R. § 230.506(d).
150 *See* 17 C.F.R. § 230.506(c).
151 *See* Jennifer J. Schulp, *Sophistication or Discrimination? How the Accredited Investor Definition Unfairly Limits Investment Access for the Non-wealthy and the Need for Reform*, CATO INST. (Feb. 8, 2023), https://www.cato.org/testimony/sophistication-or-discrimination-how-accredited-investor-definition-unfairly-limits; *see also* Page, *supra* note 127, at 34 (explaining how Rule 506(c) mandates verification of accredited investor status, in contrast to Rule 506(b), which lacks such a requirement).
152 17 C.F.R. § 230.506(c).

the offering.[153] While Rule 506(c) expands the reach of startup funding, it does little to address the issue of greater access by limiting the pool of potential investors.[154]

B. Regulation Crowdfunding

Regulation Crowdfunding (CF) is a relatively newer exemption that went into effect in 2016 as part of the JOBS Act with promise for startups.[155] "Crowdfunding" is a method by which startups use the internet and social media platforms to raise capital, which usually allows for a wide range of potential investors who contribute nominal amounts.[156] Under Rule 204 of Regulation CF, an issuer is prohibited from advertising its offering unless it merely directs an investor to the intermediary's platform and limits the information given.[157] The original idea behind Regulation CF expanded into a lengthy exemption, which compels a "funding portal" intermediary or broker-dealer to provide investors with educational material and demonstrate a baseline understanding of the relevant investment risk.[158] These intermediaries must register with the SEC and Financial Industry Regulatory Authority (FINRA).[159]

CF enables early-stage startups that may not have readily available access to the traditional methods of capital to raise capital through an online CF platform.[160] The JOBS Act amended the Securities Act by creating an entirely new Section 4(a)(6) and prompting the SEC to enact necessary or appropriate rules to protect investors.[161] As a result, Regulation CF includes disclosure requirements for startups, typically included in a Form C filing with the SEC.[162] Startups use Form C in connection with the offering statement, intended to assist potential investors with making an educated decision before investing in the startup.[163] The information on this form includes the physical address of the issuer and the

---

[153] *Id.*
[154] *See id.*
[155] Jumpstart Our Business Startups Act, Pub. L. No. 112-106, § 302(c), 126 Stat. 306, 320 (2012) (codified at 15 U.S.C. § 77d).
[156] *See* Tim Smith, *Crowdfunding: What It Is, How It Works, and Popular Websites*, INVESTOPEDIA, https://www.investopedia.com/terms/c/crowdfunding.asp (last updated Oct. 6, 2023).
[157] *See* 17 C.F.R. § 227.204.
[158] *See* 15 U.S.C. § 77d(a)(6) (2015); 17 C.F.R. § 227.300(c)(2).
[159] *Updated Investor Bulletin: Regulation Crowdfunding for Investors*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/oiea/investor-alerts-bulletins/ib-crowdfunding (Dec. 7, 2023).
[160] *See* Smith, *supra* note 156 (listing some of the most popular CF platforms, such as Kickstarter, Indiegogo, and GoFundMe).
[161] *See* 15 U.S.C. § 77d(a)(6) (2012); *Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/info/smallbus/secg/rccomplianceguide -051316#_ftnref2 (Apr. 5, 2017).
[162] *See* 17 C.F.R. § 227.203(a).
[163] *Id.*

intermediary chosen for the campaign, specific details of the offering, and other basic financial information relating to the issuer.[164]

At its core, CF platforms are flexible because they allow startups to raise capital from both accredited and non-accredited investors.[165] Although non-accredited investors can invest, there are limits placed on their investments.[166] If a non-accredited investor has an annual income or net worth less than $124,000, then he or she is limited to investing the greater of $2,500 and 5% of the greater of the investor's annual income and net worth.[167] If a non-accredited investor has an annual income and net worth of at least $124,000, then he or she is limited to investing 10% of the greater of the investor's annual income and net worth.[168] Another notable amendment to Regulation CF is that it allows a startup to "test the waters," meaning it can reach out to potential investors before filing with the SEC to determine the level of investor interest.[169] Despite these admitted benefits, the frequent changes of the securities exemptions, even to protect investors and preserve market integrity, will occasionally hinder further innovation as demonstrated below.[170] Of course, the challenge lies in crafting a regulatory landscape that safeguards against fraud or misrepresentation while fostering an environment where innovation can thrive.

IV. COMPLIANCE BURDENS ON EARLY-STAGE STARTUPS

Oftentimes, early-stage startups struggle to keep up with the overcomplicated exemption requirements and the costs associated with compliance.[171] The significant problem is that several companies expected to advance innovation were once early-stage startups.[172] After examining the SEC's requirements for securities offerings and registration exemptions, it's not difficult to see how these challenges weigh heavily on the shoulders of startups in their quest to raise capital. However, avoiding this problem is possible, or at least alleviating it. This Part scrutinizes the specific challenges faced by startups, shedding light on the advantages and disadvantages of disclosure requirements, the elusive nature of CF guidance, and how the SEC can better balance encouraging innovative growth and investor protection.

---

164 *See id.*
165 *See* 17 C.F.R. § 227.100.
166 *See* 17 C.F.R. § 227.100(a)(2).
167 *Id.*
168 *Id.*
169 17 C.F.R. § 227.206.
170 *See* Stephanie Avakian, *Protecting Everyday Investors and Preserving Market Integrity: The SEC's Division of Enforcement*, U.S. SEC. & EXCH. COMM'N (Sept. 17, 2020), https://www.sec.gov/news/speech/avakian-protecting-everyday-investors-091720.
171 *See* Vollmer, *supra* note 86.
172 Ian Schaeffer, *Private Market Growth and Innovation Have Only Just Begun*, J.P. MORGAN (May 16, 2023), https://privatebank.jpmorgan.com/gl/en/insights/investing/private-market-growth-and-innovation-have-only-just-begun.

A. Disclosing the Future: Examination of Disclosure Requirements

It is important to acknowledge that transparency is the bedrock of a healthy VC market; this is at the root of the Securities Act.[173] While the purpose of disclosure requirements is noble—to provide investors with the information they need to make informed decisions—the increase in information a startup must provide an investor has trampled the original purpose of the disclosure requirements.[174] Early-stage startups, by their very nature, operate in an environment of uncertainty.[175] They are attempting to explore uncharted territories, and their success hinges on the ability to adapt and pivot rapidly.[176] The SEC must remember that, unlike private equity, VC firms take on the highest risks when investing in an early-stage startup.[177]

The rigid disclosure requirements for Regulation D and Regulation CF may, in fact, cause startups to reveal sensitive information that competitors can use to the startup's disadvantage.[178] The fear of complying with the extensive disclosure requirements can deter a startup from going public until it becomes absolutely necessary, thus providing no incentive for a startup to expand its growth with an IPO.[179] For example, SEC Commissioner Caroline Crenshaw suggested that startups utilizing the Regulation D securities exemptions could soon be required to disclose even more than what is currently required.[180] The Commissioner went on to use the FTX fraud scandal to support her argument that the Regulation D securities exemptions commonly used by unicorns may need reform.[181] The Commissioner neglected to consider that anti-fraud statutes are already in place on both the state and federal levels.[182] A few bad actors shouldn't bar others from

---

[173] *See SEC Goals*, *supra* note 68.
[174] *See SEC Goals*, *supra* note 68.
[175] Manav Garg, *Reframing Governance as a Lever for Startup Growth and Value Creation*, SAASBOOMI (July 10, 2023), https://saasboomi.org/reframing-governance-as-a-lever-for-startup-growth-and-value-creation/; *Best Practices from six founders: How Startups Can Navigate Today's Economy*, STRIPE, https://stripe.com/guides/navigating-economic-uncertainty-for-startups (last updated Nov. 7, 2023).
[176] *OpenRotation in Startups: Accelerating Success through Agile Leadership*, FASTERCAPITAL, https://fastercapital.com/content/OpenRotation-in-Startups—Accelerating-Success-through-Agile-Leadership.html (last updated Oct. 2, 2023).
[177] Chris Mentiko, *Venture World Watches As SEC Moves To Regulate Industry*, CRUNCHBASE NEWS (Feb. 9, 2023), https://news.crunchbase.com/policy-regulation/venture-sec-regulations-web3-ftx/.
[178] *See* Anthony Cimino & Holli Heiles Pandol, *Why the startup sector should keep its eye on the SEC*, TECHCRUNCH (Apr. 9, 2023, 4:30 AM), https://techcrunch.com/2023/04/09/why-the-startup-sector-should-keep-its-eye-on-the-sec/.
[179] *See* Knight, *supra* note 37.
[180] Crenshaw, *supra* note 5.
[181] Crenshaw, *supra* note 5. ("But, there are consequences to allowing issuers to grow so large without any of the requirements of registration.").
[182] *See ,e.g.*, CAL. CORP. CODE § 25401 (West 2016) (California); FLA. STAT. § 517.301 (2021) (Florida); N.Y. GEN. BUS. LAW §§ 352, 353 (McKinney 2021) (New York); TEX. REV. CIV. STAT.

receiving the benefits of Regulation 506. Regardless, uncertainty looms in the realm of exempt offerings, especially those most commonly used.[183]

Additionally, it is often not worth it for startups to meet disclosure requirements. The SEC requires extensive filings, including financial statements, business plans, and executive summaries, among other documents.[184] Even offerings that utilize a federal securities exemption, which, depending on the type of exemption, will often preempt state securities laws, may still be subject to state Blue Sky laws that require Form D filings and fees.[185] Whereas a Rule 506(b) exempt offering requires filing a Form D with the SEC, a Section 4(a)(2) private placement exemption does not.[186] If a startup relies on Section 4(a)(2), then that startup must follow the relevant state's Blue Sky laws since Section 4(a)(2) does not preempt state securities laws.[187] So, instead of filing a Form D with the SEC, the startup will be forced to follow each Blue Sky law where a startup makes an offering. Because each state has its own Blue Sky laws, the registration fees, required disclosures, deadlines, and even the definition of a "security" can vary significantly.[188] Following each state's Blue Sky laws and thus spending more on legal and filing fees can be fatal to a young startup with limited resources.[189]

Although filing a Form D is not, itself, complicated or costly, there are a few reasons why a startup may decide to forgo filing at all. One reason is to avoid the recognition that can come from these filings. This can be desirable for a startup since "the importance of getting big fast has increased over time due to an increase in the speed of technological innovation in many industries, with profitable growth opportunities potentially lost if they are not quickly seized."[190] Second, the knowledge that a startup has filed a Form D can have significant consequences, as it signals to the market that the startup is securing funding. Competitors can adjust their business strategy in response to this new information.[191] Such adjustments can negatively impact the compliant startup while exposing it to litigation from

---

ANN. art. 581-33-1 (West 2021) (Texas); 17 C.F.R. § 240.10b-5 (2011) (Federal); 15 U.S.C. § 77q (2010).

[183] *See Rule 506*, *supra* note 135.

[184] *See e.g.*, 15 U.S.C. §§ 78m, 78o(d).

[185] *SEC Frequent Questions*, *supra* note 90.

[186] *See* 17 C.F.R. § 239.500.

[187] Waks, *supra* note 88.

[188] LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 93 (4th ed. 2004) (arguing that securities law statutes are merely a "scheme of involuted drafting" that fails to "facilitate comprehensibility.").

[189] *See* Megan Hernbroth, *Startup Founders Need to Distance Themselves from Big Tech, According to the CEO of Famed Startup Accelerator Y Combinator*, BUS. INSIDER (Aug. 15, 2019, 7:38 PM), https://www.businessinsider.com/y-combinator-michael-seibel-startups-distance-themselves-google-facebook-2019-8.

[190] Kathleen Weiss Hanley & Qianqian Yu, *Strategic Regulatory Non-Disclosure: The Case of the Missing Form D*, SSRN (Feb. 18, 2023), https://www.brettonwoodsskiconference.com/uploads/b/f9bfc8b0-0251-11ed-a646-3dea17112d2f/Hanley_Yu_SSRN_02182023.pdf; Xiaohui Gao et. al., *Where Have All the IPOs Gone?*, 48 J. FIN. & QUANTITATIVE ANALYSIS 1663, 1664 (2013).

[191] *See* Hanley & Yu, *supra* note 190.

patent trolls, for example, since money is presumed to be flowing into the company.[192]

It is reasonable to suggest that IPO disclosure requirements may prevent startups from rapid growth. For example, SEC Chairman Jay Clayton implied that increased disclosure requirements may contribute to fewer IPOs by startups.[193] Such a claim finds support in the sheer complexity of the regulatory requirements that a startup utilizes.[194] Another drawback to the IPO process is the restriction on communication. More specifically, Section 5(c) prohibits a startup from making any "offer" to sell securities, and Section 2(a)(3) defines "offer" as all communications that may condition the market for the sale of the securities.[195] As a result, the SEC could hypothetically find a founder's statement describing the startup's anticipated growth to be an inappropriate condition of the market.[196] In any event, companies that pursue IPOs frequently experience lower market valuations, raising less money for expected growth than VC-backed startups.[197]

Furthermore, the justifications for heightened regulation of the private market lack any basis.[198] It is meritless to argue that increased regulations on the private

---

[192] *See* Hanley & Yu, *supra* note 190.

[193] Andrew Hartnett, *Why Are IPOs Less Frequent? Do Public Companies Have to Disclose Too Much Information?*, GREENSFELDER (July 2017), https://www.greensfelder.com/newsroom-publications-why-are-IPOs-less-frequent-Hartnett.html ("[W]ithout explicitly saying, 'More companies would go public if we didn't subject public companies to such burdensome disclosure costs,' [the SEC Chairman] suggested as much."). *See* Jay Clayton, Chairman, U.S. Sec. & Exch. Comm'n, Remarks at the Economic Club of New York, (July 12, 2017), https://www.sec.gov/news/speech/remarks-economic-club-new-york.

[194] *See* Vollmer, *supra* note 86 (explaining how, under the current rules, "[s]ome written communications are permitted; some are not; some must have warnings or be accompanied by the SEC filing; some do not; some must be filed with the SEC; some do not. The legal restrictions are so convoluted that even well-intentioned and well-advised companies such as Google and Groupon tripped over them.").

[195] *See* 15 U.S.C. §§ 77b, 77e.

[196] Capital Markets Practice Group, *Dissemination of Information During the Initial Public Offering Process*, GIBSON DUNN, https://www.gibsondunn.com/wp-content/uploads/2019/11/CAP-Dissemination-of-Information-During-the-IPO-Process.pdf (last visited Nov. 7, 2023).

[197] *See* James Comtois, *Public Markets Reject IPO Valuations Set by VC, Investment Banks*, YAHOO! FIN. (Mar. 21, 2022), https://finance.yahoo.com/news/public-markets-reject-ipo-valuations-164425499.html.

[198] *See e.g.*, Fontenay, *supra* note 85, at 489–90 (arguing that the deregulation of private capital exacerbated the spillover issues, with more companies staying private to avoid disclosure, ultimately harming public companies); Tyler Gellasch et. al., *How Exemptions from Securities Laws Put Investors and the Economy at Risk*, Cap 20 (Mar. 22, 2023), https://www.americanprogress.org/article/how-exemptions-from-securities-laws-put-investors-and-the-economy-at-risk/ (advocating for Congress to amend the Securities Act to force large companies to go public); Allison Herren Lee, Comm'r, U.S. Sec. Exch. Comm'n, *Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy* (Oct. 12, 2021), https://www.sec.gov/news/speech/lee-sec-speaks-2021-10-12 (explaining how it is the SEC's responsibility to address the opacity in the private market, suggesting SEC is needed to increase transparency).

market will provide a correlative benefit to the investors.[199] Even if it were proven that extensive disclosure requirements did, in fact, provide a significant benefit to investors, how often does the average investor actually read them in full before investing in a public market?[200] The answer is a small fraction, presumably because of the significant amount of reading required.[201] Most investors will at least briefly review the reports, but due to the increased regulations surrounding disclosure requirements, most reports overinform potential and current investors.[202] In fact, in 2020, the average length for a mutual funds report sat at roughly 134 pages long, with some totaling over 1,000 pages long.[203] Ultimately, the question becomes whether a disclosure should be shorter with less information but more investors reading it or longer with more information but fewer investors reading it.[204]

To add to the problem, states continue to enact laws requiring increased disclosure requirements that could negatively impact the VC market.[205] For example, California Governor Gavin Newsom signed into law Senate Bill 54,

---

[199] *See e.g.*, H. David Sherman & S. David Young, *Where Financial Reporting Still Falls Short*, HARV. BUS. REV., July–Aug., at 76; J. Harold Mulherin, *Measuring the Costs and Benefits of Regulation: Conceptual Issues in Securities Markets*, 13 J. CORP. FIN.,421, 421–22 (2007) (discussing the conceptual difficulties in empirically evaluating the effects of securities laws); Alan Ferrell, *Mandated Disclosure and Stock Returns: Evidence from the Over-the-Counter Market*, 36 J. L. STUD. 1 (2007) (finding that the variance of returns for securities that trade in over-the-counter markets decreased after Congress required their issuers to make new mandatory disclosures); George Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV. 132 (1973) (concluding that the disclosures mandates of the Securities Exchange Act of 1934 were of "no apparent value to investors."); Carol J. Simon, *The Effect of the 1933 Securities Act on Investor Information and the Performance of New Issues*, 79 AM. ECON. REV. 295, 313 (1989) (finding that the dispersion of investors' forecast errors was significantly lower following the Securities Act).

[200] *See* Usha Rodrigues & Michael Stegemoller, *Disclosure's Limits*, 40 YALE J. REG. BULL. 38 (2022) (noting the sobering reality that many public investors are unlikely to even read the disclosures, much less understand them).

[201] *See Summaries of Annual and Semiannual Shareholder Reports: Investor Testing and Cost Savings Information*, BROADRIDGE (Apr. 2020), https://www.sec.gov/comments/s7-12-18/s71218-7124539-216090.pdf (explaining its findings from a survey analyzing the amount and degree to which investors read shareholder reports).

[202] *Id.* (finding that, although 73% of investors surveyed reported that they read at least some of the shareholder reports, merely 88% of those who actually viewed each shareholder report did so for less than 30 minutes).

[203] *Tailored Shareholder Reports for Mutual Funds and Exchange-Traded Funds,* Fee Information in Investment Company Advertisements, Final Rule, Release Nos. 33-11125; 34-96158; IC-34731 (Oct. 26, 2022), at 14 nn.34–35. Even assuming someone could read and grasp the information in these reports at a rate of 60 seconds per page, it would take an investor over two hours to read just one report, which is wholly impractical.

[204] *See* Deeken, *More Is Better?: Concerns on the Growing Amount of Securities Disclosure in Offering Documents and Public Filings*, 50 SEC. REG. L.J. 107 (2023).

[205] S.B. 54, 2023, Reg. Sess. (Cal. 2023); Robin M. Bergen, et. al., *California Adds to Private Fund Adviser Woes; Adopts New Diversity Reporting for Venture Capital Funds*, CLEARLY ENF'T WATCH (Oct. 12, 2023), https://www.clearyenforcementwatch.com/2023/10/california-adds-to-private-fund-adviser-woes-adopts-new-diversity-reporting-for-venture-capital-funds/.

which will force any VC firm that operates in California to disclose, among other things, the race, disability status, and sexual orientation of the founders of the startups they invest in.[206] NVCA met the bill with glaring criticism.[207] The California legislation will undoubtedly affect the VC market as a whole since "screening for [out-of-state] investors is likely to carry a significant compliance burden.[208] However, this bill is yet another example of how the disclosure requirements imposed on the VC market will inadvertently harm the startups that spur innovation by suffocating them in regulatory red tape, harming investors attempting to make an informed investment decision.

B. The Vanishing of Crowdfunding Guidance

Limitations placed on Regulation CF reduce its potential. First, Regulation CF offerings are capped at $5 million in a 12-month period.[209] Again, any startup with an ounce of optimistic growth will refrain from entertaining this exemption with Rule 506(b) still available. Second, the absence of any enforcement of startup violations has led to uncertainty and skepticism.[210] Thus, it is hard to tell how well Regulation CF has protected investors and contributed to expanding startup access to capital. Third, the closure of several CF platforms has posed challenges for startups grappling with the aftermath.[211] These shutdowns have left startups in the dark when it comes to handling investments from the now non-existent platform. Unfortunately, the SEC has not provided further guidance on how a startup should handle these investments. The increase in uncertainty deters investors and startups from fully embracing the Regulation CF exemption.

---

206 S.B. 54, 2023, Reg. Sess. (Cal. 2023).

207 *See* Bobby Franklin, *SB 54 (Skinner) – Venture Capital Companies: Reporting – OPPOSE*, NVCA (Aug. 28, 2023), https://nvca.org/wp-content/uploads/2023/09/NVCA-Letter-re-SB-54-82823.pdf;

208 Bergen, *supra* note 205.

209 17 C.F.R. § 227.100.

210 *See* Mercer Bullard, *Crowdfunding's Culture of Noncompliance: An Empirical Analysis*, 24 LEWIS & CLARK L. REV. 899, 917 (2020) ("The average filer did not comply with Reg CF's primary accounting requirements."); Greg Hansen, *7 Ways Laws Can Avoid Killing Startups*, STARTUP GRIND, https://www.startupgrind.com/blog/7-ways-laws-can-avoid-killing-startups/ (last visited Nov. 8, 2023). ("For innovation to happen, innovators need to know that their products or services will be respected by the law and not hindered.").

211 *See e.g.*, Rick Lane, *Crowdfunding Website Fig Is No More*, PC GAMER (May 29, 2023), https://www.pcgamer.com/crowdfunding-website-fig-is-no-more/; James Nelson, *What Does CrowdStreet's Fallout Mean for Crowdfunding?*, FORBES (Aug. 5, 2023, 7:14 AM), https://www.forbes.com/sites/jamesnelson/2023/08/05/is-crowdfunding-still-viable-in-todays-market/ (describing the CrowdStreet fallout, which had funded over 750 deals, totally more than $4 billion in investments); Cathy Siegner, *PieShell Food and Beverage Crowdfunding Platform Shutting Down*, FOOD DIVE (Mar. 27, 2019), https://www.fooddive.com/news/pieshell-food-and-beverage-crowdfunding-platform-shutting-down/551360/; Emma Kidwell, *Crowdfunding Platform BrightLocker Shuts Down*, GAME DEVELOPER (Mar. 6, 2019), https://www.gamedeveloper.com/business/crowdfunding-platform-brightlocker-shuts-down.

From the investor's perspective, utilizing the CF platforms can be unattractive because of its notorious illiquidity problem. While not technically "restricted" according to Rule 144 of the Securities Act, securities sold under Regulation CF are restricted from being freely traded for one year from the date of issuance.[212] Thus, an investor can only transfer their stock back to the issuing company, an accredited investor, family members, or in a registered offering.[213] This conundrum is not exclusive to Regulation CF, but the reasoning behind restricting the resale of the security under Regulation CF is lacking entirely. As you will recall, Rule 506(c) permits the sale of securities only to accredited investors or, in the case of Rule 506(b), both accredited and non-accredited, though sophisticated investors.[214] These requirements in Rule 506(b) and Rule 506(c) seem logical since the accredited investor status would be pointless without them if you could purchase the stock from someone qualified.[215] The "come to rest" concept suggests that the securities should remain with the initial investor or subsequent investor qualifying for the exemption.[216] However, the Regulation CF resale restriction lacks a similar rationale and effectively dilutes the potential for the CF market.[217]

Another critique of Regulation CF is the stereotype, whether credible or uncredible, that tends to follow CF platforms. As one author puts it:

> These smaller investments can also equate to another crowdfunding disadvantage: mediocre returns. After all, what types of startups would likely use an equity crowdfunding platform? The ones that are not able to secure VC money. It's likely that these companies have less growth potential and, therefore, won't offer the same quality investments as other companies.218

The basis for this stereotype is partly due to the limits placed on the offering, eschewing quality issuers.[219] Thus, the current regulation does not allow CF platforms to reach their full potential.

---

[212] 17 C.F.R. §§ 227.501(a), 227.100, 230.144(a)(3).

[213] 17 C.F.R. §§ 227.501(a), 227.100.

[214] 17 C.F.R. §§ 230.506(b)(2)(ii), 230.506(c)(2)(i).

[215] For example, if an accredited or sophisticated investor was allowed to simply resell their security interest to a person who was unable to invest because of their investor status, then it wouldn't matter if you originally qualified since you can purchase the stock from someone who does qualify. *See* C. Steven Bradford, *The Illogic of Crowdfunding Resale Restrictions*, BUS. L. PROF BLOG (Mar. 23, 2015), https://lawprofessors.typepad.com/business_law/2015/03/the-illogic-of-crowdfunding-resale-restrictions.html.

[216] *See id.*

[217] *See id.* (explaining how the resale restrictions in Regulation CF, unlike those in other exemptions, lack logical justifications, as they do not serve the "come-to-rest" or information disclosure purposes other regulations do).

[218] Charles Smith, *Crowdfunding Risks: An Argument Against Investing Through Equity Crowdfunding*, FIN. POISE (Aug. 29, 2023), https://www.financialpoise.com/crowdfunding-risks/.

[219] *Id.*

C. The Financial Tightrope: Analysis of Compliance Costs

Compliance costs constitute a significant burden on early-stage startups. From legal fees to regulatory filings, financial strains can divert precious resources away from innovation and growth. The very essence of startups—their agility and ability to experiment—is compromised when a sizeable portion of their budget goes to nonprofit producing expenses.[220] The amount of legal fees that go into a startup can vary significantly depending on the type of industry the founders intend to pursue.[221] At the outset, however, an early-stage startup can expect to spend anywhere from $10,000 to $15,000 on legal fees; this doesn't include the price of conducting a Series A round or an Inside round.[222]

If a startup intends to raise money through a Seed round, it can cost anywhere from $5,000 to $25,000, depending on the size and complexity of the round.[223] During the Seed stage, a startup must maintain a clean and accurate cap table since this is the first thing a prospective investor will ask to see before investing.[224] The cap table is a spreadsheet that serves as "a record of the owners of a company and their ownership percentage of the securities issued by the company."[225] If an investor sees a messy cap table, it may indicate that the founders are similarly messy with their business and not worth investing in.[226] However, cap table management will likely be a marginal expense at the Seed stage since most startups will not have many investors yet.[227]

What are the potential drawbacks for an early-stage startup that neglects to comply with every applicable requirement before seeking capital? On top of the civil penalties that the SEC and investors can enforce against a startup, criminal penalties are also at play.[228] A violation could result in rescission, meaning the

---

[220] *See* Caroline Fichthorn, *The Real Cost of Fundraising: A Look at Legal Fees and Cap Table Management*, LINKEDIN (Apr. 26, 2023), https://www.linkedin.com/pulse/real-cost-fundraising-look-legal-fees-cap-table-caroline-fichthorn/.

[221] *See* Thomas Howard, *How Much Does a Startup Spend on a Lawyer? A Comprehensive Guide*, COLLATERAL BASE, https://www.collateralbase.com/how-much-does-a-startup-spend-on-a-lawyer-a-comprehensive-guide/ (last visited Nov. 11, 2023).

[222] Kevin Vela, *Startup Cents: Planning for Your First Year of Legal Fees*, VELA WOOD, https://velawood.com/what-to-expect-in-legal-fees/ (last visited Nov. 8, 2023) (providing a non-exclusive list of items a startup will need in its first year). An "Inside Round" means "a round of financing where money is raised only from investors from previous rounds."; *Id.*

[223] Fichthorn, *supra* note 220.

[224] Vela, *supra* note 222. Anthony Rose, *What Is a Clean Cap Table? And Why It's Probably Not What You Think It Is*, SEED LEGALS (May 20, 2022), https://seedlegals.com/resources/clean-cap-table/.

[225] *Capitalization Table (Cap Table)*, VELA WOOD, https://velawood.com/?s=cap+table&submit=Search&post_type=glossary-term (last visited Nov. 7, 2023).

[226] *What Is a Clean Cap Table?*, Eqvista, https://eqvista.com/terminology/clean-cap-table/ (last visited Nov. 1, 2023).

[227] Fichthorn, *supra* note 220.

[228] *What Happens If a Startup Does Not Comply With Securities Laws?*, U.S. SEC. & EXCH. COMM'N, https://www.sec.gov/education/capitalraising/building-blocks/noncompliance (last modified June 26, 2023).

startup must return the investors' invested capital plus interest.[229] "Depending on the action, the company and certain individuals associated with the company may be subject to 'bad actor' disqualification, which would prohibit them from future capital raising using some of the most popular exemptions from registration, such as Rule 506(b) and Rule 506(c) of Regulation D."[230] The subsequent part delves into potential avenues for a more practical approach to regulating VC where startups can push innovation without being shackled by regulatory burdens.

V. THE AVENUE TO A MORE DYNAMIC VENTURE CAPITAL LANDSCAPE

Many recognize access to capital as one of the most significant challenges a startup will face.[231] Startups that cannot secure adequate capital likely contribute to the staggering failure rate for startups.[232] With innovation serving as the currency of progress in the VC industry, it is imperative to re-evaluate and reshape the avenues through which startups can access capital.[233] This Part explores the propositions for innovative-driven solutions to expanding more startup-friendly regulation. Regardless of whether these propositions sound convincing, the SEC should promote and embrace the private market instead of hindering it.

A. Rethinking Crowdfunding: Accessibility and Compliance

As mentioned, Regulation CF emerged as a hopeful alternative for startups seeking early-stage funding, promising a democratized approach to capital access.[234] However, lack of certainty and trust hinder its potential. Thus, to unlock the true power of CF, a paradigm shift is necessary—one that addresses both accessibility and compliance. For starters, the limit on capital raised under a Regulation CF exemption may thwart its potential.[235] Although the cap is more flexible than, for example, the Regulation D limit on capital, the $5 million limit is arbitrary. Again, there is no real evidence that the limit provided investors with

---

[229] *Id.*

[230] *Id.*; *see also* 17 C.F.R. §§ 230.506(b)-(c).

[231] *See* VICTOR HWANG ET AL., ACCESS TO CAPITAL FOR ENTREPRENEURS: REMOVING BARRIERS, EWING MARION KAUFFMAN FOUND. 1, 3 (2019), https://www.kauffman.org/wp-content/uploads/2019/12/CapitalReport_042519.pdf (Emphasizing the consequences of limited access to capital based on the 2016 American Survey of Entrepreneurs, where 9.5% of firms reported profit setbacks due to startup capital constraints and 10.6% reported negative impacts from capital costs).

[232] *See* Lital Helman, *Innovation Funding and the Valley of Death*, 76 SMU L. REV. 263, 281 (2023) (emphasizing the inherent risk and uncertainty in innovation as an additional contribution to the high failure rate for startups).

[233] *See* Xeraya Capital, *Why VCs Are a Catalyst for Innovation*, LINKEDIN (Apr. 13, 2023), https://www.linkedin.com/pulse/why-vcs-important-innovation-xerayacapital/.

[234] *See supra* Section III.B.

[235] 17 C.F.R. §§ 227.100(a)(1)–(2).

discernable protections.[236] Instead, the cap is a barrier to early-stage financing and requires reform. Limits based on an individual's income, like in Regulation CF, may be more desirable than an outright ban, like in Rule 506(c).[237] If the SEC refuses to eliminate the cap entirely, it should raise the $5 million cap to incentivize higher-quality startups to use CF platforms.

Alternatively, the SEC could expand their enforcement transparency. As previously mentioned, there is uncertainty about whether the SEC consistently enforces violations of Regulation CF requirements by startups using CF platforms.[238] Unlike other securities regulations, there seems to be little evidence that the SEC pursues enforcement actions against Regulation CF non-compliance—at least as often as they should.[239] This lack of transparency and accountability erodes credibility in the crowdfunding ecosystem. Investors are left unsure if issuers are actually held responsible for regulatory violations on crowdfunding campaigns, which reduces the incentive for startups to comply if consequences appear remote.

The SEC's annual report currently discloses enforcement activity and examinations conducted regarding registered offerings.[240] However, details on Regulation CF enforcement are lacking. To correct this, the SEC can start by consistently publishing statistics and other information about Regulation CF enforcement actions pursued, violations flagged, fines levied, or other enforcement metrics used in upholding the Regulation CF requirements. Such action would provide tangible proof of oversight. The SEC has made small steps towards doing this, beginning with the first enforcement action published in 2021.[241] The SEC can take this a step further by providing data on examinations opened and any deficiencies found in Regulation CF campaigns, intermediaries, and investors. This way, the SEC can list the most frequently cited Regulation CF compliance gaps, risk management weaknesses, and infrastructure issues called out in routine exam deficiency letters over the year. If the SEC signals that it actively monitors Regulation CF activity and sanctions violations, it will help resolve uncertainty. This top-down enforcement visibility would make issuers and investors take the regulatory standards more seriously.

---

[236] *See* Schulp, *supra* note 151.

[237] 17 C.F.R. §§ 227.100(a)(2), 230.506(c)(2).

[238] *See* Bullard, *supra* note 210.

[239] *See* Bullard, *supra* note 210.

[240] *See e.g.*, Press Release, U.S. Sec. & Exch. Comm'n, 2023-234, SEC Announces Enforcement Results for Fiscal Year 2023 (Nov. 14, 2023), https://www.sec.gov/news/press-release/2023-234; Press Release, U.S. Sec. & Exch. Comm'n, 2021-182, SEC Charges Crowdfunding Portal, Issuer, and Related Individuals for Fraudulent Offerings (Sept. 20, 2021), https://www.sec.gov/news/press-release/2021-182 [hereinafter Crowdfunding Portal Charges]; Press Release, U.S. Sec. & Exch. Comm'n, 2022-206, SEC Announces Enforcement Results for FY22 (Nov. 15, 2022), https://www.sec.gov/news/press-release/2022-206.

[241] *See* Crowdfunding Portal Charges, *supra* note 240.

B. The Non-Accredited Investor Under Rule 506(b)

At first glance, the SEC's reasoning behind the limitation on non-accredited investors seems logical: those who have little to lose should not be exposed to investments that will fail roughly 90% of the time.[242] However, such reasoning has fundamental flaws that need to be corrected. First, roughly 85% of households are prohibited from investing in certain exempt securities offerings.[243] For example, let's assume an individual's annual income is around $150,000 and their spouse's is closer to $125,000. Both have worked in the financial industry, but neither has a professional license. In this case, neither can invest in a startup if the securities offering is exempt under Rule 506(c).[244] Yet, suppose an individual without knowledge or experience in financial investing inherited over $1 million in assets. Although the couple is barred from investing, the SEC will regard the person who inherited $1 million as financially able to "fend for themselves."[245]

Second, the SEC's reliance on accredited investors for Rule 506(b) and Rule 506(c) introduces a dichotomy that warrants scrutiny. By requiring a limited amount of non-accredited investors, the SEC inadvertently creates a divide between those with access to investment opportunities and those without.[246] This socioeconomic disparity raises questions about the Securities Act's original intent and the SEC's ability to democratize a startup's access to capital. The wealth- and net worth-heavy reliance on accreditation excludes individuals interested in supporting innovative ideas that do not meet the Securities Act's criteria.[247] This exclusion perpetuates a market where startups are limited in their sources of capital by disproportionately concentrating on certain investors, stifling innovation and growth. Some question whether the SEC should have the authority to unilaterally determine who is worthy of partaking in specific VC opportunities.[248] This raises the question of whether an individual's wealth should determine access to investment opportunities or if the SEC should encourage more people to participate in the VC market.

The best path forward is to broaden the definition of an "accredited investor" to encourage the flow of capital in the private market. However, some urge the SEC to restrict, and not broaden, the definition to allow fewer individuals the ability to invest in startups.[249] They argue that the inflationary increases since 1982

---

[242] Howarth, *supra* note 61.

[243] *See* 17 C.F.R. § 230.506(c).

[244] *Id.*

[245] Hester M. Peirce, *Statement on Amending the "Accredited Investor" Definition*, U.S. SEC. & EXCH. COMM'N (Aug. 26, 2020), https://www.sec.gov/news/public-statement/peirce-accredited-investor-2020-08-26.

[246] *See* 17 C.F.R. § 230.506(b).

[247] Schulp, *supra* note 151.

[248] Schulp, *supra* note 151.

[249] *See, e.g.*, Managed Funds Association, Comment Letter on Managed Funds Association Regulatory Priorities 39 (May 18, 2017), https://www.sec.gov/comments/s7-07-16/s70716-1761663152156.pdf (recommending that the SEC amend the income and net worth thresholds to

have expanded the pool of investors from 1.8% in 1983 to roughly 15% today, thus falling outside the intended purpose of the original requirements.[250] However, proponents of this change provide no evidence that the inflation-driven expansion in the investor pool has led to a rise in fraud.[251] Moreover, a non-accredited investor's only viable alternative is the public market, which one can hardly argue to be divorced from any risk or fraud.[252] Although private markets are similarly risky, the solution should not be to bar nearly 85% of the U.S. population from having the opportunity to invest in early-stage startups.[253] Thus, the SEC should oppose enforcing even more restrictions on the accredited investor definition. It would be worthy for Congress to statutorily ensure greater access to the private market and prevent the SEC from enacting regulations that narrow the current accredited investor definition.

Third, the SEC's prohibition on non-accredited investors partaking in nearly all private offerings is counterintuitive.[254] To illustrate using an example, suppose casino #1 provides its patrons with slots and slots only. On average, these slots give gamblers an appreciable increase in money they started with when they entered the casino. Some dish out 5% increases, and some take a loss with 5% decreases. Although there is fair stability with these slots, they can sometimes lead to significant gains or losses, but, for the most part, they tend to be a steady gamble. Now, suppose casino #2 opens right down the road and offers unpredictable cash outs on their slots, but such earnings can exceed three to five times the original amount gambled. The caveat, of course, is that these slots can also result in a complete loss of the amount gambled.

Would it be reasonable for the government to prohibit those with less income or net worth from investing in casino #2, which has the potential to make this individual much wealthier than before? Would you support the government's decision if it reasoned that less wealthy individuals could not decide for themselves or that they couldn't control their inclination towards gambling in casino #2? This assumption ignores the fact that those with less money to invest are likely extra cautious with their money and thus may take fewer risks than those with more to lose. Would you find it persuasive if the counter-argument was that, since these

---

account for inflation and indexing those thresholds for inflation moving forward); North Am. Sec. Adm'rs Ass'n., Inc., Comment Letter on SEC's Report on the Review of the Definition of "Accredited Investor" 3 (May 25, 2016), https://www.sec.gov/comments/4-692/4692-34.pdf; Cornell Law School, Securities Law Clinic, Comment Letter on Report on the Review of the Definition of "Accredited Investor" 4–5 (Apr. 30, 2016), https://www.sec.gov/comments/4-692/4692-28.pdf.

[250] *See* PK, *supra* note 110; U.S. SEC. & EXCH. COMM'N, *Report on the Review of the Definition of "Accredited Investor"* 48 (Dec. 18, 2015), https://www.sec.gov/files/review-definition-of-accredited-investor-12-18-2015.pdf.

[251] Schulp, *supra* note 151.

[252] Schulp, *supra* note 151.

[253] Schulp, *supra* note 151; PK, *supra* note 110.

[254] *See* PK, *supra* note 110.

wealthy individuals can afford to lose more than individuals with less wealth, they are better able to "fend for themselves"?[255]

Why, then, does the SEC essentially do just that regarding investments in the private VC market vs the public market? Are we supposed to believe that support can be found in the fact that significant disclosure requirements have been imposed on casino #1, thus leaving casino #2 to wealthy individuals? Would it make things worse if those who were able, and in fact, gambled in casino #2 became even wealthier due partly to the opportunities casino #2 provided? In reality, even if this did protect individuals who are less wealthy from losing more than they can afford, is it nonetheless questionable for the government to unilaterally decide whether you are afforded the opportunity or not? It is questionable to suggest that because an investor does not meet an SEC threshold for income or net worth, they are barred from investing in a company they believe has the potential to be something huge. Imagine, in 1998, you miraculously saw in Google (formerly called "BackRub") what many people didn't before it became popular. Would it comfort you to know that the SEC bars this investment opportunity for your own protection? Presumably, the answer would be no.

While it is clear that Rule 506(b) provides the most common avenue for startups to raise capital, the reliance on accredited investors limits its potential.[256] Expanding access to non-accredited investors under Rule 506(b) would be a strategic and highly effective move to democratize the VC market and broaden the investor pool without compromising investor protection. To do this, the SEC could utilize alternative metrics that consider more than an individual's income and net worth. This can include a minimum investment-knowledge assessment for non-accredited investors. In fact, implementation of this assessment is already in the works.[257] There is a bipartisan consensus among Congress that the SEC's treatment of accredited and non-accredited investors fails to properly balance investor protection and facilitation of the flow of capital into the private market.[258] As a result, the Equal Opportunity for All Investors Act proposes certifying individuals as accredited investors upon passing an SEC-designed exam.[259] The bill aims to identify investors who, while not meeting the traditional wealth criteria, possess sufficient knowledge and capabilities to make informed investment decisions.[260]

---

[255] Schulp, *supra* note 151.

[256] 17 C.F.R. § 230.506(b).

[257] *See* Equal Opportunity for All Investors Act of 2023, H.R. 2797, 118th Cong. (1st Sess. 2023).

[258] *See* Bill Flook, *House Passes Bill to Set up SEC Accredited Investor Exam*, THOMSON REUTERS (June 2, 2023), https://tax.thomsonreuters.com/news/house-passes-bill-to-set-up-sec-accredited-investor-exam/.

[259] Equal Opportunity for All Investors Act of 2023, H.R. 2797, 118th Cong. (2023) (Introduced on May 24, 2023, by Representative Mike Flood. As of June 1, 20203, the bill has been received in the Senate, read twice, and referred to the Committee on Banking, Housing, and Urban Affairs.).

[260] *See id.*; Flook, *supra* note 258 ("[The] bill would give the SEC one year following enactment to set up an exam program that 'is designed with an appropriate level of difficulty such that an individual with financial sophistication would be unlikely to fail,' and includes methods that would demonstrate competency around different types of securities, private and public company disclosure

So, expanding Rule 506(b) access to non-accredited investors through alternative metrics, including an investment-knowledge assessment, is a step in the right direction, and the bill exemplifies the importance of identifying informed investors beyond traditional wealth criteria.

C. Raising the Cap on Capital Raising

In addition to the non-accredited investor assessment mentioned above, the SEC could simply mirror Regulation CF investment limits based on income and apply it to Rule 506(b), which can further open the door for non-accredited investors.[261] By combining the regulatory structure of Rule 506(b) with the accessibility and inclusivity of Regulation CF, startups would be better able to tap into capital from a wider pool of potential investors. Such change could combat the exclusivity problem in Rule 506(b) offerings.[262] Additionally, the SEC wouldn't have to continuously make amendments to keep up with the steadily increasing inflation rate and market requirements. It would also be practicable for Rule 506(c) to follow this method to simplify the process without so many different exemptions with varying requirements. If so, the SEC could abolish its prohibition on general solicitation to facilitate a prosperous private market for all. Should an investor desire to invest more than the 5% or 10% limit, they can then look to the public market. This way, the private market grows without subsuming the public market into one.

D. Harmonizing Investor Protection and Innovation

Aside from the solutions suggested, it is crucial to underscore the importance of harmonizing investor protection with the imperative to unleash the full potential of innovation. Striking this balance is not a zero-sum game; it requires a nuanced understanding of the evolving VC market and a commitment to adapt accordingly. The current regulation is reactive and short-lived. Take, for example, the continued amendments to Rule 504, which has had three different cap limits in a five-year span.[263] Instead of reactive regulatory measures, a proactive approach to risk mitigation involves anticipating potential challenges and crafting regulatory frameworks that address them preemptively.

VC investments plainly fuel innovation and economic growth in the United States.[264] Venture capitalists pour significant amounts of capital into new,

---

requirements, corporate governance, financial statements, potential conflicts, and aspects of unregistered securities that include risks associated with limited liquidity and disclosures, among other potential pitfalls.").

261 *See* 17 C.F.R. § 227.100.

262 *See* Schulp, *supra* note 151 ("[F]rom 2013 to 2018, only six percent of Rule 506(b) offerings included at least one unaccredited investor.").

263 *See* sources cited *supra* note 116.

264 *See* Lehot & Daugherty, *supra* note 84.

promising startups, and the SEC should give greater weight to this fact.[265] Greater support from the SEC can increase the chances of successful startups by alleviating the complexity of complying with every regulatory requirement, which is hard to do.[266] As one author puts it:

> [T]he total amount of capital raised annually in securities sales regulated by the SEC was approximately $3 trillion. If the cost of raising that capital could be reduced by just one percent, the economy would have $30 billion more each year to devote to new drugs, renewable energy research, new production plants, and more jobs.[267]

Beyond the financial aspects, compliance burdens also have a human dimension. Early-stage startups, usually limited to their founders and a few employees, dedicate valuable time and energy to navigating the labyrinth of regulations.[268] This diversion of focus from core business activities to compliance can impede a startup's ability to grow. It is safe to assume that most startups do not form with the intent to eventually violate SEC or state regulations. Acknowledging this human element involves simplifying regulations and providing resources and support to guide these early-stage startups through compliance.[269]

VI. CONCLUSION

This Paper demonstrates how the VC industry is vital to the U.S. economy, from fueling innovation to funding early-stage startups. This Paper calls for an innovation-focused approach, urging the SEC to enforce the Regulation CF rules when startups or CF intermediaries violate them to restore faith in the CF platforms, broaden the reach of investors under Rule 506(b), and amend the cap on Regulation D exemptions to allow more flexibility among certain investors. Importantly, this Paper continuously highlighted that the relationship between innovation and federal regulation is interdependent, dispelling the notion that they are opposing forces. However, if the SEC decides to impose stricter regulations on startups, the impact could be devasting. The proposed solutions are not exhaustive or even complete. Instead, they are intended to illustrate how the SEC can promote economic growth instead of being a barrier. If there is reform, it should not limit early-stage startups from accessing various sources of capital. With anti-fraud

---

265 *See* Lehot & Daugherty, *supra* note 84.

266 *See What Constitutes a Security and Requirements Relating to the Offer and Sales of Securities and Exemptions from Registration Associated Therewith*, ABA (Apr. 27, 2017), https://www.americanbar.org/groups/business_law/publications/blt/2017/04/06_loev/.

267 Vollmer, *supra* note 86.

268 *See 106 Must-Know Startup Statistics for 2023*, EMBROKER (Aug. 17, 2023), https://www.embroker.com/blog/startup-statistics/ (explaining how founders "can spend around 40% of their working hours on tasks that do not generate income. . . .").

269 *See* Hansen, *supra* note 210.

statutes already in place, expanding the private market can strategically bolster innovation and economic growth without compromising investor protection.[270] It is possible to have a future where the SEC welcomes a more practical approach to governing securities exemptions, allowing capital to flow more efficiently without compromising investor protection. However, imposing additional regulations on the private market does more harm than good for investors and startups.

---

270 *See* sources cited *supra* note 182.